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September 2021

TECHNICAL NOTE—FINANCIAL SAFETY NET, RESOLUTION AND CRISIS MANAGEMENT

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FINANCIAL SAFETY NET, RESOLUTION AND CRISIS MANAGEMENT

Prepared By

Monetary and Capital Markets Department

This Technical Note was prepared by IMF staff in the context of the Financial Sector Assessment Program for Georgia. 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

CCG	Crisis Coordination Group
DIA	Deposit Insurance Agency
DIF	Deposit Insurance Fund
DIS	Deposit Insurance System
DI Law	Law on the Deposit Insurance System
ELA	Emergency Liquidity Assistance
IFSC	Interagency Financial Stability Committee
FSC	Financial Stability Committee
ISSA	Insurance State Supervision Service
KA	Key Attribute
MoF	Ministry of Finance
MOU	Memorandum of Understanding
NBG	National Bank of Georgia
NCWO	No Creditor Worse Off
P&A	Purchase and Assumption
RC	Resolution Committee
RLD	Resolution and Liquidation Division
SIB	Systemically Important Bank
TeA	Temporary Administrator

EXECUTIVE SUMMARY

Since the prior FSAP the authorities have comprehensively updated the legal, policy and procedural framework for failing bank resolution. In 2019 both the NBG and Banking Laws were amended to provide the authorities with powers to resolve banks that in the past might have been deemed too-big-to-fail; this eventuality is now greatly diminished. In 2017 a Deposit Insurance System Law was adopted to provide protection to natural person depositors when a bank fails and is liquidated. In 2020 the NBG published a series of rules specifying its policies and procedures for the use of its new powers, and jointly with the MoF published regulations addressing the use of temporary public funding to mitigate the potential systemic implications of bank failures.

The 2019 amendments require that all banks prepare recovery plans specifying how they will overcome shocks to their capital and liquidity. The NBG issued guidance for plan preparation and for the complementary self-assessments of banks' critical functions in June 2020. The three systemically important banks (SIBs) have submitted their first plans, and all other banks are to submit plans by July 1, 2021. The NBG Bank Supervision Department will lead the review of plans with input from other specialist units, including the newly established Resolution and Liquidation Division. Written feedback on plans is to be provided within three months of receipt of the plan.

The NBG has extensive early intervention powers but has not yet adopted a formal written policy to guide the use of the powers. Among those powers is the ability to require banks to take actions defined in their recovery plans. A formal prompt corrective action policy framework should be adopted. Among its goals should be that the authorities act to intervene a bank prior to balance sheet insolvency, when it nonetheless becomes clear the bank is likely to fail.

The 2019 amendments provide a resolution regime for banks that may be systemic at the time of failure as envisioned in the relevant international standard. In principle, failing banks should be resolved by license revocation and liquidation accompanied by the transfer or payout of insured deposits. In certain circumstances bank liquidation may give rise to unacceptable financial system or economic consequences. The new powers enable the authorities to deal with these situations. They include the ability to bring to bear temporary public funding in order to facilitate effective use of their powers, including via a new *ex post* funded Resolution Fund for which the banking industry is ultimately financially responsible, thereby insulating taxpayers. The new legal provisions also enable the NBG to provide liquidity support to a failing bank that is undergoing or will soon undergo credible resolution action, supported by a full MoF guarantee.

New institutional features have been put in place to support execution of the amended legal regime. An Interagency Financial Stability Committee comprised of the MoF, the NBG, the DIA and the ISSA has been established and its Charter adopted, envisioning a role in both normal and crisis circumstances as a forum for coordination. Within the NBG a new Resolution Committee comprised of the Governor and the two Vice-Governors and relevant department heads has been created, and as noted a new unit within the NBG, the Resolution and Liquidation Division, has been established. The division is responsible for resolution planning and organizing actual liquidation and resolution actions. The division reports temporarily to the Vice-Governor responsible for bank supervision, but operational separation of resolution and supervision functions will be implemented within two years. It is anticipated that a new, additional Vice-Governor will be appointed to the NBG board so as to enable this separation. The new Vice-Governor may join the Resolution Committee as well. A new regime for a Special Manager who can undertake resolution action at the direction of the NBG in lieu of direct action by NBG staff also has been introduced.

The NBG promptly published a comprehensive set of rules guiding the implementation of its various new legal powers and responsibilities as well as Charters for new institutional features. The rules are policy and procedure documents that leverage, in part, on publications of authorities such as the European Banking Authority and the Single Resolution Board but are well adapted to the Georgian context. They address, *inter alia*: i) the development and assessment of recovery plans; ii) the identification and assessment of the critical functions performed by banks; iii) the valuations that need to be undertaken to support the resolution process; iv) the bail-in of creditors to absorb losses and recapitalize a bank in resolution; v) the issuance of new shares by a bank in resolution; vi) the licensing, management and market exit of a bridge bank to be owned by the MoF; vii) the development of resolution plans and assessment of impediments to resolution action; and viii) the activities of a Special Manager.

The MoF and the NBG have published Joint Regulations addressing the functioning of a new Resolution Fund and the reimbursement of any losses incurred by the Fund by the banking industry. One regulation specifies the means by which temporary public funding may be brought to bear, including directly by the MoF and indirectly via the Resolution Fund. Though under law there is substantial flexibility for MoF to provide direct funding, the regulations articulate a policy limiting direct funding to the capitalization of a bridge bank with all other financing to be channeled via the Fund.

The Deposit Insurance System is now well in place. The amount of deposit insurance coverage was increased from GEL 5,000 to GEL 15,000 and now fully covers the deposits of 97 percent of resident and non-resident natural persons. The expansion of eligibility to legal entities is pending in Parliament. Steps have been taken to reduce the period for initiating deposit payouts to the seven-day international standard. Back-up funding arrangements are in place but need to be strengthened.

Resolution planning for the three SIBs will commence shortly. Initial plans, setting out the preferred resolution strategy, variants on the strategy, and an analysis of impediments to resolution action, are to be presented to the Resolution Committee by year-end 2021. Given stresses arising from the pandemic, the Resolution Committee should commission a rapid stock-taking to determine whether banks other than the SIBs should be prioritized for resolution planning in 2021.

While the authorities have taken commendable actions to establish a legal, policy and procedure regime for bank resolution, financial safety nets and crisis management; additional steps to implement the regime are needed. The MoF and the NBG should work together to lay the groundwork to establish a bridge bank as soon as possible. Similarly, the NBG should soon adopt policies encouraging competitive bidding for the sale of assets and liabilities of a bank in resolution to sound banks. When developing resolution plans for the SIBs, where creditor bail-in is the preferred resolution strategy or a variant strategy, the feasibility of bailing-in existing debt issuances needs to be assessed and steps taken to ensure that banks put in place sufficient loss absorption and recapitalization capacity and that NBG's bail-in decisions will be upheld in foreign jurisdictions in the case of challenge.

Further steps can also be taken strengthen funding arrangements. The DIA should secure a backstop line of credit from the MoF to be able to replenish the insurance fund in time of need and should agree a framework with the NBG to borrow against its investment portfolio to be able to raise cash if required to make a payout. The MoF and NBG should consider developing an internal contingency policy framework that will help ensure a shared understanding of situations that might arise indicating scope for MoF direct funding beyond that envisioned in the published regulation. This internal policy should also address the potential role of NBG ELA in resolution financing, including guidance on the use of temporary public financing via the Resolution Fund to repay any NBG ELA that might have been granted.

The authorities need to prepare institution-wide contingency plans for crisis management and adopt formal plan testing programs, and these eventually should dovetail into a national-level plan and testing program. The role of the new Interagency Financial Stability Committee in coordinating this work needs to be further specified. Documented institution-wide contingency plans would enhance crisis preparedness and improve the efficiency of resolution and crisis management activity, resulting in, among other benefits, reduced potential demand on temporary public funding to resolve problems. The individual and national level plans should be tested periodically and enhanced based on what is learned during testing.

Table 1. Georgia: Summary of Key Recommendations			
	Recommendations	**Authority**	**Time**[1]
Institutional Framework			
1.	Further specify the roles and responsibilities of the IFSC in normal and crisis times with an emphasis on its role in normal times (¶15, 85)	MoF, NBG	I
2.	Amend the Special Manager Rule to define necessary skills set and ensure that NBG staff only undertake that role in extraordinary circumstances (¶16)	NBG	I
Recovery Planning and Early Intervention			
3.	Amend the Recovery Planning Rule to require that thresholds for triggering management escalation are set sufficiently above minimum prudential regulatory requirements (¶24)	NBG	I
4.	Develop policy guidance to ensure that timely action, including the initiation of license revocation or alternative failure resolution action, is taken promptly in response to financial deterioration in any bank (¶30)	NBG	I
Resolution Powers and Resolution Planning			
5.	Update the creditor hierarchy by adopting a simplified tiered structure that is consistent with deposit insurance coverage (¶38)	MoF, NBG	I
6.	Adopt a rule articulating policies and procedures for use of the sale of business tool with respect to third parties that encourages competitive bidding (¶41)	NBG	NT
7.	Adopt a regulation to require all new debt issuances to contain contractual clauses recognizing that the instrument is subject to bail-in by the NBG (¶44)	NBG	NT
8.	Increase legal certainty for NBG bail-in decisions in foreign jurisdictions (¶44)	NBG	NT
9.	Undertake a stock-taking exercise to determine which non-SIBs should be prioritized for resolution planning in an accelerated timeframe (¶54)	NBG	I
10.	Set MREL for SIBs (¶55)	NBG	NT
11.	Take steps to establish, operationalize and fund a bridge bank (¶56)	MoF, NBG	I
12.	Analyze and take any indicated steps to minimize legal uncertainty as to whether resolution decisions will be sustained in Court (¶51)	NBG	I
Deposit Insurance, NBG Liquidity Support and Temporary Public Funding			
13.	Secure back-stop DIF financing from the MoF (¶65)	DIA, MoF	I
14.	Amend the DI Law to allow for preemptive replenishment of the DIF (¶70)	MoF, NBG	NT
15.	Agree on arrangements for the execution of the MoF guarantee for NBG ELA (¶76)	MoF, NBG	NT
Contingency Planning and Crisis Management			
16.	Prepare crisis management contingency plans and adopt a plan testing and improvement programs and agency and national level under the auspices of the IFSC (¶85, 86)	All	NT
[1] Timing: I–Immediate: within 1 year; NT–near term: 1 to 3 years; MT–medium term: 3–5 years.			

INTRODUCTION[1]

A. Scope and Methodology

1. **This Technical Note assesses and makes recommendations regarding the financial safety net arrangements in Georgia**. It summarizes the findings of the FSAP mission undertaken virtually during the period January 28–February 16, 2021. The scope of the assessment includes: i) the legal, policy and procedural framework for bank failure resolution; ii) the recovery and resolution planning regimes; iii) deposit insurance arrangements; iv) funding arrangements for banks that cannot be resolved via closure and liquidation; and v) contingency planning and crisis management arrangements. The authorities relevant to this Note are the National Bank of Georgia (NBG), the Ministry of Finance (MoF), the Deposit Insurance Agency (DIA) and the Insurance State Supervision Service (ISSA). The assessments are based on an analysis of legislation and of documentation relating to policies and procedures, and on discussions with, and representations made, by the authorities and the private sector. The Note does not represent an assessment of adherence to relevant international standards, such as the *Key Attributes of Effective Resolution Regimes for Financial Institutions* (*Key Attributes*[2]) and the *Core Principles for Effective Deposit Insurance Systems*, although those standards serve as a frame of reference for certain recommendations cited in this Note.

