



SAMOA

FINANCIAL SECTOR ASSESSMENT PROGRAM

BANKING RESOLUTION, AND CRISIS PREVENTION AND MANAGEMENT FRAMEWORKS—TECHNICAL NOTE

August 2015

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BANKING RESOLUTION, AND CRISIS PREVENTION AND
MANAGEMENT FRAMEWORKS

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

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Glossary

CBA	Central Bank of Samoa Act 1984
CBS	Central Bank of Samoa
Core Principles	International Association of Deposit Insurers, IADI, <i>Core Principles for Effective Deposit Insurance Systems</i> , June, 2009
DIS	Deposit Insurance Scheme
ELA	Emergency Liquidity Assistance
FI	Financial Institution
FIA	Financial Institutions Act 1996
FSB	Financial Stability Board
Key Attributes	FSB, <i>Key Attributes of Effective Resolution Regimes for Financial Institutions</i> , October, 2014
MOF	Ministry of Finance
MOU	Memorandum of Understanding

EXECUTIVE SUMMARY¹

This Note discusses the framework for banking resolution and crisis prevention and management in Samoa, and provides comments and recommendations for its improvement.

As part of the Financial Sector Assessment Program for Samoa, this technical note evaluates the current legal powers and operational capabilities at the disposal of the financial sector authorities for confronting serious banking problems, and for crisis prevention and management. Comments and recommendations are provided, aimed at increasing the authorities' capacity to address such problems in a way that minimizes damages to the financial system and reduces costs for the tax payer and for the economy as a whole.

Key Findings and Recommendations

The current regulatory framework to deal with financial institutions (FIs) should be reformed.

The Central Bank of Samoa (CBS) has issued "Prudential Statements" containing some prudential rules, ratios and limits applicable to FIs, but there are no general standards for their enforcement, which is done on a purely discretionary case-by-case basis. The powers from the Central Bank Act (CBA) are not strong enough to enable the CBS to take enforcement actions.

For a FI at risk of becoming insolvent, the legal powers of the Financial Institutions Act (FIA) do not allow the regulator to take appropriate resolution actions while preserving valuable banking business and protecting the financial system. If a FI is in serious financial distress, the CBS, under Section 14 of the FIA, has a few possible options. The first is to "direct the FI to take whatever action in relation to its business as the [CBS] may specify." This option is so wide and imprecise that, in fact, it becomes a very weak legal basis to take specific actions especially if those actions affect personal and/or property rights, as would be the case when ordering changes in management and/or ownership, mandatory reduction of capital for restructuring process, etc. The second alternative, to appoint an advisor, is also ineffective, since it does not allow the CBS to take directly any of the actions that the situation would require. The third and fourth alternatives, revocation of the FI's license and petitioning the court for the winding up of the FI, are too extreme and do not allow the regulator to have the appropriate time and legal powers to perform effective resolution actions while preserving valuable banking business and protecting the financial system. Additionally, the current law does not allow the CBS to segregate assets and liabilities of the FI or to take any similar action that alter the rigid priority of payments order established by a different law.

The last and only option for direct action, not implying immediate closure of a distressed FI, is to apply for a court supervised management, which is uncertain and not efficient. If this route is taken the court keeps the powers to decide (i) who will be the administrator; (ii) the extent of powers that the administrator should have; and (iii) when and how the administration has to be terminated "for any reason." This process puts the regulator in a weak and uncertain position since it

¹ This Technical Note has been prepared by Ernesto Aguirre, IMF external expert.

is, in essence, not just supervised but fully controlled by the court. Considering that the actions that need to be taken to confront serious financial problems either in a FI or in a number of them (with systemic implications) have to be taken with maximum speed and confidentiality, and based in technical considerations, the current framework clearly needs to be reformed.

