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FINANCIAL SECTOR ASSESSMENT PROGRAM

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FINANCIAL SAFETY NETS—TECHNICAL NOTE

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FINANCIAL SECTOR ASSESSMENT PROGRAM

June 1, 2013

TECHNICAL NOTE

FINANCIAL SAFETY NET

Prepared By
Monetary and Capital Markets Department

This Technical Note was prepared by IMF staff in the context of the Financial Sector Assessment Program in Argentina. It contains technical analysis and detailed information underpinning the Financial Sector Assessment Program's findings and recommendations.

CONTENTS

Glossary

BCRA	Banco Central de la República de Argentina
CMG	Crisis Management Groups
CNV	National Securities Commission
ELA	Emergency Liquidity Assistance
FGD	Deposit Insurance Fund
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
IADI	International Association of Deposit Insurers
LEF	Law on Financial Entities
MECON	Ministry of Economy and Public Finances
MOU	Memorandum of Understanding
P&A	Purchase and Assumption
RRP	Recovery and Resolution Plans
SEDESA	Deposit Insurance Corporation
SEFyC	Superintendency of Financial and Foreign Exchange Institutions
SSN	National Insurance Supervisor

EXECUTIVE SUMMARY

Argentina has a well-developed financial safety net that has provided timely support to stressed institutions, but the system could be further strengthened. Although the emergency liquidity assistance (ELA) facilities for banks are comprehensive, the Banco Central de la República de Argentina (BCRA) should work with other supervisors to monitor potential liquidity risks outside its regulatory perimeter. The BCRA could strengthen crisis management preparedness by developing contingency planning for implementation in times of systemic crisis. Plans would address options to: ensure emergency back-up funding for the deposit insurance system, clarify extraordinary actions that may be implemented for prompt resolution of institutions in case of a systemic crisis, and address liquidity needs outside the BCRA current scope. A high-level systemic risk monitoring committee that included all relevant institutions would facilitate the contingency planning process.

The BCRA's facilities have not been tested, but are well-designed to manage a major banking liquidity crisis. Under these facilities that parallel the framework during the 2001–02 crisis, the BCRA is empowered to provide peso loans to support distressed financial institutions in a wide range of circumstances. In particular, banks that fall short of liquidity may apply for assistance (rediscounts or loans) using public or private sector assets as collateral—a wider range that accept under normal liquidity facilities. Assets, such as mortgages, auto loans, consumer loans, post-dated checks and publicly-offered securities may be 'pre-qualified' in anticipation of the possible need to use them as collateral for a loan. While this framework worked well in the previous crisis, it has not been tested in the current environment, where banks hold far less government securities than in 2001–02 and may face steeper haircuts on collateral than in the previous crisis.

The BCRA should work with other supervisors to monitor potential risks outside its regulatory perimeter. In particular, the BCRA should review the information about the balance sheet of stockbrokers, which will become available when the new Capital Markets Act comes into force, and it should monitor the activities of money market mutual funds. In extreme circumstances, central banks and governments may be compelled to support the liquidity shortfalls in such institutions even though they had given no undertaking to do so and had exercised no regulatory oversight of them. If it concludes that there are systemic liquidity risks outside the banking system, the BCRA should consider how to manage them, and in particular whether the entities concerned should be subject to some form of liquidity regulation, and whether facilities for providing them with ELA should be developed.

The BCRA approach to supervision is risk-based and focuses on early supervisory action to address deficiencies, but the prompt correction framework could be enhanced. Early supervisory action can be triggered by the bank's risk rating but other supervisory action benchmarks may be added to enhance current practice. The Argentine financial safety net relies on bank supervision that emphasizes preventive action through close monitoring of the banking system. Failure to address weaknesses could, in severe situations, lead to the implementation of resolution powers. The BCRA could consider establishing additional preventive prudential measures to be implemented automatically when benchmark capital or liquidity thresholds are breached;

similar to the current triggers that are linked to the CAMELBIG rating. These could help reduce the risk of regulatory delays and provide additional incentives to managers and shareholders to rectify problems. Such a framework also improves transparency as banks know what to expect when certain thresholds are reached.

A contingency funding plan for the deposit insurance fund, in time of systemic crisis, should be defined by the BCRA and the Ministry of Economy and Public Finances (MECON). The Deposit Insurance Fund (FGD) is a "pay box" style of deposit insurance fund. The Deposit Insurance Corporation (SEDESA) exercises fiduciary oversight over the FGD. However, SEDESA lacks adequate access to back-up funding for the FGD that it may need if a systemic crisis drains its reserves. If it lacks sufficient funds, SEDESA could issue bonds to depositors in payment of the deposit guarantee, but in a crisis bonds are unlikely to restore depositor confidence. The BCRA can require financial institutions to advance premiums up to amounts equal to two years of the minimum regulatory premium, and increase the deposit insurance premium but in a severe crisis, these actions could put an undue strain on the banks. For this reason, it would be important to give SEDESA access to a line of credit from MECON for use in systemic crises.