B. Financial Sector Landscape

2. **The banking system is dominated by two commercial banks of roughly equal size with a combined market share of 75 percent.** As of end-November 2020, TBC Bank (TBC) and Bank of Georgia (BOG) held 74 percent of banking system assets, 76 percent of total deposits and 74 percent of insured deposits. Both banks are deemed systemically important banks (SIBs) for supervisory purposes by the bank supervisory authority, the National Bank of Georgia (NBG), as is Liberty Bank, which has a 5 percent share of assets, 6 percent of deposits and 15 percent of insured deposits.[3] There are 12 other commercial banks, including two locally owned banks, eight subsidiaries of foreign banks or financial groups (based in Russia, Germany (2), Kazakhstan, Azerbaijan, Turkey (2) and the Netherlands), and two foreign-owned banks (China, UAE).

3. **The two largest banks comprise the vast majority of the assets of the financial groups of which they are a part.** Both banks are subsidiaries of parent non-financial legal entities listed on the London Stock Exchange. Both groups encompass a number of legal entities licensed and based in Georgia and a few foreign markets (Azerbaijan, Uzbekistan, Belarus), some of which are subsidiaries of the bank and some of which are subsidiaries of the parent entity (sister entities to the

[1] This note was prepared by David H. Scott, External Expert for the Monetary and Capital Markets Department of the IMF.

[2] Promulgated by the Financial Stability Board in 2011, the *Key Attributes* are the internationally agreed standard addressing recovery and resolution regimes for banks, insurers and financial groups.

[3] The SIB designation was determined in 2017 using internationally agreed criteria adopted by the Basel Committee on Banking Supervision and resulted in greater supervisory attention and the setting of a systemic risk capital buffer for each bank.

bank). However, the two Georgian banks represent over 95 percent of overall group total assets in both cases. The third SIB, Liberty Bank, is a subsidiary of a Georgian company which is a subsidiary of an unlisted Netherlands holding company controlled by three individuals. It has no significant subsidiary or sister financial entities.

4. Senior and subordinated debt funds is a significant funding source for several banks, especially the largest. For the banking sector overall, total deposits represent 60 percent of total assets, insured deposits represent 7 percent of total assets (and 11 percent of total deposits[4]), while senior and subordinated debt represents 25 percent of total assets, largely driven by TBC at 27 percent and BOG at 23 percent, respectively. The vast majority of the TBC and BOG debt is issued in foreign jurisdictions. Significant investors include multilateral international financial institutions.

5. No additional banks have yet been designated as systemically important from the perspective of the potential financial system or economic impact of their failure and liquidation. The three banks designated as SIBs for supervisory purposes have been presumed by the NBG to be potentially systemic in failure. Additional banks beyond these three might also be deemed to be potentially systemic in failure. The authorities have not yet developed an internal guideline for making this determination.[5]

C. Legal Framework

6. The authorities' legal powers with respect to problem and failing banks are set out mainly in two laws, both of which recently were amended to introduce a resolution regime for banks that may be systemic in failure. The Law on Commercial Banking Activities (Banking Law) and the Organic Law on the National Bank of Georgia (NBG Law) are the principal relevant legislation. Both laws were amended in 2019 to incorporate resolution powers and safeguards that can be employed in the case of a bank deemed systemic in failure and to lay the legal foundations for recovery and resolution planning, broadly following the *Key Attributes*. The Banking Law sets out the rules for liquidation of a bank and the resolution tools that can be employed as an alternative to liquidation in the case liquidation would give rise to significant adverse systemic consequences. The NBG Law defines the NBG's powers for supervisory interventions to address problems in a bank, its powers in both liquidation and the alternative of resolution, the means for employing and recouping state funds to support resolution, and an interagency institutional framework for crisis preparedness and crisis management. Also relevant is the Law on the Deposit Insurance System (DI Law). Enacted in 2017, the DI Law defines the legal framework for the establishment of the Deposit Insurance System (DIS), for the governance and authority of the Deposit Insurance Agency (DIA) and for the administration of the Deposit Insurance Fund (DIF). See the Failure Resolution Powers and Planning section of this Note for an analysis of the legal framework for bank failure resolution and the Deposit Insurance System section for more detail on the DI Law.

[4] Only deposits of natural persons are insured at present. However, if legal entities gain coverage as is pending before the Parliament, roughly 13 percent of total deposits will be insured. See Deposit Insurance section of this Note.

[5] See related recommendation in the Resolution Planning section of this Note.

D. Recent Experience with Bank License Revocations

7. There have been four noteworthy instances of license revocation since the prior FSAP. The license of one bank was revoked due to violations of anti-money laundering laws and requirements. The liquidation was terminated with no loss incurred by depositors or creditors. Most of the assets and liabilities of a second bank were acquired by another bank and the remaining assets and liabilities were liquidated. The NBG-administered liquidation was terminated with no loss incurred by depositors or third-party creditors.[6]

8. The other two instances involved foreign parent banks. The license of one of these banks was revoked in September 2016 due to the revocation of the parent bank's license in a foreign jurisdiction. At that time, the NBG Law required the license of a Georgian subsidiary of a foreign bank to be revoked in case the license of the parent was revoked in the foreign jurisdiction.[7] The Georgian subsidiary was in generally sound condition and the liquidation was terminated with no loss incurred by depositors or creditors. The license of another such bank was revoked due to a decision by the foreign parent bank to close its Georgian subsidiary. The bank managed a wind-down of its business save for a small number of depositors' accounts whose owners could not be located. Given the absence of legal provisions specific to voluntary bank liquidation, the NBG revoked the license and NBG-administered liquidation was commenced. This enabled the recently established DIA to act as intermediary for those depositors' funds, which will be transferred to an agent payout bank upon claim by the owners, with any unclaimed funds eventually being transferred to the NBG. See the Failure Resolution Powers and the Deposit Insurance System sections of this Note for related recommendations.

THE FINANCIAL SAFETY NET

A. Institutional Framework

9. The authorities of most relevance to the safety net regime are the Ministry of Finance (MoF), the NBG, the DIA and the Insurance State Supervisory Service (ISSA). The MoF has responsibility for any use of public funds in dealing with bank failures and systemic crises, as well as for promoting the sound functioning of the financial system in support of the economy. The NBG serves as the supervisory and resolution authority for banks, the monetary authority and the lender of last resort for banks. The DIA administers the DIS and the DIF. The Insurance State Supervision Service (ISSA) supervises the developing insurance industry, which largely entails health and property insurance with very limited life insurance penetration.

[6] The NBG fully controls the bank liquidation process and NBG staff typically serve as the Liquidator. See the Failure Resolution Powers section of the Note for further details.

[7] The Banking Law was subsequently amended to provide that the revocation of a parent bank's license in a foreign jurisdiction could but was not required to be the basis for revocation of a Georgian subsidiary bank's license.

10. The 2019 NBG Law amendments established a Resolution Committee (RC) to oversee the NBG's resolution functions.[8] Under the law the RC is comprised of the NBG Governor and all Deputy Governors (of which there are currently two) and is chaired by the Governor. The RC oversees the NBG's failing bank resolution functions, especially for systemic banks, and including resolution planning, decisions to exercise resolution powers and the conduct of actual resolutions. (See the Failure Resolution Powers and Planning section of this Note.) It is to report at least annually and upon request to the NBG Board.[9] A Charter for the RC further defining the governance, membership, powers, responsibilities and decision-making procedures of the RC has been adopted.[10] Under the Charter the Vice-Governor responsible for the new Resolution and Liquidation Division (see next paragraph) serves as Deputy Chair. This Vice-Governor currently is also responsible for NBG's bank supervisory functions. The NBG Law transitional provisions require operational independence of resolution functions from supervisory functions be implemented within two years so as to prevent conflicts of interest. To implement this mandate there is the presumption that another Vice-Governor will be added to the NBG Board so as to enable the required operational separation and independence of supervisory and resolution functions. Under the Charter, the heads of relevant NBG departments are non-voting members of the Committee and other persons including external experts may be invited to the Committee if their attendance is required. The RC held its initial meeting in December 2020 and will likely meet next in June 2021.

11. Resolution and liquidation functions will be executed by a newly established Resolution and Liquidation Division (RLD) into which a preexisting liquidation unit was merged. The RLD, consisting of a division head and 3 staff at present, is directly accountable to the Vice-Governor in charge of supervisory functions. The means for doing so have not been finalized. The division is responsible for resolution planning and related activities,[11] as well as the management of any bank failure situations, including liquidations. It also serves as the secretariat of the RC. RLD management will recruit two additional staff during 2021. The RLD can request the support of additional NBG staff in time of need and can contract for external experts.

12. There is a mandatory DIS for banks that is administered by the DIA. As noted, the DIA was established under the DI Law enacted in 2017. It functions essentially as a paybox in that it may only reimburse insured deposits via payment to the depositor in the event of the liquidation of a bank and has no supervisory powers. The DIA and the NBG have entered into a Memoranda of Understanding (MOU) and cooperation is reported by both entities to be good. See the Deposit Insurance System section of this Note for more details and for related recommendations.

13. The MoF and the NBG entered into MOU in 2014 to facilitate information exchange and cooperation in pursuit of financial system stability. The MOU called for the creation of a Crisis Coordination Group (CCG) to be comprised of the Minister of Finance and his/her deputies

[8] NBG Law 16^2

[9] In addition to the Governor and three Vice-Governors, the NBG Board is comprised of five individuals chosen by the Parliament.

[10] *Rule on Procedures of the Functioning of a Resolution Committee of the National Bank of Georgia*

[11] Such as reviewing and commenting on banks' recovery plans, described later in this Note.

and the Governor and two Vice-Governors of the NBG. The MOU also envisioned establishment of a working group comprised of representatives of relevant MoF and NBG departments. However, neither the CCG nor the working group were formalized and made functional. The need for the CCG has been mitigated by the establishment of a new Interagency Financial Stability Committee (see below), which provides an additional institutionalized platform for information sharing. The MoF/NBG MOU adequately provides for the sharing of personal, commercial, and professional information subject to it not being used for purposes other than those related to the goals and scope of the MOU and subject to maintaining the confidentiality of the information. Given the many recent developments cited in this Note, the MOU should be reviewed and updated. A number of specific recommendations made in this Note should be taken into consideration in that review.[12]

14. The NBG has MOUs in place with relevant foreign supervisory authorities but none that are specific to resolution purposes. The MOUs are seen by the NBG to be sufficiently broad so as to accommodate information sharing, cooperation and coordination in the context of failure resolution where the supervisory authority is also the resolution authority. In a few cases a relevant foreign authority did not agree to enter into a formal MOU with the NBG but nonetheless cooperation in practice is reported to be good. To date there have been no cases of cooperation with the work of foreign resolution authorities. The RLD should review the current inventory of MOUs to determine whether revised or new MOUs should be pursued for resolution purposes.