A fully amended legal and regulatory banking resolution framework is needed for the CBS to be able to deal effectively with serious banking problems. The FIA should be amended in order to: (i) empower the CBS to issue an appropriate regime for timely preventive and corrective actions, based on prudential rules and enforcement actions to be applied incrementally according to the gravity of the non-compliance by the respective FI; (ii) provide a clear legal basis for the regulator to develop indicators to determine whether a FI is non-viable or whether it is likely to become so. Based on those indicators, the CBS should be given the power by the law to start taking resolution actions before the FI becomes balance sheet insolvent; (iii) empower the CBS to directly take an array of resolution actions, including: to remove and replace senior managers and directors; to appoint an administrator to take control and manage the distressed FI; and to undertake all necessary actions to preserve its viable banking business, and to restructure or wind down the FI's operations; and (iv) grant the CBS the power to use key resolution tools, including: to transfer, or to sell, partially or fully, selected assets and liabilities of the distressed FI to a viable entity; to establish and operate a temporary bridge institution to continue certain critical and viable operations of the distressed FI while the resolution is completed; and powers to override rights of existing shareholders, as required, to recapitalize, restructure and dispose of the FI business or of its assets and liabilities as needed.

A funded Deposit Insurance Scheme (DIS) with contributions from the industry should be considered over the medium-term once pre-conditions are in place. Pre-conditions include a strengthened bank supervision framework and an upgraded bank resolution regime. Funding for the DIS, under a well-designed "least cost principle," should be readily available to help in the efficient performance of key resolution actions like the transfer of selected assets and liabilities from a distressed FI to a sound entity.

A proper emergency liquidity assistance (ELA) framework should be introduced. The Central Bank has in place basic instruments to conduct open market activities and repo transactions, but arrangements for provision of liquidity during stress should be upgraded. The amended CBA shall establish the CBS as lender of last resort with adequate safeguards against potential losses, enabling the CBS to grant financial assistance against collateral to illiquid but solvent banks or special financing to a bank to preserve systemic financial stability, with adequate protection for the CBS financial position in concurrence with the Ministry of Finance (MOF).²

² Following a TA mission from the IMF Legal Department (January 2013), the CBS has prepared a draft law amending the CBA, which is currently being considered by the Government before being presented to the legislative for consideration and enactment.

Arrangements for contingency planning and crisis management coordination should be in place. Arrangements for coordination between the MOF and the CBS in the monitoring of the system should be in place both, at the highest level and at the operational level. In addition, a unit in the CBS should be in charge of monitoring the system, and designing and developing a contingency plan both at the system level and specific for FIs with systemic implications. The high level authorities shall meet in a Committee at least half yearly (more frequently in cases of need) to approve the contingency planning, to review the monitoring of the system, and to make recommendations and approve actions like simulation exercises and appropriate training. It should also take decisions whenever exemptions to the application of normal rules are to be taken based on systemic implications. Coordination with foreign supervisors should also be established at the highest level and be made operational at the level of working committees. In times of crisis the roles and responsibilities established in the contingency plan should be strictly followed under the general supervision of the high level committee. Consideration should also be given to emergency financial arrangements to be used in times of systemic crisis.

Table 1. Key Recommendations	
Recommendation	Time*
Issue a complete set of prudential regulations, including specific enforcement actions by the regulator, to be applied incrementally according to the gravity of the non-compliance. Those enforcement actions should be applied in a general manner providing certainty and fairness to the whole regime. An appropriate amendment of the FIA would be required to provide a firmer legal basis for preventive and corrective actions.	ST
Amend the FIA in order to reflect a complete and efficient resolution framework, including: (i) quantitative and qualitative triggers for the regulator to start resolution actions; (ii) key resolution powers for the regulator to take direct actions to confront serious financial distress; and (iii) specific powers to make effective key resolution tools, such as the transfer of assets and liabilities of a distressed FI to a sound entity. Those powers should include modification in the priority of payments laws to provide special preference to deposits and/or to selected groups of deposits (e.g., insured deposits).	ST
Create an appropriate scheme of Emergency Liquidity Assistance starting from a well-designed lender of last resort function.	ST
Create inter agency arrangements for monitoring and coordination on systemic financial sector issues and institutions, development and enforcement of a crisis contingency plan, and determination of official assistance in cases of systemic financial sector crisis.	MT
Create a Deposit Insurance Scheme (DIS) as an element of the reformed banking resolution framework, once pre-conditions are in place.	MT