Reviewing and updating the bank resolution framework, processes and norms about tool options in case of systemic crisis would also help the BCRA in contingency planning. Since 1995, the BCRA has been involved in 36 bank resolutions with only one resulting in a depositor payout. In 34 of these cases, the purchase-and-assumption (P&A) process was successfully employed, with 98.6 percent of deposits being assumed. In 2002, a bridge bank process was used. There was a case of open bank assistance to a systemically important bank and one credit union payout of all insured deposits in 1996. A forward looking review of existing tools and considering possible market growth and diversification of services and financial instruments offered would aid the BCRA in maintaining adequate resolution tools during times of crisis. It would be important to establish clear principles for systemic situations to safeguard the use of public funds. Moreover, a review of liquidation arrangements with home country supervisors, including information on the crisis management groups (CMG), would aid the BCRA on contingency planning.

A high-level systemic risk monitoring committee that includes all relevant institutions would provide stronger safeguards. The functions of the committee, formed by the BCRA, MECON, National Securities Commission (CNV), National Insurance Supervisor (SSN), and FGD, could include the development of contingency planning for crisis management, meeting on a recurring frequency to highlight systemic risks, ensure that all possible legal hurdles for taking action during a crisis are cleared and that procedures for implementing resolution and recovery tools are well defined.

As recommended in the 2011 assessment of compliance with the Basel Core Principles, protection for BCRA staff from lawsuits should be enhanced. The BCRA law and the Law on Financial Entities (LEF) state that the BCRA cannot be subject to a claim for damages for suspension and resolution actions. These statutes do not address BCRA staff.

Table 1. Argentina: Key Recommendations

Recommendations and Authority Responsible for Implementation	Timeframe[1]
Emergency Liquidity Assistance	
Maintain surveillance over activities of nonbank financial companies to detect emergence of systemic liquidity risks. (BCRA, in conjunction with CNV).	Near Term
Bank Resolution Frameworks	
Clarify in the norms the resolution framework in case of a systemic crisis, formalizing the figure of bridge bank and necessary regulations and manuals (BCRA).	Medium Term
Set strict conditions to the use of open bank assistance (BCRA).	Medium Term
Correction Action Arrangements	
Enhance prompt correction action scheme (BCRA).	Medium Term
Deposit Insurance Scheme	
Establish a contingent funding mechanism for the FGD (MECON, FGD).	Medium Term
Coordinating Arrangements	
Establish a high-level systemic committee comprising all players of the safety net to monitor and plan for crisis coordination (BCRA, MECON, CNV, SSN, FGD).	Medium Term
Review liquidation arrangements and crisis management group formation in significant jurisdictions (BCRA).	Medium Term
Legal Protection	
Raise the threshold for lawsuits to gross negligence (BCRA).	Medium Term
Extend legal protection to SEDESA (BCRA).	Medium Term

"I-Immediate" is within one year; "NT-near-term" is 1–3 years; "MT-medium-term" is 3–5 years.

INTRODUCTION[1]

1. **The uncertainty, as well as the legacy of the 2001 crisis, has kept Argentina's financial system relatively small (with assets slightly less than 50 percent of GDP).** The banking sector accounts for two-thirds of the financial system, and about 43 percent of bank assets are state owned. The banking sector is moderately concentrated, with the three largest banks representing about 40 percent of banking assets. Insurance sector assets represent less than 7 percent and mutual fund assets less than 4 percent of the financial system. The equity market is small at about 10 percent of GDP, with 99 listed firms at end-2011.

2. **Banks safeguard against risks through strong capital and liquidity cushions and conservative funding strategies.** As of June 2012, the system-wide capital adequacy ratio reached 16.6 percent, with a leverage ratio of 11 percent. As of October 2012, liquid assets (cash or holdings of central bank securities) amounted to 25 percent of deposits. Banks fund their assets almost entirely through deposits. As of October 2012, deposits from the public and private sector

[1] Prepared by José Tuya (IMF consultant), with inputs for the section on ELA from William Allen (IMF consultant).

accounted for almost 80 percent of total funding and equity for another 11 percent; less 3 percent of funding came from subordinated debt and foreign credit lines.

3. **The banking system is regulated and supervised by the BCRA.** Supervision is conducted by the Superintendence of Financial and Foreign Exchange Institutions (SEFyC) that forms part of the BCRA. Supervision is conducted through a blend of onsite and offsite activities and resources are allocated based on risk. Banking institutions are rated by the SEFyC based on eight risk categories: capital, assets, market, earnings, liquidity, business, internal controls and management. Argentina is in the process of implementing Basel II and III.

4. **Argentina has a well-developed financial safety net that has provided timely support to stressed institutions.** The agencies involved in the financial safety net are: (i) the BCRA that provides ELA, manages the bank resolution process, implements preventive action, determines least-cost option to be employed, and has information exchange agreements with cross-border supervisors; (ii) the SEDESA that serves as trustee for the FGD; and (iii) MECON. The system worked well during the most recent crises and the authorities demonstrated flexibility and innovation in adjusting the practices to reflect the complexities of specific resolution cases.

5. **The review conducted during the mission focused on evaluating current practices and on adjustments that may be required as the Argentine financial system evolves and becomes more complex over time.** The options for enhancements outlined below aim at addressing gaps that may develop as the financial system evolves and the recommendations are guided by emerging international best practice.