15. The 2019 NBG Law amendments established a new Interagency Financial Stability Committee (IFSC) to promote financial stability and to develop mechanisms for crisis management.[13] The IFSC is chaired by the Minister of Finance[14] and is comprised in addition by the Governor of the NBG, the Head of the DIA and the Head of the ISSA. The NBG is to serve as secretariat though the task has yet to be assigned. The IFSC is to meet at least annually and more frequently as required by the NBG. Under the law, the NBG is to provide early notification to the committee in case a bank may need to be resolved or might require temporary public support and/or ELA. The IFSC Charter sets out its main tasks and powers. Its main task is to develop mechanisms for financial crisis management to support the stable financial system functioning. Its powers include the ability to request information from the NBG, to review the need for last resort loans by the NBG, and to review the need for temporary state funding of a bank in resolution, though decision-making authority resides with the NBG and the MoF. (See the NBG Liquidity Support and Temporary Public Funding sections of this note.) The Charter defines information the NBG is to provide the IFSC and envisions that it is to review potential responses to financial stability risks and to potential bank failures. The secretariat of the IFSC is to plan and oversee the conduct of periodic crisis simulation exercises. The roles and responsibilities of the IFSC in normal times and in times of crisis should be further specified. (See the Contingency Planning and Crisis Management section of this Note for more specific recommendations in this regard.)

[12] The NBG also entered into a MOU with the ISSA in 2014.

[13] NBG Law 55^6

[14] In his/her absence, by the Vice Minister.

16. The 2019 amendments introduce a Special Manager regime for executing resolution actions at the NBG's direction. The Banking Law stipulates that the NBG may exercise its resolution powers directly or may appoint one or more Special Managers to exercise such powers.[15] The NBG published a rule addressing the role of the Special Manager which makes it clear that the manager will function as an agent of, and report directly to, the NBG.[16] The rule sets out the process for selecting and appointing individuals to serve as Special Manager and provides that NBG staff can do so. The rule stipulates that to qualify, an individual must meet the "fit and proper" criteria set out in the rule and be free of any conflicts of interest. The rule is silent, however, on the desired skill set for a Special Manager.[17] The rule details the Special Manager's powers and duties. The powers include the ability to exert full control over the bank and to assume the authority of all bank bodies (i.e., the Management Board, Supervisory Board and General Meeting of Shareholders). A Special Manager can be appointed for up to one year, though this term can be extended. The NBG should amend the rule to define the desired skills set of a Special Manager[18] and to establish a presumption that NBG staff, as a general principle, have a conflict of interest and should only serve as Special Manager in extraordinary circumstances.[19] Steps should be taken to identify qualified independent professionals who would be willing and able to serve as a Special Manager.

17. The 2019 Banking Law and NBG Law amendments entailed a substantive revision to the existing Temporary Administrator (TeA) regime. Prior to introducing the new resolution regime, a TeA enjoyed legal powers that could enable the TeA to function in a resolution capacity. Specifically, the TeA could be vested with the power of the General Meeting of Shareholders and in that capacity take decisions that were comparable to some of the new resolution powers explicitly introduced in the 2019 amendments. The capacity of the TeA to function as the General Meeting has been revoked, now being vested with the Special Manager, and thus rendering the TeA regime applicable as a supervisory intervention tool only. In practice, the NBG has not imposed a TeA in any bank since the prior FSAP.

18. Legal protections for NBG and DIA staff are adequate. The NBG Law provides that current and former NBG staff cannot be held personally liable for actions or omissions taken in good faith, and that the NBG shall defend their interests.[20] These protections apply to TeAs, SMs, Liquidators and administrators of bridge banks (see resolution tools). They also apply to external parties that have been contracted by the NBG based on a contract of employment. Comparable legal protections exist for DIA staff.

[15] Banking Law 37(1)

[16] *Rule on Appointing and Activities of the Special Manager of a Bank*, December 2020

[17] The rule specifies having "relevant professional experience" as a selection criterion but does not elaborate on what experience would be deemed relevant.

[18] For example, managerial and leadership experience in running and restructuring banks or other businesses.

[19] For example, pending appointment of a third party professional Special Manager.

[20] NBG Law 68(6). With respect to the defense of the interests of staff, the law provides that this may take for form of providing legal services to the employee, compensation of dispute related costs and any other measures the NBG may find expedient for the protection of employee interests.

19. Summary of Recommendations:

- Review the MoF/NBG MOU in light of the recommendations in this Note and update as necessary;
- Review the current inventory of MOUs to determine whether revised or new MOUs should be pursued for resolution purposes;
- Further specify the roles and responsibilities of the IFSC in normal times and in times of crisis;
- Amend the Special Manager rule to define the desired skills set and to establish a presumption that NBG staff have a conflict of interest and should only serve as Special Manager in extraordinary circumstances; and
- Identify qualified independent professionals who are able to serve as a Special Manager.

B. Recovery Planning and Early Intervention

Introduction

20. The *Key Attributes*, the international standard for recovery and resolution regimes, requires that any bank that could have an impact on financial stability in the event of its failure should be required to prepare a recovery plan.[21] Recovery plans should: (i) define measures the institution would employ to address shocks to capital or liquidity; (ii) set out credible recovery options to deal with a range of stress scenarios covering both idiosyncratic and market-wide stress; and (iii) define clear backstops and escalation procedures, identifying the quantitative and qualitative criteria that would trigger implementation of the plan by the institution.[22] To ensure the quality and effectiveness of recovery plans, supervisors should have the power to require improvements in the plan and, if deemed necessary, to require implementation of recovery options.

21. The *Key Attributes* advocate for timely intervention to deal with failing banks. Resolution should be initiated when a bank is no longer viable or likely to be no longer viable and has no reasonable prospect of becoming so.[23] The authorities should act early, before a bank has incurred losses exceeding its equity capital. There should be clear standards or indicators of nonviability to help guide decisions.

[21] While the *Key Attributes* use the acronym "RRP" to refer to recovery plans and resolution plans collectively, in practice these are two distinct matters. Recovery plans are to be prepared by banks (and other potentially systemic financial institutions), whereas resolution plans are to be prepared by resolution authorities, albeit with substantial input from banks, including from their recovery plans. A few jurisdictions (e.g., Canada) require institutions to prepare their own resolution plans for review and use by the resolution authorities.

[22] *Key Attributes Assessment Methodology for the Banking Sector*, October 2016. See also I-Annex 4 to the October 2014 update to the *Key Attributes of Effective Resolution Regimes for Financial Institutions*.

[23] Key Attribute 3.1

Recovery Planning

22. The 2019 amendments to the Banking Law include provisions requiring banks to prepare recovery plans[24] and the NBG has published an implementing rule.[25] Under the law, plans must be prepared by all banks including branches of foreign banks. Plans must be approved by supervisory boards and updated annually or when changes material to the plans occur. The NBG is to review the plans and is authorized to require banks to makes specific changes to the plans. Banks and banking group entities are obliged to cooperate and supply any information required. The Recovery Plan Rule is comprehensive and adheres closely to internationally adopted guidance. It sets out the factors that the NBG will consider in assessing the completeness and quality of recovery plans. The NBG is to provide the conclusions of its assessment to the bank within three months of receiving the plan,[26] and the bank is to revise the plan within two months. The NBG may take any supervisory enforcement action necessary to ensure compliance with the recovery planning requirements. All banks are required to submit comprehensive recovery plans by May 31, 2022. In the interim, transitional provisions required SIBs to submit plans addressing one stress scenario[27] by January 1, 2021 and plans addressing additional stress scenarios by July 1, 2021. Other banks are to submit plans addressing one stress scenario by June 30, 2021 and plans addressing an additional stress scenario by December 31, 2021. The first submission by the three SIBs were delayed due to pandemic but were received in the first quarter of 2021. All banks are expected to adhere to the other transitional deadlines.

23. As a component of its recovery plan a bank must prepare a self-assessment of the critical functions it provides and here too the NBG has issued an implementing rule.[28] The Critical Functions Rule also adheres closely to internationally adopted guidance. It provides detailed criteria that banks are to use for identification and assessment of critical functions and shared critical services. In brief, critical functions are those that are important to the economy or financial system stability, while critical shared services are those essential to the provision of critical functions.[29] Banks must update the self-assessment annually in the context of updating their recovery plans. The rule specifies the process for NBG review of the self-assessments which is essentially the same as for recovery plans described above, although in the case that a bank's self-assessment, after instructions from the NBG, is not completed in a satisfactory manner, the NBG may make its own assessment where there are any concerns regarding possible economic or financial system impacts.

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[24] Banking Law 19[1]

[25] *The Rule on Developing and Assessment of Recovery Plan of a Commercial Bank* (Recovery Plan Rule), June 2020

[26] By means of a letter signed by the Vice Governor responsible for supervisory activities.

[27] The Regulation sets out in detail the requirements for the stress scenarios that banks must consider when preparing recovery plans. The stress scenario requirements adhere well to internationally adopted standards. SIBs must eventually address four stress scenarios, while other banks must address three.

[28] *Rule on the Identification and Assessment of Critical Functions of a Commercial Bank* (Critical Functions Rule), June 2020

[29] The Critical Functions Regulation elaborates on these definitions.

24. The triggers for assessing whether recovery options should be implemented should be set well above regulatory minimums. The Recovery Plan Rule provides guidance on setting triggers for assessing whether recovery options should be considered by bank management for implementation but does not indicate the relationship between those thresholds and the minimum prudential regulatory requirements. The NBG should amend the rule to make clear that the thresholds for triggering escalation within management and a decision on whether to implement one or more recovery option should be set sufficiently above the regulatory minimums to preclude any breach of those minimums.

25. The NBG is working with banks and has made internal preparations to review and comment upon recovery plans. As set out in the Recovery Planning Rule, the NBG is to assess whether each recovery plan is compatible with and satisfies all the requirements laid down in the rule and is to evaluate its completeness, quality and efficiency.[30] The NBG has held a series of meetings with the banks to clarify expectations for recovery plans and critical function self-assessments. The Bank Supervision Department will lead the review of recovery plans and will obtain inputs from the Supervisory Policy Department, the Specialized Risks Department and the RLD. To promote improvement in the quality of recovery plans over time, the NBG should consider formally seeking feedback from banks to determine scope for clarifying and perhaps simplifying the Recovery Plan and Critical Functions Rules. The Bank Supervision Department needs to be alert to bank management viewing recovery planning as a compliance exercise rather than a means to improve bank risk management. Ensuring the rules are practically suitable for that purpose in smaller banks will be important.

26. At present there is no role envisioned for the MoF in evaluating the banks' critical function self-assessments. While the MoF should not be involved in evaluating an individual bank's self-assessment, it should be informed of banks' assessment of functions deemed critical to the economy and provided the opportunity to periodically present its views. The NBG should seek input from MoF in assessing the adequacy of banks' self-assessment of critical functions, either directly or through the forum of the IFSC.

27. At present recovery plans are required at bank level but consideration could be given to eventually requiring plans at group level, where relevant. Group level plans would address the recovery of sister entities (financial subsidiaries of the parent entity that are not subsidiaries of the bank itself). Certain of these entities are significant participants in certain sectors, such as the insurance industry. Group level recovery plans would also serve as a useful input to resolution plans (addressed below).

Early Intervention

28. The Banking Law provides the NBG wide-ranging supervisory corrective action powers.[31] These powers can be used with respect to banks and their managers as well as to

[30] Efficiency is evaluated in terms of whether the plan can be practically implemented in a timely manner.

[31] Banking Law 30

controlling persons[32] and may be imposed in case of problems with a bank that might jeopardize the stable and efficient operation of financial sector or the interests of depositors and other creditors.[33] The 2019 amendments to the law incorporated explicit authority for the NBG to require a bank to implement one or more measures set out in its recovery plan, including restructuring debt and obtaining additional capital from significant shareholders as envisioned in the plan.