* / Short-term (ST), Medium-term (MT)

INTRODUCTION

1. This note discusses the current banking resolution and crisis prevention and management frameworks in Samoa. It presents comments and recommendations aimed at providing the financial authorities with legal powers and operational capabilities to deal effectively with serious banking problems, both, in cases of individual entities and in cases with actual or potential systemic implications. In the next section the current banking resolution framework is described and comments and recommendations for its improvement are provided. In the second section specific recommendations for a reform of the Financial Institutions Act (FIA) to introduce a new banking resolution framework in the country are presented. In the third section the possible introduction of a Deposit Insurance Scheme is discussed. The fourth section provides recommendations to improve the Emergency Liquidity Assistance (ELA) legal and operational framework. The last section discusses the legal, operational and institutional underpinnings for contingency planning.

CURRENT FRAMEWORK

A. Preventive and Corrective Actions

2. The Central Bank of Samoa (CBS) may issue directives to correct unsafe or unsound practices by Financial Institutions (FI). Whenever the CBS determines that a financial institution is following “unsound or unsafe practices” in the conduct of its business, in a way that is “likely” to affect its obligations to depositors or other creditors, or to affect the stability of the financial system; or in the case the CBS considers that a financial institution contravenes the provisions of the FIA, it may issue a directive to the FI to “cease and desist” from such practice or contravention and also to “take such action as may be specified in the directive, to correct the conditions resulting from such practice, contravention or noncompliance.”³

3. The CBS has issued basic prudential rules, but under its supervisory approach the consequences for non-compliance are discretionary, that may be different for each bank. Invoking the powers given to the CBS governor by the CBA, for the “execution of the Bank’s policies and the efficient management of the Bank,”⁴ the CBS has issued a number of “Prudential Statements” containing rules on aspects that include licensing, ownership and management of banks, capital adequacy, asset concentration and risk, large exposures, liquidity, connected lending, provisioning, accounting and internal controls, and foreign currency exposures. In some cases the statements contain mainly general recommendations and guidance (e.g., regarding liquidity) while in other areas they contain specific ratios, limits, norms for calculation, etc., (e.g., in the case of capital adequacy). Nevertheless, the consequences for non-compliance are not specified in the rules. Instead, as part of CBS’s “approach to supervision” it is stated that the prudential standards “will

³ FIA, Sections 13 (a) and (b).

⁴ CBA, Section 9, (2). See also FIA sections 3(2) and 3(3).

serve as triggers for discussions with banks on particular aspects of their operations” and that “[t]he objective is to develop a consensus because prudential standards can constrain banks’ commercial judgments concerning the volume and quality of assets that they may hold and this can affect banks’ profitability. However, the Bank will, if it becomes necessary, assume the role of final arbiter.”⁵

4. The lack of specificity regarding enforcement action by the CBS applies to capital adequacy. The Prudential Statements prescribe a number of rules, including minimum capital ratios, risk weightings, and treatment of off-balance sheet items, and include detailed forms for the measurement of capital, and risk weighting for on- and off-balance sheet items. For the calculation of the final capital ratios, it is stated that specific procedures will be agreed with individual banks failing to comply with the standards, and that specific plans will be required from the particular bank, including actions to correct the situation. Unspecified “enforcement proceedings” will be included for cases where bank management fails to develop an acceptable remedial plan or to adhere to a plan already approved by the CBS.