- **Systemic liquidity risks outside the banking system.** The experience of the United States during the recent financial crisis shows that liquidity crises can emerge outside the regulatory perimeter. The BCRA should consider how to manage them, and in particular whether the entities concerned should be subject to some form of liquidity regulation, and whether facilities for providing them with ELA should be developed.

- **Institutional framework and coordination arrangements.** The BCRA is the central pillar of the institutional framework and coordination arrangements, which has worked well during past crises. However, as the financial system gets more complex, and bank organizational structures become more complex, risks may arise in other sectors overseen by other regulators. Currently, the Coordinating Council of Monetary, Financial, and Exchange Policy is composed of the BCRA and MECON officials. It is recommended that a systemic risk committee be instituted that incorporates all financial system regulators, as well as MECON and any other government entity that would play a role in crisis management preparedness.

- **Prompt corrective action.** The BCRA has a prompt correction action program in place requiring banks to respond by specific actions when certain thresholds are breached. The BCRA could consider establishing additional triggers related to capital or liquidity and additional specific actions required of banks. These measures would be implemented automatically when thresholds are breached with exceptions to implementation being fully documented and requiring approval by the BCRA Board. Such automatic triggers help reduce delays in corrective action and provide additional incentives to managers and shareholders to rectify problems. The framework also improves transparency as banks know what to expect when certain thresholds are reached.

- **FGD liquidity support.** Adequate funding should be secured for the FGD in the event of systemic crisis/risks. The funding should be provided as a credit line from the government.

- **Resolution powers.** A forward looking review of existing tools and considering possible market growth and diversification of services and financial instruments offered would aid the BCRA in maintaining up-to-date resolution tools. Additionally, while authority to employ the bridge bank and the open bank processes is broadly derived from existing legislation, the use of those tools should be formalized in regulation to specifically address conditions for their use.

- **Cross-Border bilateral arrangements.** A review of arrangements with home country supervisors and deposit insurance funds to determine the adequacy of information exchange agreements to develop an effective cross-border resolution and liquidation framework.

- **Legal protection.** Amend legislation or regulation to address legal protection for BCRA staff, currently only BCRA liability is addressed. To limit filings and frivolous lawsuits, the threshold should require charges of gross negligence, when it comes to civil liability of the BCRA employees.

CRISIS MANAGEMENT FRAMEWORK

A. Emergency Liquidity Assistance

6. The BCRA's charter designed emergency liquidity facilities to manage a major bank liquidity crisis. Under these facilities, the BCRA is empowered to provide peso loans to support distressed financial institutions in a wide range of circumstances. In particular, banks that fall short of liquidity may apply for assistance (rediscounts or loans) using public or private sector assets as collateral—a wider range that accept under normal liquidity facilities. Total assistance is capped at the equivalent of the capital and reserves of the borrower, although the BCRA board can decide to lift this limit in times of systemic stress.

7. The ELA regulation was revised in 2003 to include a more explicit scheme under the same legal framework, included in articles 17 b and c of the BCRA's charter. The scheme was designed to take into account the lessons of the 2001–02 crisis and included some new topics such as the introduction of the liquidity ratio (for accessing and paying back the ELA), more limits in terms of the maximum amount available, and automatic mechanism for paying back the liquidity assistance, among others. The current framework is described in detail in Communication A5304 of May 10, 2012.

8. The main features of the framework are as follows:

- ELA is available to financial entities that, having exhausted their other opportunities for borrowing from the BCRA, have a liquidity ratio of less than 20 percent.

- The maximum amount that may be borrowed is the lowest of:

  a. The amount requested by the prospective borrower;

  b. The amount necessary to get the borrower's liquidity ratio up to 30 percent;

  c. The size of the funding sources that the borrower has lost;

  d. The amount consistent with the BCRA's monetary policy.

- Any bank's total borrowing from the BCRA is thus limited in size to its capital base, and this limit is specified in the BCRA's Charter (article 17 b and c). However, in the words of the Charter, 'Where it becomes necessary to provide adequate liquidity to the financial system, or where general and extraordinary circumstances so warrant at the discretion of an absolute majority of the members of the Board,' the limit may be exceeded.

- The initial term is 180 days but loans may be extended for further periods of 180 days. Interest is payable every 30 days.

- Loans must be repaid if the borrower's liquidity ratio rises above 30 percent, by an amount depending on the excess.

- The interest rate is 1.35 times BADLAR for the first 180 days, and 1.70 times thereafter.

- A range of private sector assets are eligible as collateral. The surplus margin required varies from 25 to 75 percent, depending on the nature of the collateral.

- Assets, such as mortgages, auto loans, consumer loans, post-dated checks and publicly-offered securities can be 'pre-qualified' as collateral for 90 days in anticipation of the possible need to use them as collateral for a loan.

9. Borrowers are subject to restrictions on their activities which become increasingly stringent and intrusive as the ratio of the amount borrowed to the capital base of the bank increases (for instance, because the capital base is shrinking because of running losses). When the limit specified by the BCRA Charter (article 17 b and c) is exceeded, borrowers also have to agree to the potential application of article 35 bis of the Law on Financial Institutions. Under this article the BCRA may restructure the borrower in defense of depositors, pending revocation of its license.