29. In the event that supervisory corrective actions do not or are likely to not prove effective, the NBG may appoint a Temporary Administrator (TeA) for the bank. The NBG will issue a formal legal act imposing the TeA and specifying its roles, duties and powers with the goal to rectify the bank's problems. In general, key decisions taken by management will require the consent of the TeA or the TeA may take such decisions directly. As noted in the Institutional Arrangements section of this Note, the capacity of the TeA to function as the General Meeting of Shareholders was revoked in the 2019 amendments to the Banking Law, and this was appropriate given the role of the TeA as a tool for supervisory intervention and the creation of the Special Manager regime with the power to function as the General Meeting of Shareholders.

30. The legal triggers for the NBG to act in a timely manner in response to deteriorating financial conditions are adequate but a written policy to guide when and how to use the specific powers should be adopted. The triggers in the Banking Law[34] are broad and provide sufficient basis for the NBG to act before an institution has incurred losses exceeding its equity capital. But there is no explicit written policy guidance indicating which powers to use in which situations. The NBG should develop detailed policy guidance geared to ensuring that timely action, including the initiation of license revocation or alternative failure resolution action, is taken promptly in response to financial deterioration in all banks. One explicit goal of such a policy should be to mitigate the risk that the NBG forbears on action until failure is imminent.

31. Summary of recommendations:

- Amend the Recovery Planning Rule to ensure thresholds for triggering escalation within management and decisions on whether to implement recovery option are set sufficiently above minimum prudential regulatory requirements.
- Seek feedback from banks to determine scope for clarifying and perhaps simplifying the Recovery Plan and Critical Functions Rules.
- NBG should seek input from MoF in assessing the adequacy of banks' self-assessment of critical functions.
- Consider requiring recovery plans to be prepared at group level so as to address sister entities

[32] Shareholders with 10 percent or greater direct or indirect ownership, including shareholders acting in concert, and thus considered significant shareholders.

[33] See BCP Technical Note prepared as a component of this FSAP.

[34] Banking Law 7

that are important participants in sectors other than banking in the financial system.

- Develop detailed policy guidance to ensure that timely action, including the initiation of license revocation or alternative failure resolution action, is taken promptly in response to financial deterioration in any bank.

C. Failure Resolution Powers and Planning

Introduction

32. **With the recent legislative amendments, there are now more clear legal avenues to deal with a bank whose failure might give rise to systemic implications.** The NBG can resolve bank failures by means of liquidation with reimbursement by the DIA of insured deposits. The new failure resolution powers offer a range of alternatives to liquidation, substantially enhancing NBG's capabilities relative to the former regime under which a TeA could assume the powers of the General Meeting of Shareholders in order to affect resolution while avoiding liquidation.

33. **Formal resolution planning supports the ability of the authorities to effectively use their new failure resolution powers**. Resolution planning, as advocated in the *Key Attributes*, is intended to facilitate the effective use of resolution powers in order to protect critical functions, with the aim of making the resolution of a systemic bank feasible without severe disruption, and without exposing taxpayers to loss.[35] Resolution plans serve as: (i) a mechanism under which to evaluate, in advance, the menu of resolution tools available under the legal framework as they would apply in the case of the specific bank or group; and (ii) based on that evaluation, as the means to articulate both a preferred resolution strategy,[36] employing specific resolutions tools, and a backup strategy employing alternative resolution tools.[37] Resolution plans should specifically define the means by which to preserve those critical functions in the case of the threatened failure of a bank, and the planning process should identify impediments to implementation of the resolution strategies. In principle, resolution plans should be prepared, at least, for all banks that could be systemically important in failure at the group and significant subsidiary levels.[38]

Failure Resolution Powers

34. **The NBG can initiate liquidation under the provisions of the Banking Law.[39]** The Banking Law provisions override those in the general Law on Insolvency Proceedings. Bank liquidation is triggered by the NBG by means of license revocation. Only the NBG can declare the

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[35] Key Attribute 11.6. While public funds may need to be brought to bear, they should be fully recovered, in the last resort from the banking industry.

[36] The preferred resolution strategy is the authorities' best-case plan for how to most effectively and efficiently protect systemically important functions without causing severe disruption, and without exposing taxpayers to loss.

[37] The back-up strategy is the authorities' pre-identified plan should execution of the preferred resolution strategy prove impractical under the circumstances at the time.

[38] This may include entities in addition to those designated as SIBs for supervisory purposes.

[39] Banking Law 37[12]

insolvency and bankruptcy of a bank.[40] The 2019 legal amendments clarified that liquidation is to be conducted with a view to preserve financial stability and to protect insured deposits while also maximizing value for creditors. The grounds for license revocation are broad,[41] including when a bank is expected to face significant financial problems or is likely to become insolvent.[42] The law thus provides the NBG with the discretion necessary to initiate license revocation when in its judgment the bank is likely to fail but before failure is imminent. Decisions in this regard are taken on a case-by-case basis. However, as noted earlier, there is no written policy geared to ensuring that the NBG acts promptly to trigger license withdrawal when a bank is deemed likely to fail, and it is recommended that such a policy be adopted.[43]

35. **The Banking Law sets out the main procedures and timelines for liquidation.[44]** The procedures for liquidation, including the role played by the NBG, have been further elaborated by the NBG in a Liquidation Regulation.[45] The law and regulation are adequate to guide the efficient liquidation of a bank. Bank liquidations since the prior FSAP were concluded in a relatively short period of time.[46]

36. **Under the Banking Law the Liquidator is appointed by, overseen by and accountable to the NBG, and in practice NBG staff are typically appointed to this role.** The Liquidator is authorized to transfer the failed bank's assets to other banks along with some or all of its liabilities.[47] When transferring assets and liabilities the consent of depositors, creditors or debtors is not required.[48] In practice, NBG staff typically serve as Liquidators. In this case the salary costs are borne by the NBG while incidental expenses are borne by the liquidation estate. The practice of appointing NBG staff as Liquidator should be phased out. The Liquidation Regulation does not specify the required skill sets of a Liquidator and on the potential for conflicts of interest.[49] The regulation should be amended to specify the desired professional qualifications and to establish a presumption that NBG staff, as a general principle, have a conflict of interest and should only serve as Liquidator in extraordinary circumstances. These steps would reduce the potential for legal challenge of a

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[40] NBG Law 49(5) and Banking Law 8(4). Creditors or depositors cannot petition the court to trigger insolvency and bankruptcy without the concurrence of the NBG.

[41] Banking Law 7(1)

[42] The law also allows license revocation if a bank requires extraordinary liquidity support from the NBG.

[43] See recommendation in the Recovery Planning and Early Intervention section of this Note.

[44] Banking Law 37^{12}

[45] *Regulation on Liquidation of Commercial Banks*, 2018

[46] See the Recent Experience with Bank Failures section of this Note.

[47] Banking Law 37^{12}(4). In addition, the Liquidator can sell assets at a public auction, or can select another form of sale in agreement with the NBG and can transfer the assets to creditors according to their priority in the creditor hierarchy.

[48] Banking Law 37^{12}(5)

[49] The Banking Law only stipulates that a person related to the commercial bank shall not be appointed as a Liquidator. Banking Law 37^{12}(1)

Liquidator's actions. The RLD should identify third party professionals qualified to serve as Liquidators.

37. The Banking Law does not make specific provision for voluntary liquidation or the conversion from one form of regulated entity to another when initiated by shareholders. The legal procedures for winding-up a sound bank upon the decision of its shareholders are the same as those for the NBG-administered liquidation of a failing bank. Similarly, the conversion of a bank branch license or a microfinance organization license to a commercial bank license is not explicitly addressed in the law. In the case of voluntary liquidation, this has given rise to the need for the NBG to appoint a Liquidator to administer the late stages of a voluntary liquidation. As will be noted in the Deposit Insurance System section of this Note, the lack of legal provisions specific to voluntary liquidation might also trigger a deposit insurance payout. The lack of explicit provision addressing conversions means the procedures lack legal certainty, must be handled on case-by-case basis, and give rise to the need for various administrative decision (e.g., with respect to tax consequences). The MoF and the NBG should plan to amend the Banking Law and other relevant legislation to explicitly address these transactions.

38. The creditor hierarchy in liquidation was updated as part of the 2019 amendments[50] but with the adoption of increased deposit insurance coverage on July 1, 2020, should be further updated. Under the current provisions, after secured creditors, unsecured claims of the Resolution Fund (see para below) and the NBG have the highest priority, followed by claims of the DIA subrogated for insured depositors.[51] Thereafter the priority is as follows: i) individuals up to GEL 10,000 in local and foreign currency; ii) legal entities up to GEL 10,000 in local and foreign currency; iii) individuals up to GEL 100,000 in local or foreign currency; iv) individuals in local currency in excess of GEL 100,000; v) individuals in foreign currency in excess of GEL 100,000; vi) legal entities in local currency in excess of GEL 10,000; v) legal entities in foreign currency in excess of GEL 10,000; vi) loans disbursed by other banks to the liquidation estate; vii) tax liabilities, and; viii) other claims. Thereafter in the order of priority are non-deposit claims of direct and indirect owners, subordinated debt and several tiers for various classes of regulatory capital. The creditor hierarchy needs to be updated to reflect recent and planned changes in deposit insurance coverage and eligibility.[52] When doing so, the hierarchy should be made consistent with deposit insurance coverage and any future coverage changes, and should employ a simplified tiered structure under which insured deposits have priority, followed by eligible uninsured deposits (amounts above the deposit insurance coverage limits at the time), other deposits (those ineligible for deposit insurance), and other

[50] Banking Law $37^{12}(10)$.

[51] Or insured depositors themselves pending payment by the DIA.

[52] Coverage was increased from GEL 5,000 to GEL 15,000 and legal entities are likely to gain eligibility. See Deposit Insurance System section of this Note.

unsecured claims.[53] In addition, the claims of a bank that lends to a liquidation estate[54] should be reassigned to have the same priority as NBG unsecured claims.

39. The 2019 amendments provided the NBG with substantial new powers to deal with the failure of a bank whose liquidation could give rise to systemic consequences. The potential systemic consequences might involve impairment to the sound functioning of the banking or financial system or a significant negative effect on the economy. Overall, the amendments to the NBG Law and the Banking Law[55] provide the NBG with the systemic bank resolution powers and lay the groundwork for the recovery and resolution regimes, envisioned in the *Key Attributes*. The powers may be used when the grounds for revoking a bank's license have been met and when, in addition, the use of the powers is necessary to achieve certain resolution objectives.[56] The amended NBG Law specifies the resolution objectives and these are consistent with the *Key Attributes*.[57] The amended Banking Law sets out appropriate principles to guide resolution action, including that shareholders shall bear losses first, that creditors bear losses after shareholders in order of priority of their ranking in the creditor hierarchy applicable in liquidation, that creditors in the same ranking should be treated equally (with certain limited exceptions cited below), and that insured deposits should be protected.[58]

40. The range of systemic bank resolution powers now available to the NBG are comprehensive. These include: i) the power to write down shares and other regulatory capital instruments or convert regulatory capital instruments into shares or other instruments of ownership;[59] ii) the power to effect the merger of a bank under resolution with an acquiring bank;[60] iii) the *sale of business tool*,[61] the power to effect the sale of the shares or any of the assets and liabilities of a bank under resolution to another bank;[62] iv) *the bridge institution tool*, the power to transfer all or any shares, assets and liabilities of a bank under resolution to a bridge bank (see

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[53] See: *The Case for Depositor Preference*, IMF, December 2020 at https://www.imf.org/-/media/Files/Publications/TNM/2020/TNMEA2020002.ashx

[54] Banking Law 37^{12}10(j)

[55] As well as to a range of other affected legislation.