5. The enforcement regime in the preventive and corrective area needs to be strengthened. The rules contained in the Prudential Statements need to include clear consequences for non-compliance, in a manner that introduces certainty and fairness to the system, based on clear expectations and equal treatment. The general powers given to the governor of the CBS by section 9 of the Central Bank Act (CBA) for the “execution of the Bank’s policies” are not strong enough to enable the CBS to take appropriate enforcement actions.⁶

B. Banking Resolution

6. If the FI problems are more severe, the CBS Board has to take other measures, through more formal resolution. If the CBS determines that a FI is carrying on its business in a manner, “detrimental to the interest of its depositors, creditors, or the public” or that it is likely to be unable to meet its obligation when they fall due, the CBS Board “shall” issue a resolution, exercising one or more of the following powers to: (i) direct the FI to take “whatever actions in relation to its business as the CB may specify;” (ii) appoint a qualified person to “advise” the FI in the proper conduct of its business; (iii) revoke the license of the FI; or (iv) present a petition to the court for the winding up of the FI.⁷

7. If the CBS wants to take direct actions, that do not imply the immediate closure and liquidation of the FI, it has to apply to the court to initiate a court supervised management. If the CBS considers “that it is proper” to take control of, and manage, “the banking business” of a FI, in order to “protect the stability of the financial system, the interest of depositors or in the public

⁵ CBS, Prudential Statement No. 1, (5).

⁶ Under current Section 29 FIA, the Head of State, on the advice of the Cabinet, may issue regulations required for “giving full effect to this Act.” Although some regulations could be tried under this provision, a more precise legal basis would be needed to provide a firm legal basis for a fully effective resolution regime.

⁷ FIA, Section 14.

interest” it may apply for a court order. Then it is up to the court to decide whether “in the circumstances of the case” it is “appropriate” to accept the request of the CBS. If so, the court has the power to approve, or not, the person suggested by the CBS as manager, and it also has the power to decide on the scope of the powers the manager should have to either carry out, cease or sell the business of the FI, or simply the powers to liquidate it under the Companies Act 2001. The court would also have the power to give directions to, and supervise, the administrator,⁸ and to decide when to terminate the administration “for any reason.” The CBS can also apply to the court to terminate the appointment of the administrator and “present a petition” for the winding up of the FI under administration.⁹

8. The legal capabilities of the CBS to deal with FIs in serious financial problems need to be substantially upgraded. If a FI is in serious financial distress and the cease-and-desist orders that the CBS can issue under Section 13 of the FIA have not been enough to redress the situation, the legal tools at the disposal of the CBS are not strong and effective enough. As explained, the regulator has only four possible options under Section 14 of the FIA:

- The *first*, to “direct the FI to take whatever action in relation to its business as the CB may specify,” is so general and imprecise that, in fact, it becomes a weak legal basis to take specific actions, especially if those actions affect personal and/property rights. Additionally, that legal basis would not allow the CBS to segregate assets and liabilities of the FI or to take any similar action that can be considered as contrary to the existing priority of payments order established by a different law.
- The *second alternative*, to appoint an advisor to help the FI to solve its problems,¹⁰ is not effective as it does not allow the CBS to take directly any of the actions that the situation may require, while, at the same time, it generates responsibility for the regulator that it would not be in a position to adequately meet.
- The *third and fourth alternatives*, revocation of the FI’s license and asking the court for the winding up of the troubled FI, are too extreme and do not allow the regulator to have the time and legal powers to take appropriate resolution actions while preserving valuable banking business and protecting the financial system.

9. The court supervised management is uncertain and inefficient. Under the current FIA, the only possibility for the CBS to take direct action to confront serious financial distress in a FI (other than its immediate and irreversible closure) is to apply for a court supervised management. This process puts the regulator in a weak and uncertain position since it is, in essence, not just supervised, but fully controlled by the court. Considering the actions to confront serious financial

⁸ The court appointed manager “shall comply with any written direction” of the CBS unless such directions conflict with any order of the court (FIA, section 15, (8) (a)).

⁹ FIA, Section 15.

¹⁰ Section 14 (b) and (c) of the FIA.

problems either in a FI or in a number of them (with systemic implications) have to be taken with maximum speed and confidentiality, and based in technical considerations, the current framework clearly needs to be reformed. The court should not have power to reverse the key resolution actions, while the right to claim fair compensation in justified cases should be maintained.