- Loans need to be collateralized with surplus margins of 25–75 percent, depending on the nature of the collateral, and loan applications must be accompanied by an independent auditor's report attesting to the value of the collateral offered. This protects the BCRA against loss. It also means that the proprietors of an insolvent bank who want funds to keep the business going while they plunder the assets have to give up more value in collateral than they receive in cash, if they use the ELA facility.

- Borrowers are required to observe restrictions on their business activities, which become more severe as the amount borrowed increases relative to the bank's capital base. No borrower can pay dividends, make loans or pay fees to related parties. If the loan exceeds 50 percent of the borrower's capital base, the borrower is required to produce a rationalization plan, which would expose cases of insolvency, or cases in which the bank could be expected to remain solvent only on the basis of implausibly optimistic assumptions about the value of its assets.

10. The BCRA's facilities have not been tested since the new ELA regulation was established in 2003. While this framework worked well in the previous crisis, it has not been tested in the current environment, where banks hold far less government securities than in 2001–02 and may face steeper haircuts on collateral than in the previous crisis.

11. Although the facilities for banks are comprehensive, the BCRA should work with other supervisors to monitor potential risks outside its regulatory perimeter. In particular, the BCRA should review the information about the balance sheet of stockbrokers, which will become available when the new Capital Markets Act comes into force, and it should monitor the activities of money market mutual funds. The experience of the United States during the recent financial crisis shows that liquidity crises can emerge outside the regulatory perimeter. In extreme circumstances, central banks and governments may be compelled to support the liquidity shortfalls in such institutions even though they had given no undertaking to do so and had exercised no regulatory oversight of them. If it concludes that there are systemic liquidity risks outside the banking system, the BCRA should consider how to manage them, and in particular whether the entities concerned should be subject to some form of liquidity regulation, and whether facilities for providing them with ELA should be developed.

B. Bank Resolution Frameworks

12. The bank resolution framework is based primarily on P&A model. The P&A process is implemented with the support of the FGD under a least-cost criterion. The deposits and the assets with economic value of the failed bank are transferred to create a new business unit (good bank). The assets can then be transferred directly to the acquiring bank or to a trust fund that ultimately issues certificates of the participation to the acquiring bank. The bank resolution process of transferring assets and deposits from the failed institution: (i) does not require the consent of debtors and creditors, (ii) cannot be challenged in court, and (iii) effectively transmits obligations and rights. Moreover, actions from the Superintendent of Banks and the Board of the BCRA, in connection with the transfer of assets and privileged liabilities under a resolution process, do not require any judicial authorization. Moreover, the resolution process cannot be stopped nor subject to judicial appeal.

13. **Since 1995 the BCRA has been involved in 36 bank resolutions with only one resulting in a depositor payout.** In 34 of these cases, the P&A process was successfully employed, with 98.6 percent of deposits being assumed. In 2002 a bridge bank process was developed (Box 1). There was a case of open bank assistance to a systemically important bank and one credit union payout of all insured deposits in 1996. Assistance available through the FGD was supplemented by assistance from a government contribution through the Fiduciary Fund for Bank Capitalization, which was last used in 2002. However, since then the FGD has been self-sustaining and has not required additional support or an increase in premium.

Box 1. Crédit Agricole Resolution Case

In 2002, Executive Decree 838/2002 was issued to license Nuevo Banco Bisel S.A., Nuevo Banco Suquía and Nuevo Banco Entre Rios. The three banks would serve as bridge banks to resolve Banco Bisel S.A., Banco Entre Rios, and Banco Suquía. The resolution was prompted by the decision of Crédit Agricole, parent of the three banks to exit Argentina and marked the first time the authorities used the bridge bank model for a resolution. The process demonstrates the flexibility of the regulatory framework and the crisis collaboration between the authorities.

Article 35bis of the Law of Financial Entities does not address the licensing of a bridge bank among the resolution tools. Therefore, an Executive Decree was obtained to license bridge banks to be capitalized by Banco de la Nación Argentina. The bridge banks assumed the deposits while the assets were placed in a trust (one for each bank). The trusts then issued certificates "A" and "B" to each bank under resolution representing the assets. Certificate A (good assets) is then transferred to the bridge banks. Certificate B and unsecured creditors remain with the banks being resolved as residual value to be liquidated through bankruptcy court.

The bridge banks were then sold through open solicitation to other banks. Suquía was sold in 2004, Entre Rios in 2005 (FGD purchased ARS$190 million in preferred shares), and Bisel in 2006 (FGD purchased ARS$132 million in preferred shares).

14. **There are currently three banks under recovery programs and none is receiving FGD assistance.** The recovery and resolution processes are administered by the BCRA. Once the SEFyC requires a bank to develop a recovery plan to correct deficiencies under LEF Article 34 or triggers a resolution plan (as directed by the BCRA Board) under the LEF Article 35bis, the FGD is informed of any contribution that may be required. The SEFyC also prepares the least-cost computations to support liquidation payout or other resolution/recovery options. Liquidations take place only after the BCRA has revoked the financial institution's license and are under the purview of the bankruptcy court. There have not been any resolutions since 2005. The three institutions currently under special supervision for recovery plans are in compliance with the benchmarks imposed by the SEFyC and have returned to profitability.