[56] Banking Law 34

[57] NBG Law 55^{1}. The resolution objectives are to ensure the continuity of critical functions, to avoid a significant adverse effect on financial system stability, and to protect budgetary, other public funds, insured deposits, and client funds and assets.

[58] Banking Law 32(1)

[59] Banking Law 37^{4}. This power can be exercised independently (e.g., to recapitalize a bank so as to mitigate the need to take other resolution action) or in conjunction with the use of other resolution powers/tools, generally as precursor.

[60] With the consent of the acquiring bank.

[61] The reference to various resolution "*tools*" in this Note adopts the terminology set out in the European Union's *Bank Recovery and Resolution Directive* (BRRD) (*Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014*), the Union's implementation of the *Key Attributes*, terminology which to some extent is also used in Georgian law. The BRRD's mandatory 8% bail-in requirement appropriately has not been adopted in Georgia.

[62] Banking Law 37^{6} and 37^{7}

below) established by the MoF;[63] v) *the bail-in tool*, the power to write-down or convert liabilities (in addition to the regulatory capital instruments cited in i) above) in order to recapitalize a bank in resolution or a bridge bank,[64] and; vi) the power to recapitalize a bank in resolution by causing the issuance of new shares.[65] The use of these resolution tools is not subject to the approval or consent of shareholders, debtors, creditors or depositors of the bank under resolution. Where other laws applicable to the bank under resolution might interfere with the implementation of these tools, the provisions of those laws do not apply.[66]

41. With the *sale of business tool*, the NBG has the power to transfer the shares or any of the assets and liabilities of a bank under resolution to an acquiring bank or to an asset management company. The remaining assets and liabilities would be dealt with under the Banking Law liquidation provisions. The sale of business provisions can be used to sell the sound operations of a failing bank to an acquiring bank or to sell non-performing loans to an asset management company.[67] Unlike for many of the other powers described in this Note, the NBG has not adopted a rule articulating its policies and procedures for employing these legal provisions but should do so in the context of sales to third parties.[68] An important matter to address is how to organize competitive and transparent bidding for the assets and/or liabilities of a bank in resolution.

42. The NBG has the power to transfer the shares and/or assets and liabilities of a bank under resolution to a *bridge bank* established by the MoF, and the NBG has issued an implementing rule. To be prepared for potential use of a bridge bank, the MoF is authorized to establish in advance a joint stock company that can operate as a bridge bank upon NBG granting a license.[69] The bridge bank is to be managed and operated on a professional and commercial basis,[70] and the NBG is authorized to prescribe any requirements for its management and operation.[71] The NBG may exempt a bridge bank from certain regulatory requirements for up to six months if required in the interest of financial stability, NBG staff cannot serve as managers, and the bridge bank must be returned to the private sector as soon as feasible and to that end it must prepare an

[63] Banking Law 37^{8}

[64] Banking Law 37^{10}. Certain liabilities are excluded from being subject to this provision, including insured deposits, liabilities with a remaining maturity of up to seven days owed to payment, settlement and clearing systems, and interbank liabilities with an original maturity of less than seven days.

[65] Banking Law 37^{9}. Prior to issuing new shares, the NBG shall apply its power under Article 37^{4} to write down shares and other regulatory capital instruments or convert regulatory capital instruments into shares or other instruments of ownership.

[66] Banking Law 37^{5}(2) & (3)

[67] An asset management company could be a private non-bank entity operating with objective of maximizing the value of distressed assets.

[68] The use of the sale of business tool in conjunction with use of the bridge bank tool is addressed in the Bridge Bank Rule discussed immediately below.

[69] Banking Law 37^{8}(2). The bridge bank can be owned directly by the MoF or via an entity that it owns (NBG Law 55^{4}(4)).

[70] Banking Law 37^{8}(8)

[71] Banking Law 37^{8}(13)

exit plan. The NBG issued a rule applicable to the licensing and operation of a bridge bank.[72] The rule is comprehensive and addresses the objectives of a bridge bank (to ensure the continuation of critical functions of a bank under resolution); the licensing process; the process for the transfer of shares, assets and liabilities to a bridge bank; rules for the administration of a bridge bank; prudential regulatory requirements;[73] and the process for ensuring that the bridge bank is transferred to the private sector (either by means of sale to acquirors or merger with another bank) as expeditiously as possible. Under the rule the supervisory board is to undertake its functions with the agreement of the NBG.

43. The NBG has issued a rule addressing its use of the *bail-in tool*.[74] The Bail-in Rule defines in detail the manner in which bail-in (the write-off of liabilities or their conversion into shares) is to be affected. The rule envisions the tool being used in the context of the recapitalization of a stand-alone bank in resolution and the capitalization of a bridge bank. The bail-in rule defines the nature of an action plan setting out the post bail-in restructuring to be developed and executed by the Special Manager and the bank management team. The action plan is to be submitted to the RLD and Bank Supervision Department within one month of the bail-in transaction. To promote the ability to affect bail-in, the NBG has the power to require banks to issue a specific volume of debt instruments that can be readily bailed-in,[75] referred to as MREL (Minimum Required Eligible Liabilities) but has not yet done so. The NBG's current regulations do not require that debt issuances legally subject to bail-in contain contractual clauses highlighting that they might potentially be written-off or converted into equity.[76]

44. The NBG should take steps to enhance legal certainty regarding the effectiveness of bail-in as a resolution tool. The three SIBs (as well as some other banks) have issued a significant volume of senior debt and subordinated debt, all of which is subject to bail-in in principle. Much of the existing debt is issued in foreign jurisdictions and is subject to foreign law. The NBG should adopt a regulation to require all new debt issuances to include contractual clauses recognizing that the instrument is subject to bail-in by the NBG. In its Bail-in Rule, the NBG requires that banks individually certify that a bail-in decision with respect to each debt instrument is enforceable under foreign law. Where banks cannot provide the certification, the instrument will not count toward the bank's eventual MREL. To complement this requirement, the NBG should commission its own legal analysis in each relevant jurisdiction of the likely outcomes of investor challenges to potential NBG bail-in decisions. This analysis may inform steps the NBG can take to increase legal certainty regarding the extraterritorial effectiveness of its bail-in decisions. It should also inform an analysis of

[72] *The Rule on Licensing, Management and Market Exit of a Bridge Bank*, December 2020

[73] Under the rule, in general a bridge bank must adhere to the prudential regulatory requirements applicable to other banks, though the NBG can establish specific liquidity requirements for a bridge bank and can waive prudential capital requirements for up to six months.

[74] *Rule on Recapitalization of a Bank in Resolution by Means of Write-down or Conversion of Bank's Liabilities*, December 2020

[75] Banking Law 37[10](16)

[76] NBG regulations do require banks to include similar contractual clauses in contingent convertible capital instruments that qualify as regulatory capital.

the practicality of bailing-in existing and new debt issuances in different jurisdictions, which in turn, may guide the NBG in further defining and setting bank's MREL. (See the Resolution Planning section of this note for related recommendations.)

45. The NBG issued a rule addressing its power to recapitalize a bank in resolution by issuing new shares.[77] This power is seen as one that would be used subsequent to use of the bail-in tool. The rule envisions the potential acquisition of new shares by existing or new shareholders. However, there are no mechanisms in place to require existing or new shareholders to subscribe new shares. The rule should be amended to make clear that this power is to be used subsequent to the full write-off of the pre-resolution shareholders as part of the implementation of bail-in of creditors, such that the existing shareholders referred to in the rule are bailed-in creditors and not pre-resolution shareholders.[78]

46. To facilitate rapid execution of resolution decisions the NBG issued a rule defining simplified procedures for acquiring a significant share of a bank in resolution.[79] The use of most resolution tools likely will result in a change in ownership of a bank in resolution. The Banking Law requires NBG authorization of acquisitions of direct and/or indirect holdings at thresholds of 10 percent, 25 percent and 50 percent. To enable rapid decision-making and execution, the rule sets out streamlined documentation requirements and review procedures for evaluating the suitability of potential acquirers. The procedures envision possible conditional consent being granted, subject to further assessment based on more complete documentation, and that conditional consent might involve a suspension of the acquirer's voting rights or a decision that the NBG will exercise the voting rights until complete information is submitted and a final decision is made.

47. The NBG has extensive powers to stay actions by shareholder, creditors and other third parties. Among these, the NBG can impose a moratorium of up to 90 days to suspend payments due by a bank in resolution, except payments for insured deposit claims and claims associated with the bank's involvement in payment and settlement systems.[80] It can apply to the court to suspend for up to 90 days legal proceedings against a bank in resolution.[81] The law provides that no right or obligation under any contract to which the bank in resolution is a party may be terminated, accelerated, or modified by the bank's counterparties solely due to the initiation of resolution or any resolution action taken by the NBG.[82] The NBG may impose a stay of up to two

[77] *Rule on Recapitalization by Means of Issuing New Shares of a Bank in Resolution*, December 2020

[78] The rule indicates that dilution suffered by existing shareholders would be considered a loss incurred in resolution subject to the NCWO principle. This should only be the case for shareholders who are bailed-in creditors and not for pre-resolution shareholders.

[79] *Rule on Simplified Procedures for the Acquisition of a Significant Share of a Commercial Bank under Resolution*, June 2020

[80] Banking Law 37^2

[81] Banking Law 37^2(3) and NBG Law 55^2(1)(g)

[82] Banking Law 37^2(5)

days on the early termination rights arising with respect to financial collateral arrangements and netting arrangements/contracts of a bank.[83]

48. The 2019 Banking Law amendments specify the role of valuations in the resolution process.[84] To support a decision as to whether the conditions for license revocation exist, the NBG is to commission a valuation by an independent valuer using regulatory accounting standards, though in case of urgency the NBG can take a decision to trigger resolution action based on its own valuation.[85] To support decisions on the specific resolution tool(s) to be applied and the terms and conditions associated with the chosen tool(s), the NBG is to commission an independent valuation using more conservative valuation principles, including an assessment of value should the bank be liquidated, but again in case of urgency may conduct its own valuation for this purpose. If it applies resolution tools based on its own valuation, the NBG is to commission the independent valuation as soon as practical thereafter, and on the basis of that valuation, may make adjustments to the terms associated with the resolution tool(s) applied. In addition, a post-resolution independent valuation is required to determine whether creditors have been left worse-off under resolution than they would have been had the bank been liquidated (see more below.)

49. The NBG has issued a rule and further guidance addressing valuations.[86] The rule provides comprehensive guidance on rules, procedures and methodologies for valuations prepared by independent valuers as well as for provisional valuations that might be prepared by the NBG. The rule specifies the content of the reports that are to be prepared by independent valuers. It sets out qualification requirements and criteria for selection of independent valuers. The rule is supported by a guideline that further elaborates on valuation methodologies. The rule does not address in detail the NBG's expectations for the information that banks have to make available in order to enable the valuations and this should be specified and promulgated.

50. The creditor hierarchy applicable in liquidation applies in resolution and creditor safeguards are in place. In applying the resolution tools, and in particular when imposing losses on creditors, the NBG must respect the creditor hierarchy. Consistent with the resolution principles, creditors in the same class are to be treated equally, except in certain circumstances set out in the law.[87] No creditor should incur a loss under resolution actions in an amount greater than they would have incurred had a bank been liquidated, the No-Creditor-Worse-Off (NCWO) principle.[88] If, based on the independent valuation described above, it is determined that creditors did incur losses

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[83] Banking Law $37^{11}(7)$

[84] Banking Law 37^3

[85] This valuation is comparable to the financial analysis the NBG would undertake to make a decision on license revocation.