11. The CBS lacks appropriate powers to use key resolution tools. Key modern resolution tools as mentioned by the Financial Stability Board (FSB),¹¹ including the transfer of selected assets and liabilities of a distressed entity to a sound FI, and the establishment of a bridge institution to preserve certain critical functions and viable operations of a failed firm, do not have a firm legal basis under the current version of the FIA. Other key powers, like the power to remove and replace senior managers and directors, and the power to directly appoint an administrator to manage the affected firm with the purpose of restoring the firm or part of its business to financial viability, cannot be exercised by the regulator under the current FIA.

REFORM OF THE FINANCIAL INSTITUTIONS ACT

12. The FIA should be amended to establish a new resolution framework. The amended law should include the provision of clear regulatory powers to the CBS to issue an appropriate regime for timely preventive and corrective actions. The new resolution regime should also include: (i) quantitative and qualitative triggers to allow the CBS to start resolution actions before the FI becomes insolvent; (ii) powers to undertake in a timely and efficient manner the required resolution actions, under its direct administration;¹² (iii) specific legal basis for the use of modern resolution tools; (iv) legal powers to apply special rules in cases with systemic implications; (v) a complementary deposit insurance scheme; and (vi) some provisions for the lender of last resort function and official financial assistance. Those topics are discussed in detail below.

13. As a precondition for a good resolution framework the Law should specifically empower the CBS to issue an appropriate regime for timely preventive and corrective actions. As mentioned above, the existing prudential norms (“Prudential Statements”) prescribe a number of prudential rules, limits and ratios, but leave the consequences of non-compliance to be decided discretionarily on a case by case basis. It is important that prudential rules be applied by the regulator in a general and clear manner, incrementally according to the gravity of the non-compliance. This will provide certainty and fairness to the whole regime.¹³

14. The amended law should include the basis for the initiation of the resolution actions. The FIA, as amended, should include the basis to develop indicators to help the regulator to determine whether a FI is non-viable or whether “it’s likely to be no longer viable and has no

¹¹ Financial Stability Board, Key Attributes of Efficient Resolution Regimes, October 2011, sections 3.2, 3.3, and 3.4.

¹² The term “direct administration” should be understood as including the administration being carried out by one or several persons appointed and supervised by the regulator.

¹³ The norm should allow for a very limited and conditioned number of exceptions especially for cases of fraud on which it would not necessary to go step by step through the ladder.

reasonable prospects of becoming so.”¹⁴ Based on the key parameters given by the law, the CBS, using its regulatory powers, should developed precise triggers to start resolution actions before the FI becomes balance sheet insolvent.

15. The FIA should empower the CBS to require, prepare and monitor recovery and resolution plans. Recovery and resolution plans are useful tools for monitoring developments and help to start the resolution actions on time if and when needed. The FIA should empower the CBS to require the FIs to present a recovery plan for approval of the CBS, the time bound plan should contain objectives, actions, and specific measures that would be taken by the FI in order to comply permanently with the prudential rules and, more importantly, a general overview of the way the banking business are being conducted by the FI and how it would recover its sound financial condition in case it falls behind. At the same time the CBS should develop a resolution plan, which should be prepared within its own offices and gives the CBS a clear idea of the situation of the FI and of the different options and alternatives at the disposal of the CBS to be used in case compliance with the prudential norms and/or with the recovery plan is not fully met.

16. Additional key resolution powers should be given to the regulator in a clear and specific manner. The amended FIA should empower the CBS to take an array of resolution actions, including powers to remove and replace senior managers and directors, powers to appoint an administrator to take control and manage the distressed FI and to undertake all necessary actions to preserve its viable banking business, and to take any other action to restructure or wind down the FI’s operations. The CBS should also have the powers to use key resolution tools, including the power to transfer or sell, partially or totally, selected assets and liabilities of the distressed FI to a viable entity; power to establish and operate a temporary bridge institution to continue certain critical and viable operations of the distressed FI while the resolution is completed; and powers to override rights of existing shareholders, as required, to recapitalize, restructure and dispose of the FI business or of its assets and liabilities as needed.¹⁵

17. The transfer of selected assets and liabilities of a distressed FI to a sound entity should be a key resolution tool available in Samoa. The particular structure of the Samoan banking sector, with each of the four licensed commercial banks having a considerable share of total assets, makes outright closure likely difficult. As such, resolution tools like the transfer of selected assets and liabilities of a distressed bank to a sound entity would then be important to allow the regulator to confront cases of serious banking problems, avoiding system contagion and preserving valuable banking business. The law should provide CBS the power to terminate contracts or to temporarily stay the exercise of termination rights, and should also include a provision giving legal preference to deposits in the context of winding up procedures. The depositor preferences should be designed in a way that allows the regulator to segregate either total deposits or a certain category of them

¹⁴ Key Attributes 3.1.