15. Pursuant to the LEF, the BCRA has the power to adopt, at its sole discretion, corrective or resolution measures, as appropriate, regarding a financial entity that faces solvency or liquidity problems. Whenever the liquidity and/or solvency deficiencies of a financial entity are so severe that, in the judgment of the BCRA, the situation cannot be normalized by a regularization and stabilization plan, the BCRA may choose between ordering the restructuring of a financial entity to protect its depositors or revoking its license (LEF, articles 35 bis and 44).

16. To implement the restructuring of a financial entity, the BCRA may adopt one or more of several measures contemplated in section 35 bis. The measures include booking of losses against partial or total provisions for doubtful assets, capitalization by the shareholders, withdrawal of the BCRA's approval for all or any of the shareholders to remain as such and subsequent transfer of the stock by a given deadline, sale of the financial entity or the right to subscribe capital increases, and exclusion of assets selected by the BCRA and liabilities.

17. The BCRA has broad powers, but liquidations are dealt through the judicial system. The LEF article 34 grants the BCRA the authority to require banks to develop plans to address deficiencies concerning: solvency/liquidity, minimum reserves, noncompliance with prudential limits and noncompliance with regulatory capital minimums. Failure to provide the plan within 30 days authorizes the BCRA to revoke the bank's license. Article 44 establishes the BCRA authority to resolve a bank when: it has failed to provide or is unable to meet its plan to address deficiencies, or solvency/liquidity deficiencies beyond the bank's ability to correct. Once the BCRA withdraws the license, the appropriate bankruptcy court assumes responsibility for liquidation and appoints a liquidator.

18. The BCRA is provided with a number of recovery options to protect the value of the assets, and restructure or sell the bank. Under article 49 of the BCRA charter, the Superintendent can suspend the bank's operations for a period of 30 days (may be extended to 90) during which a determination can be made as to whether the bank can be restored.

19. Although the BCRA successfully employed open bank assistance and a bridge bank model in the 2001 crisis; it is recommended that the process be more fully addressed in regulation. During the crisis of 2001/2002 the BCRA utilized open bank assistance and a bridge bank which are not currently specifically defined in the LEF. The LEF could be amended to include those tools and the BCRA should review internal guidelines to ensure they properly capture and address the risks related to those operations. For example, it is important to limit the duration of a bridge bank license so a resolution timetable can be established, define activities to be conducted by the bank, establish situations appropriate for a bridge bank (large and/or complex banks), and identify the licensing authority (previous bank was licensed by an executive decree). Open bank assistance is considered controversial for several reasons, including (i) a weak institution remains open and competes with sound institutions; (ii) shareholders and creditors lose substantial portions of their investments but not all; and (iii) it reinforces "too-big-to-fail" moral hazard, because this procedure is normally used for large institutions.

20. Reviewing and updating the framework, processes, and norms about the resolution tool options in case of a systemic crisis would help the BCRA in contingency planning. A forward looking review of existing tools and considering possible market growth and diversification of services and financial instruments offered would aid the BCRA in maintaining adequate resolution tools during times of crisis. Manuals and draft regulation listing all the steps and possible instruments to undertake in case of systemic crisis will allow for a speedy process in the future. It would be important to establish clear principles for systemic situations to safeguard the use of public funds.

21. Concerning open bank assistance, it would be important to set strict conditions to minimize the risk of moral hazard. As recommended in the Key Attributes of Effective Resolution Regimes for Financial Institutions issued by Financial Stability Board, FSB (October 2011), the conditions should include (i) a determination that the provision of temporary funding is necessary to foster financial stability and will permit implementation of a resolution option that is best able to achieve the objectives of an orderly resolution; and (ii) an allocation of losses to equity holders and residual costs, as appropriate, to unsecured creditors. Similarly, the U.S. Federal Deposit Insurance Corporation (FDIC) states, in its Resolution Handbook, that to provide open bank assistance it must be the least costly option to the insurance fund. In cases of "serious adverse effect on economic conditions or financial stability" or "systemic risk to the banking system" the FDIC may deviate from the least costly requirement.

CRISIS PREPAREDNESS FRAMEWORK

A. Legal Framework and Corrective Action Arrangements

22. The supervisory approach of the SEFyC is risk-based and provides the BCRA with timely information on the soundness of the banking system. The SEFyC assigns an inspector-in-charge to monitor a bank or a group of banks in the case of the smallest and lowest-risk institutions. Onsite and offsite supervision are consolidated under the inspector-in-charge for the institution, allowing for seamless follow-up and monitoring. The Inspector is responsible for monitoring the bank on a continuous basis and oversees the compendium of supervisory activities: planning, onsite and offsite activities, follow-up and frequent communication with bank management. At the end of the onsite process every year, the bank is assigned a rating based on CAMELBIG on a scale of 1–5. Based on the rating, a supervisory plan is developed focusing on areas identified as higher risk. A follow up plan is developed to address significant weaknesses, with the corrective actions calibrated to the severity of the issues.