[86] *Rule for the Valuation of the Assets and Liabilities of a Commercial Bank for the Purposes of Resolution,* December 2020

[87] Banking Law $37^{11}(3)$. The NBG may deviate from *pari passu* treatment of creditors in a class if resolution action must be taken urgently, if deviation is necessary and proportionate to achieving the continuity of critical functions and core business lines or to avoid giving rise to widespread contagion of financial difficulties and threats, or if the losses borne by other creditors would be higher absent such deviation.

[88] Banking Law 32(1)(d) and $37^{11}(4)$

greater than in liquidation, they are entitled to compensation from the new Resolution Fund (described in the Temporary Public Funding section of this Note).[89] The recommendations for revisions to the creditor hierarchy cited earlier in this section would contribute to reducing the risk of successful NCWO claims.[90]

51. While the legislative amendments provide the NBG broad administrative resolution powers, the Court continues to play several roles during resolution and the legal framework includes useful provisions to clarify the interaction between the Court and the NBG.[91] Court approval is required for the NBG to exercise its power to suspend legal proceedings against the bank in resolution.[92] As per good practices, recent legal amendments require the Court to issue its decision within a day.[93] The Court can confirm or declare the NBG resolution action as illegal, although appropriate provisions exist to ensure that judicial actions do not impede resolution implementation. During appeal the NBG's actions will continue in force. In its deliberations the Court is to defer to the quantitative and qualitative assessments of the facts as presented by the NBG unless there is manifest error. In the event that the Court finds resolution action as illegal, the legal effects of resolution actions are preserved, and there is no returning to the pre-resolution *status quo ante*. Rather, the NBG is financially liable for any proven actual damages as determined by the Court. While useful, these provisions are not yet tested, and therefore it is prudent to rely on robust resolution decision-making to ensure that the NBG's resolution actions are upheld. To that end, while the current legal framework is appropriate, the NBG should analyze and take any indicated operational steps to minimize legal uncertainty as to whether its resolution decisions will be sustained by the Court.[94]

52. The NBG Law addresses resolution action in cooperation with foreign resolution authorities. When the basis for resolution action under the Banking Law exist, the NBG may exercise its resolution powers to support the resolution actions taken by a foreign resolution authority. However, the NBG may refrain from doing so if it would have adverse effects on financial stability or give rise to material fiscal implications in Georgia, or if the creditors of a Georgian bank would not be treated equitably under the foreign resolution proceedings.[95]

[89] Banking Law 37^{11}(4)

[90] In addition, it is worth noting that the proposed expansion of deposit insurance eligibility to legal entities' deposits would mostly benefit small and medium-size entities, which given economic importance of this sector, would ensure consistency with their likely-desired treatment in resolution.

[91] NBG Law 68

[92] Banking Law 37^{2}(3) and NBG Law 55^{2}(1)(g). As noted above, the suspension can be for a period of up the 90 days.

[93] The Civil Procedure Code was amended in several respects as part of establishing the new resolution regime.

[94] Legal uncertainty can be minimized, in part, by being able to demonstrate that the NBG has adhered to clear policies and procedures in taking resolution decisions. Potentially valuable is this regard are the various regulations and rules described in this Note which serve to document in the public domain the policies and procedures the NBG will use in such cases. The current lack of clear policies and procedures guiding the NBG to act promptly to trigger entry into resolution is a weakness in this context.

[95] NBG Law 5(2^{1})

Resolution Planning

53. A resolution planning regime is being implemented and the NBG issued a rule to guide the planning process.[96] The rule is comprehensive, defining, *inter alia,* the contents of a resolution plan, the procedures for assessing the resolvability of a bank (identifying impediments to the use of resolution tools), and the criteria for selecting a preferred resolution strategy. The rule calls for an initial assessment of the credibility and feasibility of liquidation as a means to deal with any bank's failure. If the NBG assesses that liquidation would have an adverse impact on the financial system or the economy, a preferred resolution strategy identifying the intended resolution tools is to be developed. The resolution strategy is also to include identification of possible variants to the intended approach in the event the preferred resolution strategy cannot be practically implemented due to circumstances at the time. Plans are to be reviewed annually and updated as necessary.

54. Initial resolution plans are to be developed for the three SIBs, but resolution planning for other banks should be considered. The plans are to be developed by the RLD by year-end 2021 and will need to be approved by the RC. The RLD also will need to develop a process for assessing, with respect to all banks, the credibility and feasibility of liquidation as a means to resolve their failure, a task not envisioned to be initiated until 2022 due to the other priorities facing the RLD. Nonetheless, given the stresses on the banking system arising from the pandemic, the RC should commission a rapid stock-taking based on the NBG's institution-wide knowledge of the circumstances of all banks with a goal to determine whether banks other than the SIBs, specifically those were there is reasonable doubt the bank could resolved by means of liquidation and insured deposit payout without systemic consequences, should be subject to at least some form of resolution planning in 2021.[97] If this is the case, the NBG Board should consider bolstering staff resources of the RLD.

55. The NBG should leverage the first round of resolution plans to contribute to setting MREL for at least the SIBs. In the context of undertaking resolvability assessments, the RLD, working with relevant supervisory and legal staff, should analyze the status of banks' existing debt issuances with respect to the practicality and legal certainty of executing bail-in in the various jurisdictions. This analysis should help guide the NBG in further defining and setting banks' MREL. A formal policy decision on setting and implementing MREL should be adopted as soon as practical, along with a timeline for phasing-in the requirements.

56. The MoF needs to take steps to be in a position to establish and operate a bridge bank. These efforts should be undertaken in collaboration with the NBG. As noted, the MoF is authorized to establish in advance a joint stock company that can apply for a banking license in time of need. The MoF should set up such an entity as soon as feasible. The NBG and the MoF should work to ensure that the information to be provided by MoF to the NBG in order to support a decision on licensing the entity as a Bridge Bank is prepared in advance. MoF will need to form a

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[96] *Rule on Developing a Resolution Plan for a Commercial Bank,* December 2020

[97] Liquidation may be inappropriate when multiple smaller institutions fail near simultaneously due to, for example, a system-wide crisis and/or contagion from one or more other failing banks.

Supervisory Board that will meet the approval of the NBG, and a protocol will need to be developed for coordination between the Supervisory Board and the NBG as all Supervisory Board actions must be taken with the agreement of the NBG. The MoF also will need to make arrangement to be able to capitalize the Bridge Bank and templates for the required submissions to the Cabinet and Parliament should be prepared. The MoF and NBG should consider establishing a joint working group to carry these tasks forward within deadlines agreed by the Minister and the NBG Governor. (Additional recommendations for collaboration between the MoF and the NBG in the context of financing effective resolution action are set out in the NBG Liquidity Support and Temporary Public Funding sections of this Note.)

57. The RLD is planning to contract independent experts to undertake the valuation necessary to support decisions on entry into resolution, the terms of the use of resolution tools, and the adjudication of potential NCWO claims. As noted, the rule on valuations sets out the relevant criteria. To be able to perform the valuations, the RLD should place at least two firms under standby contracts that would enable them to initiate work within a short period of time, such as within a week. In doing so, the RLD should solicit feedback from the providers on the valuation rule, the guideline and the information requirements and make enhancements where indicated.

58. The regional expansion of Georgian financial groups may eventually imply responsibility for the RLD to engage in cross-border analysis and cooperation related to resolution planning. This implies tasks such as understanding the relevant legislation in jurisdictions hosting any significant subsidiaries or branches of local groups and determining whether and how NBG resolution actions can be made effective in the host jurisdiction, and ensuring adequate cooperation with host resolution authorities, especially where the subsidiary or branch is systemically important in the host jurisdiction, though this is not situation at present.

59. Summary of recommendations:

- Amend the Liquidation Regulation to specify the desired professional qualifications of a Liquidator and to establish a presumption that NBG staff, as a general principle, have a conflict of interest and should only serve as Liquidator in extraordinary circumstances.
- Identify qualified third parties to serve as Liquidators.
- Amend the Banking Law to include legal provisions specific to voluntary liquidation and conversions of one form of regulated entity to another.
- Amend the Banking Law to update and simplify the creditor hierarchy by adopting a tiered structure that is consistent with deposit insurance coverage and by assigning the claims of a bank that lends to a liquidation estate the same priority as NBG unsecured claims.
- Adopt a rule articulating policies and procedures for use of the sale of business tool with respect to third parties.

- Adopt a regulation to require all new debt issuances to contain contractual clauses recognizing that the instrument is subject to bail-in by the NBG.
- Commission legal analyses of the likely outcomes of investor challenges to NBG bail-in decisions in relevant foreign jurisdictions and take any steps indicated to increase legal certainty.
- Clarify the rule on recapitalization by issuing new shares so it is clear the existing shareholders referred to in the rule are bailed-in creditors and not pre-resolution shareholders.
- Expand the valuation rule to make clear NBG's expectations for the information that banks have to make available in order to enable the valuations.
- Consider the implications for the sequencing of creditor bail-in when revising the creditor hierarchy.
- Analyze and take any indicated steps to minimize uncertainty as to whether NBG's resolution decisions will be sustained in Court.
- The RC should commission a rapid stock-taking of all banks to determine whether banks other than the SIBs should be subject to at least some form of resolution planning in 2021.
- Set MREL for SIBs as soon as practical and leverage the first round of resolvability assessments in doing so.
- The MoF should take steps to establish, operationalize and fund a bridge bank in collaboration with the NBG.
- The RLD should place at least two valuation firms under standby contracts to enable them to initiate work within a short period of time.
- In the context of placing independent valuers under contract, solicit their feedback on the valuation rule, the guideline and the to-be-specified information requirements and make enhancements were indicated.

D. Deposit Insurance, NBG Liquidity Support and Temporary Public Funding

Deposit Insurance System

60. A Deposit Insurance System (DIS) was introduced since the prior FSAP. The Law of Georgia on the Deposit Insurance System (DI Law), enacted in 2017, established the Deposit Insurance Agency (DIA) and the Deposit Insurance Fund (DIF). The DIA is an independent legal entity under public law that reimburses (pays out) insured deposits in the case of the failure of a bank. It is governed by a five-member Supervisory Board comprising the Minister of Finance, the NBG President, the Minister of Economy and Sustainable Development, and two independent members nominated and selected by the banks.[98] The chair of the Board rotates between the three *ex officio* members.[99] The Board approves the DIA's annual budget and staffing, its investment policy, the guidelines issued by the DIA and the premium schedule. The DIA is led by the Head of the Agency recruited by the Board who is responsible for day-to-day operations. The current Head has been in their position since the inception of the DIA. At present the DIA has a permanent staff complement of six,[100] and in addition employs five part-time specialist contractors.[101] The DIA regularly obtains support from NBG staff. The staff of the DIA cannot be held personally liable for any actions or omissions if executed in the course of performing their duties in accordance with the law.[102] The DIA is further governed by a Charter which reflects well the provisions of the DI Law. As noted, the DIA is one of the four members of the IFSC.[103]

61. Deposit insurance is triggered upon the occurrence of an Insurance Case which is the commencement of liquidation, insolvency or bankruptcy proceedings under the Banking Law.[104] Under the DI Law, deposit payouts are to commence within 20 days of the occurrence of an Insurance Case.[105] While deposits in local and foreign currency are covered, payouts are only made in local currency.[106] In the event of a payout, the DIA becomes the first ranked creditor in liquidation after secured creditors and the unsecured claims of the NBG, the MoF and the Resolution Fund.[107] Depositors have up to three years to make a deposit insurance claim.[108]

62. The original coverage offered by the DIS has been and is further being expanded. Originally, only resident and non-resident natural persons were eligible for insurance up to GEL 5,000, covering both local and foreign currency deposits.[109] Coverage was increased to GEL 15,000 on July 1, 2020.[110] A legislative amendment is pending in Parliament to extend coverage to legal

[98] The independent members cannot have worked for a bank for a least six months or have any conflicts of interest. DI Law 7(2). The process under which the banks select the independent members is organized by the NBG. DI Law 7(3).