¹⁵ Key Attributes 3.2.

(could be insured deposits for example) as part of the packages of assets and liabilities to be transferred in the context of the resolution procedure.¹⁶

18. The establishment of “bridge banks” should also be an important resolution tool. In order to facilitate the completion of the resolution process it is in many cases necessary for the regulator to establish a bridge institution able to continue performing certain critical functions and viable operations of the distressed entity in a temporary manner. Clear legal basis for this should be provided to the CBS by the FIA.

19. Application of triggers in cases with significant systemic implications. As explained, , the law should determine the basis for the initiation of resolution actions, and basic quantitative and qualitative triggers should be included in the Law. Additional powers would be given to the regulator to fill the general norm with specific numbers and ratios (specific triggers) which may need to be modified from time to time. Those triggers would be applied in a general manner to all FIs. Nevertheless, an exception should be established for cases having clear systemic implications to allow the application of different resolution actions to preserve financial stability while still resolving the institution. The determination of “systemic implications” need a number of preconditions: (i) the existence of an inter-institutional committee comprising management of the CBS and the MOF to take the decision (see further below); (ii) the development of indicators of systemic implications by a technical staff of the CBS, as explained further below; (iii) if a deposit insurance scheme (DIS) has been created, any use of funds for resolution operations beyond the limits imposed under a well designed “least cost principle”¹⁷ will only be triggered by the declaration of systemic implications to be made by the above mentioned High Level Committee.

¹⁶ Key Attributes 3.3.

¹⁷ For a brief definition of the “least cost principle” see paragraph 21 last sentence.

DEPOSIT INSURANCE SCHEME

20. A funded DIS with industry contributions should be considered as an element of the banking resolution framework over the medium-term, once pre-conditions are satisfied. Other key elements of the safety net should be put in place “before or in concert with the adoption or reform of a deposit insurance system.” according to the Core Principles for Effective Deposit Insurance Systems (Core Principles).¹⁸ A generally strong banking supervision framework is also necessary.

21. The DIS should have the legal power to contribute financially to “preserve critical banking functions.” This would be done by facilitating the acquisition by a sound FI of the assets and the assumption of the liabilities of a failed bank.¹⁹ The DIS should be able to use its funds to help in the integration of appropriate packages of assets and liabilities of a distressed FI to be transferred to a sound entity in the context of resolution operations. The DIS could then play an enhanced role in supporting the stability of the system compared to being used exclusively for the repayment of small depositors in case of full closure of a bank (which appears less likely in Samoa where all banks have significant market shares). The use of DIS funds should, furthermore, be subject to a well-designed “least cost principle,” which in general terms means that the costs to the DIS of injecting funds to make up for losses in the institution as part of its participation in a particular resolution operation should not exceed the cost of payment of insured deposits in case of liquidation of the same FI.

22. Basic aspects of the DIS should first be discussed among the authorities, then with the industry, and finally be reflected in a draft Law. An appropriate analysis of the different types of DISs and of their main basic features in relation to the Samoan context should be prepared by the CBS in coordination with the MOF to provide the financial authorities the technical basis to decide on the adoption of the DIS and its key features. Once a preliminary decision has been taken, it should be consulted with the industry, and then the key aspects of the agreed scheme should be included in a draft law to be presented to the legislature accompanied by a request for powers for the CBS and MOF to take final decisions on details of the scheme.