23. Some regulatory restrictions and fines are linked directly to the bank's rating. For example, banks rated 4 are prohibited from lending to related parties or expand through branches or acquisitions. Banks rated 3 or worse pay higher deposit insurance premiums. The SEFyC can also levy fines, suspend managers, directors or auditors and shareholders and revoke the bank license. The ratings also determine the premium paid by banks for the deposit insurance coverage.

24. Although the BCRA has implemented quantitative corrective action triggers keyed-off the CAMELBIG rating, other opportunities for quantitative triggers may be considered. For example, the BCRA could consider establishing preventive prudential measures to be implemented when benchmark capital or liquidity thresholds are breached. Moreover, the BCRA could require a bank to be placed into a special regime if regulatory capital and or liquidity minima fall below certain threshold (Box 2).

Box 2. Example of Prompt Intervention Triggers

The BCRA's intervention powers are based on a bank's CAMELBIG rating. For example, banks rated 4 are prohibited from lending to related parties or expand through branches or acquisitions. Banks rated 3 or worse pay higher deposit insurance premiums. Additional triggers could be put in place related to capital. Communication A5398 issued February 13, 2013, implementing Pillar 2, expects banks to operate above the capital regulatory minima established. The following is provided as example only and is neither calibrated nor linked to specific BCRA requirements.

Capital Level	Supervisory Action
75 percent of buffer or level in excess of regulatory minima	Recapitalization plan required. No asset growth. Unless permitted by the BCRA
80 percent of minimum capital	The actions above plus: No salary increases for senior management. Dividend restrictions or elimination. Issue stock or sell the bank. Restrict interest bank can pay to attract deposits to the average in its market. Replace Board. Replace senior management. Divest of subsidiaries, assets.
30 percent of minimum capital	Appoint receiver No repayment of subordinated debt

25. Failure to address weaknesses could, in severe situations, lead to the implementation of resolution powers. The supervisory process emphasizes preventive action and this is reflected in the legal framework which also provides the BCRA with broad powers to resolve the bank. Under the LEF article 34 the BCRA can require banks to establish plans to address weaknesses and establish timeframes. Failure to address weaknesses, that could result in solvency or liquidity concerns and may not be solved through a recovery plan, will lead to implementation of the resolution powers in LEF article 35bis. The SEFyC also has the authority under article 49 of the BCRA charter to suspend the bank from transacting business for 30 days (which may be extended up to 90 additional days with BCRA board approval) until a serious short-term threat is addressed. These powers have been actively used in time of crisis.

26. Once a bank fails to correct deficiencies, supervision of the bank is transferred to the Specialized Supervision Department. The Specialized Supervision Department will monitor the restructuring process and coordinate the involvement of SEDESA. The department will also manage the sale of the bank's assets and liabilities.

27. While this system has been effective, the BCRA could enhance their prompt corrective action framework. The BCRA could consider establishing preventive prudential measures to be implemented automatically when benchmark capital or liquidity thresholds are breached; similar to the current triggers that are linked to the CAMELBIG rating. These could help reduce the risk of regulatory forbearance and provide additional incentives to managers and shareholders to rectify problems. Such a framework also improves transparency as banks know what to expect when certain thresholds are reached.

B. Deposit Insurance Guarantee

28. The FGD is a "pay box" style of deposit insurance fund. The FGD was established in 1995 by Decree 540/95, implementing Law 24.485, as a pre-funded mechanism from premiums paid by covered entities. The BCRA establishes the risk-adjusted annual premium within the range specified in the FGD legislation between 0.015 and 0.06 percent (currently 0.015 percent). The risk-adjusted premiums are based on the soundness rating assigned to the bank by SEFyC and other quality indicators established by BCRA regulations. Currently, the FGD reserves amount to the equivalent of 1.3 percent of total deposits and 4 percent of covered deposits. The current reserve levels compare quite favorably with those of other countries, as disclosed in the Thematic Review on Deposit Insurance Systems published by the FSB in February 2012. These reserves are currently invested in U.S. Treasuries (65 percent) and BCRA instruments (LEBAC) (35 percent).

29. SEDESA exercises fiduciary oversight over the FGD. Decree 540/95 established SEDESA to perform the fiduciary functions over the FGD assigned to it by the BCRA. The SEDESA administration is governed by a Board of Directors composed of three members for a term of three years, who may be reappointed. Board members are elected by the shareholders of the corporation pursuant to the procedure established for this purpose. The Steering Committee of the FGD was created by Article 10 bis of Decree 540/95 and its amendments. It is a body that only meets when summoned by the central bank. It is composed by a representative of the BCRA who chairs the Steering Committee, without right to vote but with power to veto decisions made by the Steering Committee, according to the procedure in the fifth Article of the Trust Agreement that was signed in March 7th, 1997 between the central bank and SEDESA. The Members of the Steering Committee of the FGD may also hold a position in the Board of Directors of SEDESA.