[99] The independent members may not serve as chair. DI Law 7(11).

[100] One position is vacant as present.

[101] For matters such as accountancy, server maintenance and procurement.

[102] DI Law 3(6)

[103] The Interagency Financial Stability Committee, along with the MoF, the NBG and the ISSA.

[104] As noted previously, liquidation is triggered by license revocation by the NBG.

[105] DI Law 19(4)

[106] The amount of foreign currency deposits is converted to a local currency equivalent based on the NBG exchange rate on the date of occurrence of the Insurance Case.

[107] DI Law 20(3)

[108] DI Law 17(7)

[109] Certain individuals are ineligible for coverage. In general, managers and 5 percent or greater shareholders and their family members and accounts with unidentified holders are excluded from coverage.

[110] The DIA is authorized under the law to increase the level of coverage in line with international standards and practice. (Deposit Insurance Law (16).)

persons as well.[111] Under the original arrangements around 7 percent of total deposits were insured. With the increase in coverage to GEL 15,000 around 11 percent became insured, and with the planned expansion of eligibility to legal entities, around 13 percent of total deposits will be insured.[112] The deposits of 97 percent of natural persons are fully insured.[113]

63. Banks pay regular monthly risk-based insurance premiums into the DIF. Under the DI Law the regular monthly premium for each bank is capped at 0.067 percent of its insured local currency deposits plus 0.1 percent of its insured foreign currency deposits.[114] Banks paid premiums at this rate from the inception of the DIF until the introduction of the higher coverage limit, at which time the premium charged on local currency deposits was reduced to 0.03 percent in order to mitigate the financial impact on banks.[115] A risk-based methodology for computing each bank's regular premium, subject to the cap, was mandated by the law and was implemented. Concurrently, the DIA increased the highest monthly premium for local currency deposits to 0.05 percent,[116] though on average banks pay around 75 percent of the highest possible overall premium under the risk-based regime. Thus, there is scope to increase premiums further should, for example, the DIA perceive risks increasing.

64. Banks are potentially liable for extraordinary premiums. Extraordinary premiums may only be assessed in the event of the occurrence of an Insurance Case that causes the resources of the DIF to be insufficient to fully reimburse all insured deposits in the failed bank. Extraordinary premiums are further limited in amount to 1 percent of insured deposits in a calendar year.[117] Extraordinary premiums are to be paid within 5 days. Should there remain a deficiency in available resources notwithstanding the aggregate extraordinary premium, the DIA would have to borrow to fund the deficiency.

65. The DIA may borrow and may benefit from a state guarantee in doing so. The DIS Law provides that the DIA may borrow from the NBG and MoF, among other sources.[118] However, borrowing is authorized only when an Insurance Case causes the resources of the DIF to be insufficient to meet the payouts associated with that Insurance Case. The DIA can enter into a line of credit arrangement in anticipation of a possible need to borrow. The DIA may also borrow from the NBG on a fully collateralized basis, which should allow it to quickly liquify (convert to cash) its investment portfolio. The DIA should both secure a back-up funding line of credit with the MoF and enter into a framework agreement with the NBG.

[111] It is anticipated that the Parliament will approve these amendments in its Spring 2021 session.

[112] With the granting of eligibility to legal entities, the volume of total deposits will not differ materially from the volume of total deposits eligible for coverage.

[113] An increase from 95 percent prior to adoption of the higher coverage level.

[114] DI Law 13(2)

[115] The rate for foreign currency deposits was not changed.

[116] Again, the rate for foreign currency deposits was not changed.

[117] DI Law 14(1)

[118] DI Law 14(2)

66. The DI Law establishes a 6 percent of insured deposits DIF target balance. Under the law, regular premiums must be paid until the DIF reaches the 6 percent target.[119] There is no provision for the target balance to be adjusted. While the target is reasonable, the DIA and MoF should consider legal amendments to provide that the target balance can be adjusted by the DIA Supervisory Board, for example in case guidance on international best practices is further defined.

67. At year-end 2020 the DIF balance of GEL 60.5 million represented around 1.5 percent of insured deposits. At that level the DIA could payout the insured deposits of any but the seven largest banks (in terms of insured deposits) and could payout the six smallest banks combined. With the pending expansion of coverage eligibility to legal entities, projected total insured deposits by year-end 2021 will be approximately GEL 4.56 billion, of which GEL 466 million will be deposits of legal entities. At the current level of risk-based premiums, projected year-end 2021 DIF resources will approximate GEL 95.6 million, representing 2.1 percent of insured deposits. The DIA projects the DIF will reach the 6 percent target in 2026, assuming no occurrence of an Insurance Case in the interim and that the coverage level remains unchanged.

68. The DIA is taking steps to accelerate deposit payouts. Under the DIA Law, deposit payouts are to be made within 20 days.[120] It is completing implementation of a digital payout system that enable it to commence payouts via one or more agent banks with the seven-day internationally agreed standard.[121] The payout system involves provision by banks of specified data in specified digital formats that then can be processed by the DIA's system. All banks have implemented the system and the DIA is testing the ability of the largest banks to provide accurate data in the required format in collaboration with the NBG. The DIA intends to enter into standby contracts with two agent banks that can be activated in time of need to administer payouts.[122]

69. The DIA does not have the legal authority to transfer insured deposits to another bank nor to fund such a transfer by the liquidator. Rather, the DIA can only reimburse insured depositors. Having the ability to allow an acquiring bank to purchase the (good) assets and assume the insured deposits of a failing bank (often referred to as a purchase and assumption, or P&A, transaction) offers the benefit of eliminating the demand on DIF resources (or at least greatly reducing the demand[123]) relative to a payout and simplifying the procedures for depositors whose insured deposits are transferred to another bank without requiring action on their part. As noted in the Failure Resolution Powers section of this Note, the power to transfer assets and liabilities to an acquiring bank is explicitly available under the liquidation legal regime. The authorities should

[119] DI Law 11(4)

[120] DIA Law 19(4)

[121] As per the *Core Principles for Effective Deposit Insurance Systems*, IADI

[122] The DIA has one bank under contract at present.

[123] In the event there is a shortfall in the value of assets purchased relative to the value of insured deposits assumed, the DIF would only need to provide cash to compensate the difference, or even less should the acquiring bank assign intangible value to the transaction.

amend the legal regime to enable the DIF to be able to fund P&A transactions in liquidation if lesser cost for the DIF.

70. The current constraints on the ability to preemptively obtain additional resources for the DIF may undermine confidence in the DIS. Under the DI Law and DIA's Charter, one goal of the agency is to prevent a significant outflow of deposits from other banks upon the occurrence of an Insurance Case. The inability to replenish the DIF in the absence of an actual deficiency in available resources may conflict with this goal. As noted, the constraints are the inability to require banks to make an extraordinary premium other than in a situation where a single Insurance Case requires a payout in excess of the DIF balance, and the inability to borrow except in the same circumstance. The inability to assess extraordinary premiums in an amount greater the 1 percent of insured deposits in a calendar year is a further constraint. Taken together these constraints mean that subsequent to an Insurance Case that exhausts its resources, there is no mechanism by which to replenish the DIF. A depleted DIF may raise questions regarding the system's capacity to handle another Insurance Case (bank failure) and might lead to deposit outflows. The MoF and DIA should amend the DI Law to allow for preemptive replenishment of the DIF.[124]

71. Voluntary liquidation is construed to be an Insurance Case under the DI Law. This derives from the absence of Banking Law provisions specific to voluntary liquidation. In principle this could allow a bank to force the DIA to initiate a payout insured deposits should the bank take action that triggers license revocation by the NBG prior to completion of a bank-led winding-up and repayment of all insured depositors. It also leads to the DIA playing a role not envisioned in its Charter in acting as an agent in the handling of unclaimed deposits in a voluntary liquidation. The NBG and MoF should amend the Banking Law to adopt provisions specific to voluntary liquidation.

72. The DIA has drafted a Crisis Management Plan. Under the DIA's Charter it is to adopt crisis management policies, procedures and systems to ensure effective response to risks associated with the occurrence of an Insurance Case. The Crisis Management Plan is to serve that purpose. The plan should be finalized and adopted by the Supervisory Board. The Board should require that DIA management adopt a regular plan testing program in part for the purpose of further elaborating and enhancing the plan over time. In 2021 the DIA intends to simulate a bank failure to test the functioning of the new payout MIS.

NBG Liquidity Support

73. The NBG provides secured intra-day, overnight and term loans to banks and may provide a "last resort loan." In addition to the intraday and overnight facilities, the NBG offers standard seven-day and one-month auction-based facilities.[125] A "last resort loan" is emergency liquidity assistance (ELA).

[124] Specifically, by eliminating the constraint of there being a deficiency in the DIF balance for both borrowing and requiring an extraordinary premium and the 1 percent per calendar year cap on such premiums.

[125] In response to the pandemic crisis the NBG in April and May of 2020 established three additional temporary financing facilities that permit use of a broader range of collateral than is accepted for the standing facilities.

74. The NBG has published a comprehensive Regulation of Financial Collateral Management. The regulation, last updated in December 2018, specifies the forms of collateral eligible for each of its various facilities, including ELA.[126] It specifies the means to register the pledge for all forms of assets and the procedures to foreclose upon and liquidate the assets in the event of default. Haircuts for all forms of assets are also published.

75. The 2019 amendments to the NBG Law allow the NBG to provide ELA to a bank whose solvency is in doubt, including a bank in resolution. Previously a bank was required to be solvent to be eligible, and ELA could be granted for a period not exceeding three months at an interest rate higher than the benchmark for the standard facilities.[127] The law now provides that in exceptional circumstances the NBG may provide ELA to a bank whose solvency may be in doubt, such as a bank pending resolution action or a bank undergoing resolution. The law requires the bank be deemed to be viable under a realistic time-bound restructuring, rehabilitation or resolution plan that is to be accompanied by a funding plan, and that the ELA be secured by an unconditional and irrevocable guarantee issued by the MoF, in addition to any collateral taken by the NBG.[128] The NBG has published a policies and procedures rule for all forms of ELA (ELA Rule).[129] The ELA Rule stipulates the purpose of ELA as the prevention of potential systemic problems and financial crises or minimizing their negative impacts in order to ensure financial system stability. By policy all ELA is to be provided in GEL though there is no legal restriction to lending in foreign currency. The duration of ELA to a bank whose solvency is in doubt can be extended by an additional three months. The Vice-Governor responsible to supervision initiates any request for ELA to the NBG Board, which must approve all ELA. The rule should be amended to incorporate the role of the RLD and RC in initiating a request for ELA for a bank pending or undergoing resolution.