23. Designing a DIS would require a number of decisions by the authorities. They should be based on technical considerations and in the size and type of scheme that may be deemed desirable for Samoa. Some of the key aspects include: target size of the Fund, coverage, premiums and any other funding source, starting funding, etc. A number of comparative studies and technical assistance reports on the topic are readily available.²⁰ Taking into account the structure of the Samoan banking sector, it would be key to have a DIS with actual funds (instead of just

¹⁸ International Association of Deposit Insurers, IADI, Core Principles for Deposit Insurance, June 2009.

¹⁹ Core Principles. Principle 16.

²⁰ See, for example: IADI, Funding Mechanisms of Deposit Insurance Systems in the Asia-Pacific Region, Research Paper. Basel, 2011; IADI, Comparative Analysis of Deposit Insurance Systems in CIS Countries, Research Paper. Basel, 2012; FSB, Thematic Review on Deposit Insurance Systems, Peer review report. Basel. 2012.

commitments for an ex-post contribution) contributed by the industry to facilitate the performance of resolution operations with the speed and efficiency needed. After a target size for the Fund is determined, and also the amount of periodic contributions (premiums) has been determined, it would be important to specify what kind of transitory public support, if any, the Fund could have during the starting period.

24. The DIS fund should be administrated within the CBS. Given the current constrains of the financial authorities both in financial terms, and, especially, in terms of available personnel qualified in the areas of financial sector regulation and supervision, the DIS should be established as a specialized fund within the CBS with adequate safeguards to preserve an appropriate degree of operational autonomy.

EMERGENCY LIQUIDITY ASSISTANCE

25. The current framework for emergency liquidity assistance (ELA) should be upgraded. The Central Bank has in place basic instruments to conduct open market operations and repo transactions,²¹ but arrangements for liquidity during stress are not well developed. Section 32 of the CBA currently allows the CBS to grant advances to the banks “for periods nor exceeding 5 years” secured by “such other assets and on such terms and conditions as the Board may specify.”²² This provision gives to the CBS the possibility to grant liquidity assistance in an extremely flexible manner, but without adequate safeguards to its financial condition.

26. The proposed amendment of the CBA would provide a proper basis for an ELA framework with safeguards against potential losses and adequate protection for the CBS financial position in concurrence with the MOF. The amendments have been supported by IMF technical assistance, which noted that the CBS should have its lender of last resort function regulated by the CBA in a way that allows it to provide financial assistance to illiquid but solvent banks with adequate collateral for pre-established periods of, say, 91 days with one possible extension.²³ The CBS should also be empowered to provide emergency liquidity assistance in support of an insolvent bank without taking appropriate collateral and with possible extension of the maximum lending period, in cases of systemic implications, as determined through the specific procedures indicated for that purpose in the law. However, solvency support should ultimately be the responsibility of the government and could ideally be provided by the government. If the government cannot provide such solvency support in a timely manner, and the CBS needs to

²¹ CBS securities of varying maturities from 14 to 365 days are issued regularly through auctions while banks can gain access to liquidity through repurchase agreements (repos) and the discount window.

²² CBA Section 32 (d).

²³ In normal times, the CBS must closely monitor the liquidity of banks including assets that could be used as collateral for liquidity support.

provide it, the government should provide guarantees on, and compensate for losses arising from the CBS' solvency support in order to protect the CBS' financial conditions."²⁴

CONTINGENCY PLANNING ARRANGEMENTS

27. Contingency planning arrangements should be in place. The institutional, legal and operational arrangements required for the prevention and management of financial sector crisis should be adopted in Samoa. To that end, work should start in order to develop the key aspects, including: (i) institutional arrangements for coordination and crisis prevention and management; (ii) adoption of the legal and regulatory regimes and practices to deal with systemic financial sector institutions and crisis; and (iii) preparation and training to deal with credit institutions in trouble and with systemic implications and crisis.