30. The BCRA performs most key functions envisioned by the International Association of Deposit Insurers (IADI) principles. The Argentine deposit insurance system integrates the FGD as a pay box style of deposit insurance fund, and the BCRA as the implementing authority. The BCRA sets the risk-adjusted premium within an authorized range, monitors the condition of the banking system, manages the resolution/recovery process, declares insolvency, determines least-cost option to be employed and has information exchange agreements with cross-border supervisors; and consequently performs most key functions envisioned by the IADI principles.

31. The steering committee of the FGD must opt for the payment of the deposit insurance unless the alternatives to capitalize or provide liquidity to the entity are less costly. However, if the revocation of the license of a financial entity in distress could endanger the stability of other financial entities or of the financial system as a whole, such alternatives may exceptionally be carried out, even when entailing a bigger cost for the FGD. However, under no circumstances can the use of those alternatives involve an amount that is higher than the insured deposits of the financial entity (Decree 540/95, section 10 bis).

32. A contingency plan in time of systemic crisis should be defined by the BCRA and MECON. SEDESA lacks adequate access to back-up funding for the FGD that it may need if a systemic crisis drains its reserves. If it lacks sufficient funds, SEDESA could issue bonds to depositors in payment of the deposit guarantee (Article 13bis of Decree 540/95), but in a crisis bonds are unlikely to restore depositor confidence. The BCRA can require financial institutions to advance premiums up to amounts equal to two years of the minimum regulatory premium (Article 9) and increase premiums up to the regulatory maximum of 0.06 percent (Article 6), but in a severe crisis, this could put an undue strain on the banks. At the time the FGD was established, the regulatory framework (Convertibility Law and former BCRA Charter) prevented the BCRA from issuing currency and acting as lender of last resort, which amplified liquidity shortages at banks, resulting in a number of failures. Those restraints no longer exist; which enables the BCRA add a buffer to the FGD by providing solvent banks a source of liquidity that may prevent a liquidity insolvency. However, in a systemic crisis the above options have limitations and the FGD may require alternate funding, for this reason, it would be important to give SEDESA access to a line of credit from MECON for use in systemic crises.

C. Coordinating Arrangements

33. The BCRA has a mandate for financial stability and macroprudential policy. The BCRA Charter article 3 includes promoting financial stability. Accordingly, the BCRA must take into account such goal as it performs its regulatory and supervisory duties over the financial system (BCRA Charter, article 4(a); LEF, article 4) and the foreign exchange system (BCRA Charter, article 29). These powers apply also to payment systems, settlement and clearing houses, money remittance entities, cash-in-transit companies, as well as any other activity related to financial and foreign exchange activities (BCRA Charter, article 4(g)).

34. However, the BCRA shares responsibility with the MECON on the use of specific macroprudential instruments to control systemic risks. The BCRA and MECON share responsibilities over the set of macroprudential instruments available to control systemic risks, the detection of any increase in systemic risk and decisions regarding adoption, implementation and enforcement of macroprudential policies.

35. Moreover, there are other governmental agencies in charge of making official decisions about the use of macroprudential instruments. The BCRA exercises macro and microprudential regulation and supervision over financial entities, foreign exchange entities and the other entities such as cajas de ahorro; while the CNV exercises them over capital markets and the Argentine Superintendence of Insurance (SSN) exercises them over the insurance market.

36. The BCRA and the MECON belong to the Coordinating Council of Monetary, Financial, and Exchange Policy. This council is chaired by the Minister and comprises the Secretary of Economic Policy and the Secretary of Finance as well as the President, Vice President and a Director from the BCRA. The Minister of Economy, or a representative, participates (without a vote) in board meetings of the BCRA (Article 12 of the BCRA charter).

37. Current regulation and outstanding cooperation agreements between the BCRA and other government agencies allow financial system regulators to share relevant information. Decree 1759/72, sets forth the general duty of the departments and agencies of the national public administration to cooperate with each other. Argentina follows international standards regarding banking confidentiality and, as a general rule, any information obtained by the BCRA while exercising its functions (LEF, article 40) and by the SEFyC in the course of inspections (BCRA Charter, section 53) is confidential. Likewise, the CNV and the SSN are bound by similar confidentiality duties (Capital Markets Law, sections 25, 26 and 27; Insurance Companies Law, section 74). Additionally, section 27 of the Capital Markets Law provides that no confidentiality restrictions or limits apply to the BCRA, the CNV, and the SSN, as well as to their officials and employees, if the information is formally required by the head of any such agency. The same exception is made when information is requested by the Financial Information Unit in connection with the Anti-Money Laundering Law 25,246 (Capital Markets Law, section 27).

38. The BCRA, acting through the SEFyC, has entered into agreements of cooperation and information exchange with the CNV and the SSN. Recently, the BCRA agreed with the CNV (as the result of the new capital market law) and the SSN to cooperate and share information, subject to the legal restrictions that may apply in a particular case. These agreements are aimed at contributing to the fulfillment of their respective duties and the promotion of an adequate and sound operation of financial institutions, as well as capital and insurance markets. They provide that any request for information must be made in writing by the officials designated by the requesting agency to be the contact officials assigned by the agency to which the request is addressed, except with respect to urgent matters, in which case this requirement may be satisfied later. The parties commit to give confidential treatment to any information they may obtain under the agreements and to use it only in the exercise of the oversight and control powers of the requesting agency. When confidential information is granted to others, they are subject to the same confidentiality obligation applicable to the BCRA and SEFyC. Courts have the power to order the lifting of banking secrecy.