76. The MoF and the NBG have yet to agree arrangements for the execution of the MoF guarantee for NBG ELA. A formal joint agreement should be pursued. Among policy matters, the agreement should address MoF's expectations regarding NBG collateral requirements for ELA, and the relationship of ELA financing and potential Resolution Fund liquidity financing (see next section). The agreement should define in detail the procedures for putting in place the guarantee and for calling upon the guarantee in the event of a default on the ELA and a consequent NBG loss, including the roles of both parties.

77. The NBG can lend to DIA under certain conditions.[130] Under the NBG Law lending is permitted if the DIA is facing a severe liquidity problem. The lending must be fully secured. This provision allows the NBG to liquify (convert to cash) the DIF in time of need, but no arrangements are in place at this time. As recommended above in the Deposit Insurance System section of this Note, the DIA and NBG should enter into a framework agreement for this purpose.

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[126] For these purposes, all forms of bank assets are classified into one of six categories.

[127] NBG Law 33(2)

[128] NBG Law 33(3)

[129] *Rule and Conditions for Issuing a Last Resort Loan by the National Bank of Georgia*, December 2020

[130] NBG Law 31(4) & (5)

Temporary Public Funding

78. The 2019 amendments provide that the MoF can provide temporary public funding to support implementation of resolution actions either directly or by means of a new Resolution Fund. The MoF can deploy temporary public funding directly by means of: i) capitalizing a bridge bank; ii) acquiring the equity of a bank in resolution and/or purchasing or guaranteeing its regulatory capital instruments; or iii) providing loans, guarantees and/or financing in any other form.[131] Alternatively the MoF can provide funding indirectly via the conduit of the Resolution Fund. The Fund can be used to provide: i) loans to a bank under resolution or to a bridge bank; ii) the guarantee of the liabilities of a bank under resolution or of a bridge bank; iii) contributions to close any difference between the liabilities and the assets transferred to an acquirer under the *sale of business tool* or a *bridge bank tool*;[132] iv) contributions to absorb losses that have not been absorbed by shares or other liabilities in the use of the *bail-in tool*;[133, 134] v) the payment of successful NCWO claims;[135, 136] and vi) loans or guarantees to a purchaser in the context of the *sale of business tool* (including via merger). A precondition for any temporary public funding is that all shares, other regulatory capital instruments, other subordinated debt, debt with contractual write-down and conversion provisions, and any other claims of direct and indirect owners, should have fully absorbed losses to the extent of such losses.[137, 138] Before the use of temporary public funding, the NBG may require any regulatory capital instruments that were not written-off to absorb losses to be converted into common shares under terms and conditions to be determined by the NBG.[139] A request for the use of temporary public funding is to be submitted by the NBG to the MoF.[140]

79. The Resolution Fund is ex post funded and backstopped by the banking industry.[141] The Fund is an account at the NBG that will be funded by the MoF, and/or via grants, borrowings, or other sources as provided by the National Budget. The MoF may issue guarantees for the liabilities of the Fund.[142] To the extent they are not recovered from the outcome of resolution action (e.g., from the resolved bank), any losses incurred by the Fund are to be repaid to the MoF by the banking

[131] NBG Law 55^4(3)

[132] In other words, to bring regulatory capital to zero.

[133] Banking Law 37^{10}(12)

[134] Again, to bring regulatory capital to zero.

[135] Banking Law 37^{11}(4)

[136] Claims of creditors who were determined to incur losses in resolution greater than they would have incurred had the bank been liquidated.

[137] NBG Law 55^4(1)

[138] Note that the IMF has observed that there may be some scenarios where bailing in certain capital instruments could be destabilizing. See: https://www.imf.org/-/media/Files/Publications/SDN/2018/sdn1802-trade-offs-in-bank-resolution.ashx

[139] Banking Law Article 37^4(6)

[140] In addition, as noted earlier, and under the terms of the Joint Regulation, the NBG is notify the plan to the IFSC.

[141] NBG Law 32 and 55^5

[142] NBG Law 55^5(4)

industry, including branches of foreign banks.[143] The NBG is to manage and report on any activities of the Fund.

80. The MoF and the NBG published a Joint Regulation guiding the use of temporary public funding and the operation of the Resolution Fund.[144] Although under the law the MoF has wide latitude in providing financing directly, the regulation limits the use of direct funding to the capitalization of bridge bank by policy; all of forms of financing will be channeled through the Fund. The regulation sets out the agreed content of the required written request by the NBG to the MoF for financing, including, *inter alia,* identification of the resolution tools to be employed, quantification of the nature and volume of necessary financial support, an assessment of the stability implications of using liquidation rather than the resolution tools, and the envisioned means of recouping the temporary public financing.[145] It similarly defines the information requirements necessary for the issuance of a MoF guarantee of Fund liabilities. The procedures set out in the regulation provide adequately for rapid decision making. Under the regulation, consultations to support decisions can be made directly between the MoF and the NBG, or in the forum of the IFSC.

81. The NBG Law and the Joint Regulation provide for a high degree of flexibility in bringing to bear temporary public financing to support effective use of the resolution tools, suggesting the utility of having an internal policy agreed in advance. The flexibility provided in the law is appropriate in enabling the MoF and the NBG to respond as needed to any circumstance. The regulation, which is in the public domain, usefully articulates the policy that limits MoF direct financing to the provision of capital to a bridge bank. Given the substantial latitude in law for other forms of direct financing, the MoF and NBG should consider developing an internal contingency policy framework that will help ensure a shared understanding of situations that might arise that call for possible alternative policy responses. This internal policy framework should also address the potential role of NBG ELA in resolution financing, including expectations and guidance on the use of temporary public financing via the Fund to repay any NBG ELA that might have been granted.[146] Having such a framework in place will help facilitate rapid decision-making in possible extraordinary circumstances.

82. The provision of temporary public funding by the MoF is subject to Parliamentary approval. The funding requires an amendment to the Annual Budget Law. The draft amendments would need to be approved by the Finance Minister, the Cabinet and the Prime Minister and then submitted by the Prime Minister to the Finance and Budgetary Committee of the Parliament. Under

[143] MoF/NBG *Joint Decree on Approval of Criteria for the Collection of Contributions and the Procedure for Making Contributions for the Purpose of Repayment of Funds Allocated under Temporary Public Funding*, December 2020. The decree sets out a risk-based methodology for determining the amounts due from each bank and foreign bank branch. It defines the circumstances under which payment of amounts due may be deferred in case of negative impact on the financial condition of a bank/branch. The timing of repayments is to be determined by the NBG in consultation with the MoF.

[144] MoF/NBG *Joint Regulation on Establishing and Administering the Resolution Fund and Provision of Temporary Public Financing by the Ministry of Finance*, December 2020

[145] The regulation requires that the NBG notify the IFSC of any such request.

[146] Consequently, extinguishing the MoF guarantee of ELA.

expedited procedures provided for in amendments to the Organic Budget Code as an element of introducing the new resolution regime, the committee has two days to discuss the draft amendment, and the full Parliament has five days within which to take a decision. It is expected the timeline can be accelerated in urgent situations. The MoF should prepare in advance templates for the documentation that would need to be provide Parliament to secure approval for the use of public funds. When the fiscal space exists, the MoF should consider providing for an explicit contingency fund for this purpose in the annual budget.

83. Summary of recommendations:

- DIA and NBG should enter into a framework agreement to be able to quickly liquify the DIF investment portfolio;
- Consider amendments to the DI Law to provide that the DIF target balance can be adjusted by the DIA Supervisory Board.
- Amend the legal regime to provide for P&A transactions in liquidation that are funded by the DIF.
- Amend the DI Law that allow for preemptive replenishment of the DIF.
- Amend the Banking Law to adopt provisions specific to voluntary liquidation.
- The DIA's Crisis Management Plan should be finalized and adopted by the Supervisory Board and the Board should require that DIA management adopt a regular plan testing program.
- Amend the ELA Rule to incorporate the role of the RLD and RC in initiating a request for ELA for a bank pending or undergoing resolution.
- The MoF and the NBG should enter into an agreement regarding arrangements for the execution of the MoF guarantee for NBG ELA.
- The MoF and NBG should develop a written internal policy framework addressing temporary public funding, including the use of temporary state financing to repay NBG ELA.
- The MoF should prepare in advance templates for the documentation that would need to be provide Parliament to secure approval for the use of public funds.
- The MoF should consider providing for an explicit contingency fund for temporary public funding of bank resolutions in the annual budget.

CONTINGENCY PLANNING AND CRISIS MANAGEMENT

84. **None of the authorities have in place a formal agency-wide contingency plans addressing their roles in systemic failure and other crisis situations, nor is there an agreed national contingency plan**. It is recognized that the priority over the last few years has been to put in place a substantially enhanced legal framework and the attendant policy and procedure regime. Attention should now be given to preparing formal contingency plans within each individual authority and at the national level. Having well-developed contingency plans in place would enhance crisis preparedness and improve the efficiency of resolution and crisis management activity resulting in, among other benefits, reduced potential demand on temporary public funding to resolve problems. A prerequisite first step is for each authority to develop their own internal contingency plan for executing their legal powers and responsibilities quickly and effectively under stress situations. Stress situation will normally be characterized by the need to make decisions rapidly under conditions of imperfect information, to execute those decisions in what will likely be a chaotic environment, and to communicate clearly to the public and vested interests. Conceptually, the individual authorities' plans should dovetail into a national level plan. The individual and national level plans should be tested periodically and enhanced based on what is learned during testing.

85. **The IFSC should play a leading role in contingency planning and crisis preparedness and its Charter should be amended to make this clearer.** Under the NBG Law,[147] the IFSC's objective is to support stable financial system functioning and to develop mechanisms for financial crisis management.[148] At the same time, the law requires the NBG to provide notification to the IFSC of the possible provision of ELA and any request to the MoF for temporary public funding. These legal provisions indicate a role for the IFSC in normal times and in potential crisis times. The Charter could more clearly distinguish between these two distinct roles. The IFSC's role in crisis times is principally consultative; decision-making authority resides with the NBG and the MoF. The IFSC's role in normal times may be more consequential and the Charter should further elaborate that role. The IFSC should have responsibility for coordinating the development of institution-wide contingency plans in each of the four member authorities with the goal that the plans can eventually be integrated into a national plan. The IFSC should serve as a forum in which members periodically can also share their plan testing programs and the results of tests conducted. Under the Charter as currently framed, the IFSC secretariat (a unit within the NBG yet to be specified) is to prepare and oversee the conduct of periodic crisis simulation exercises. This responsibility should lie with the IFSC itself and be undertaken with the support of the secretariat. The decision as to which NBG unit should serve as the secretariat should be taken with the IFSC's role in normal times foremost in mind.

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147 NBG Law 55^6

148 This also is reflected in its Charter, which specifies the IFSC's main objective as being to develop mechanisms for financial crisis management.

86. **The governing bodies of the NBG, the DIA, the ISSA as well as the MoF should mandate development of internal institution-wide contingency plans and plan testing programs.** The character of appropriate contingency plans is described above. Plan testing should involve a regular program over a multi-year horizon geared toward enhancing preparedness by practicing implementation of the plan or elements of the plan and identifying scope for enhancements to plans.

87. **Summary of recommendations**

- When revising the IFSC Charter give emphasis to its role in normal times of overseeing contingency planning and plan testing programs, including crisis simulation exercises.
- Assign the IFSC responsibility for coordinating development of contingency plans in each authority and for serving as a forum to share plan testing programs.
- The IFSC should be responsible for overseeing the conduct of periodic crisis simulation exercises.
- Each authority should prepare a crisis management contingency plan and adopt a plan testing and improvement program.
- Undertake regular national level crisis-simulation exercises.