28. A permanent coordination mechanism between the CBS and the MOF should be created. A financial stability and contingency planning committee should be in charge of high level monitoring of the financial system, analyzing the risks affecting the system, and discussing the appropriate policies to mitigate those risks. The Committee would comprise the Minister of Finance, the Governor of the CBS and, possibly, their two key deputies on the matter.²⁵ In times of crisis the Committee would review the system's diagnostics made by the technical units, agree on the basic measures to be adopted, and oversee and coordinate the execution of those measures. The Committee should meet regularly, at least every half a year in normal times, and more frequently, as needed in times of crisis.²⁶

29. A technical committee with members of the CBS and the MOF at the appropriate operational level should also be created. It should be charged with monitoring the system on a continuous basis, preparing the contingency strategies to be submitted to the high level Committee, and supervising the execution of the resolution programs of FIs considered carrying significant systemic risks. The Committees would be supported by staff in the CBS in charge of the preparation of the inputs to be considered by the high level and operational Committees, and ad-hoc working groups could also be integrated as needed.

30. Coordination with relevant foreign regulators should be supervised and directed by the high level Committee. At the proposal of the technical committee, the high level Committee should be in charge of the design, review and update of the Memorandum of Understandings

²⁴ ELA should only be considered for non-banks in conjunction with arrangements that give the CBS powers to obtain information and direct as required the non-bank receiving financial support.

²⁵ Under the Finance Sector Plan of the government, a Finance Sector Policy Coordination Committee is being created, but that Committee would not be the most appropriate for the Contingency Planning given the participation of a number of other high level officers not directly involved in the contingency planning and also because this Committee would have a different and much broader set of functions.

²⁶ The high level committee should be created by a MOU the near-term. Then, as part of the amendments of the FIA, the high level committee should get a formal legal basis, including legal decision-making powers regarding the application of the exceptional regime for cases with systemic implications.

(MOUs) with relevant foreign regulators, including internal arrangements of Samoan subsidiaries with their parent banks, for example possible liquidity support when needed. In times of crisis, the high level Committee will be in charge of the policy coordination with the relevant foreign regulators.

31. A financial stability unit should be created at the CBS, assigning staff to regularly assess financial stability and to support the financial stability committees. The unit would support the Committees, and be in charge of preparing and updating the draft contingency planning, for consideration and approval by the high level Committee. The unit should also design and supervise the Recovery and Resolution plans for individual FIs, and conduct Resolvability Assessments of FIs with significant systemic implications, which should be submitted to the high level Committee for approval.²⁷

32. The Unit should develop indicators of the systemic importance of FIs and groups. Those indicators would be based on criteria including size, interconnectedness, substitutability, complexity, and cross-border operations, among others, and would be used by the CBS for identifying and monitoring systemically important institutions. This would allow the CBS to determine what FIs are considered to have domestic significant systemic implications, and the analyses would also be critical points of reference for the application of any exception in the use of triggers for resolution actions.²⁸

33. Training and simulation exercises should be developed in order to familiarize relevant staff with systemic issues and crisis management. All relevant domestic entities (CBS and MOF) should participate and, ideally, also relevant foreign regulatory agencies should be involved. If at all possible, the creation of crisis management groups with relevant regulatory agencies (domestic and foreign) would be an important objective.

34. It would be appropriate to explore possible sources of temporary official financial assistance for systemic crisis. Any assistance of this kind should be temporary and only be used to protect the stability of the system at a critical point, after private sources have been exhausted.²⁹

²⁷ According to the Key Attribute 10, the resolvability assessments for FIs with significant systemic implications should be designed and monitored by the financial stability authorities of a country. Those assessments should evaluate the feasibility of resolution strategies and their credibility in light of the likely impact of the firm's failure on the financial system and the overall economy. In the case of FI with cross border linkages the assessments should also evaluate the nature and extent of intra-group exposures and their impact on resolution if they need to be unwound.

²⁸ See Basel Committee on Banking Supervision, A framework for dealing with domestic systemically important banks, October 2012, specially, Principles 1, 5, and 6.

²⁹ According to the Key Attributes, 6.4 (ii) private sector contributions could come from the industry, through ex post assessments, insurance premiums or other mechanisms or through the allocation of losses to equity holders, or residual costs, as appropriate, to unsecured and uninsured creditors.