39. The BCRA has also concluded a number of memoranda of understanding (MOU) with cross-border supervisors in many countries. The MOUs include Bahamas, Brazil, Cayman, Chile, Germany, Italy, Mexico, Paraguay, South Africa, Spain, United Kingdom, United States, and Uruguay. The agreements follow international best practices.

40. A review of liquidation arrangements with host country supervisors, including information on the CMG, would aid the BCRA on contingency planning. The BCRA has MOU with home and host country supervisors of significance to the Argentine banking market. However, these MOUs typically do not deal with resolution issues. In some jurisdictions the deposit insurance fund or some other entity may be responsible for bank resolution thus requiring bilateral arrangements with those entities. Since the international community is reviewing ways to strengthen the cross-border resolution framework for banks, it would be important to review cross-border liquidation procedures with home countries of foreign banks operating in Argentina (Box 3). Appropriate cross-border bilateral agreements between deposit insurers facilitate resolution in case of the failure of the parent company.

41. A high-level systemic risk monitoring committee that includes all relevant institutions would provide stronger safeguards. While there are domestic information exchange mechanisms in place, there is not a high-level systemic committee comprising all players of the safety net to monitor and plan for crisis coordination. The functions of the committee, formed by the BCRA, MECON, CNV, SSN, and FGD, could include the development of contingency planning for crisis management, meeting on a recurring frequency to highlight systemic risks, ensure that all possible legal hurdles for taking action during a crisis are cleared and that procedures for implementing resolution and recovery tools are well defined.

Box 3. Crisis Management Groups

The BCRA has established MOUs with a number of jurisdictions concerning the ongoing supervision of cross-border banks. However, the BCRA as the resolution authority should also establish information exchange agreements with resolution authorities in the home jurisdiction of the cross-border banks in Argentina. Information exchange issues may arise as some regulatory frameworks in some countries do not permit the exchange of confidential information between a banking supervisor with the Ministry of Finance or the deposit insurer in another country. It is important to hold discussions with the home country authorities to determine how the home authorities would process a resolution, what the priorities in payouts are and how foreign branches or subsidiaries are treated.

As a result of the Key Attributes of Effective Resolution Regimes for Financial Institutions issued by the FSB in October, 2011, G-20 countries are establishing CMG. The CMGs have the objective of facilitating the recovery and resolution of a cross-border bank. The CMGs include supervisory authorities, central banks, resolution authorities, finance ministries and the public authorities responsible for deposit guarantee schemes.

For global significant financial institutions (G-SIFI) countries are developing bank-specific recovery and resolution plans (RRP) outlining: objectives for cooperation through CMGs, define participants in the RRP, set out information sharing process for a crisis and define the mechanisms for informing and including host supervisors of not only CMG participants but the less significant hosts.

It is important for the BCRA to participate as a member or to establish contact and remain informed of CMG groups being developed by home supervisors. In cases where CMGs are not applicable, it is important that the BCRA understand the recovery and resolution authorities of the home country and establish the proper contacts and legal arrangements to be able to act quickly in case of resolution of a bank.

LEGAL PROTECTION

42. **Employees of supervisory agencies and resolution authorities should not be inhibited by the threat of lawsuits against their actions, while exercising their professional judgment and taking the necessary measures.** In the context of crisis management, liability may occur when (i) the supervisory authority fails to take any action notwithstanding the knowledge of serious problems in the bank, (ii) measures were inadequate in response to the problems, or (iii) a shareholder of a bank challenges the appointment of an interventor or other solution measures. Hence, it is important that liability accrues only in the event of gross negligence or willful misconduct on the part of the supervisory agency, resolution agency, or its employees. It would help clarify in advance to potential plaintiffs that a case would have no chance of success, unless it is based on criminal activity, gross negligence, or bad faith. Moreover, if employees face personal action and have to defend the proceedings, they should have access to resources for actually defending the proceedings, including having an indemnity for costs.

43. Article 35ter of the LEF establishes that actions taken by the BCRA or the SEFyC in the exercise of competencies and duties are only subject to review by the courts in the event of arbitrariness or when manifestly unreasonable and it is up to the court to establish if the case has merit. BCRA personnel bylaws establish that in the case of criminal proceedings due to facts derived from the exercise of their duties, the BCRA may advance sums to fully or partially cover the legal costs. Articles 49 of the BCRA Charter and 35bis of the LEF provide that suspension and resolution actions taken by the BCRA cannot be subject to a claim for damages against the BCRA and the National State by the financial institution, its creditors, shareholders, and managers.

44. The framework for the legal protection of the BCRAs employees as well as persons appointed by the BCRA under the resolution regime could be enhanced. The following measures are recommended: (i) address BCRA staff liability in regulations that currently only address BCRA institutional liability, (ii) require gross negligence, as a threshold to the civil liability of the BCRA employees and persons appointed by the BCRA such as interventors; and (iii) consideration should be given to extending legal protection to SEDESA staff.