



WEST AFRICAN ECONOMIC AND MONETARY UNION

FINANCIAL SECTOR ASSESSMENT PROGRAM

August 2022

TECHNICAL NOTE ON FINANCIAL SAFETY NET AND CRISIS PREPAREDNESS

This technical note on Bank Stress Test for Climate Change Risks was prepared by a staff team of the International Monetary Fund and World Bank in the context of a joint IMF-World Bank Financial Sector Assessment Program (FSAP). It is based on the information available at the time it was completed in July 2022.

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July 20, 2022

TECHNICAL NOTE

FINANCIAL SAFETY NET AND CRISIS PREPAREDNESS

Prepared by
**Monetary and Capital Markets
Department (MCM)**

This technical note was prepared by IMF staff in the context of a Financial Sector Assessment Program (FSAP) mission to the West African Economic and Monetary Union. The note contains technical analysis and detailed information underpinning the FSAP assessment'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

AMC	Asset Management Company
BCEAO	Central Bank of West African States (In French: <i>Banque Centrale des États de l'Afrique de l'Ouest</i>)
CBU	Banking Commission of the WAMU (In French: <i>Commission Bancaire de l'UMOA</i>)
CM	Council of Ministers of the WAEMU
CSF-UMOA	Financial Stability Committee of the WAMU (In French: <i>Comité de Stabilité Financière dans l'UMOA</i>)
DFS	Decentralized Financial Systems
ELA	Emergency Liquidity Assistance
FGDR-UMOA	Deposit Guarantee and Resolution Fund of the WAMU (In French: <i>Fonds de Garantie des Dépôts et de Résolution dans l'UMOA</i>)
FSB	Financial Stability Board
FSF	Financial Stability Fund
FSAP	Financial Sector Assessment Program
G-SIB	global systemically important bank
IADI	International Association of Deposit Insurers
SIB	Systemically Important Bank
WAEMU	West African Economic and Monetary Union
WAMU	West African Monetary Union

EXECUTIVE SUMMARY

The institutional and legal frameworks for financial stability in the West African Economic and Monetary Union (WAEMU) have seen significant progress since the previous Financial Sector Assessment Program (FSAP) in 2008.¹ The institutional reform of the WAEMU and the Central Bank of West African States (BCEAO) in 2010 clarified the respective mandates and responsibilities of the latter and the WAEMU Banking Commission (CBU), and it strengthened the CBU's legal autonomy and enforcement powers. A new banking law adopted in 2010 established an overall framework for the operation and supervision of banking activities, which has been rendered more proactive and risk based with the gradual implementation of the Basel II/III mechanism initiated in 2016. A bank resolution regime was introduced in 2015 and the mandate of the deposit guarantee fund, created in 2014, was expanded to bank resolution funding in 2018. A macroprudential policy framework, including for monitoring systemic financial sector risks, was developed around the BCEAO and the Financial Stability Committee (CSF-UMOA) in 2010. This series of reforms has greatly enhanced the robustness of the financial safety net via its four components: the early intervention mechanism, the bank resolution regime, the deposit insurance system, and the emergency liquidity assistance (ELA) mechanism.

However, numerous steps still need to be completed to ensure that financial safety net mechanisms, which were recently instituted and remain untested, become fully effective. In particular, this FSAP's review of violation reports and CBU-applied administrative measures and disciplinary sanctions in recent years show that some credit institutions persistently struggle to operate in accordance with their license terms. In this context, it is noteworthy that no resolution measures have yet been taken, even for entities whose failure could have a systemic impact. The FSAP's analysis of the resolution regime and its funding modalities revealed numerous issues that need to be addressed.

The preparation of bank resolution plans is a key operational priority. Despite the adoption of the bank resolution regime in 2015 and its underlying framework in 2017, the process of preparing resolution plans remains incomplete. The required implementation texts, published in 2020, provided a pathway for credit institutions (including systemic institutions and financial companies) to prepare preventative recovery plans, however, delays persist. Plans were expected by end-2021, but drafting was still ongoing in March 2022. Furthermore, these plans will not be final until the completion of a final CBU review. The FSAP team stresses the urgency of this task and the need to coordinate with resolution authorities in each country. Meeting this timeline and the need for cross-border dialogue requires mobilization of adequate human resources at the CBU.

Increasing the independence of key stakeholders in the financial safety net is a key institutional priority. This issue concerns the independence of the CBU's Resolution Board from its Supervisory Board and national authorities, as well as the independence of the Deposit Guarantee and Resolution Fund (FGDR-UMOA) from the CBU, the BCEAO, and the banking industry. Specifically:

¹ This technical note was prepared by Thierry Bayle.

- *For the CBU*, the difference in the membership of its two boards (Supervisory and Resolution) does not rule out a significant overlap when resolution-related decisions have to be taken. Furthermore, the mandate to initiate a bank resolution currently lies exclusively with the Supervisory Board. This appears to limit the autonomy of the Resolution Board, whose independence is also jeopardized by the large number of *ex officio* state representatives on its board, and by the jurisdiction of the Council of Ministers of the WAEMU (CM) to hear appeals to its decisions. To address these concerns, the Resolution Board should have powers to initiate bank resolutions (exercised jointly with the Supervisory Board). In addition, the CM should increase the number of Resolution Board members appointed by virtue of qualifications ("*intuitu personae*"). Finally, appeals of Resolution Board decisions should be submitted to the WAEMU Court of Justice rather than to the CM. Evaluation and accountability mechanisms providing for independent assessment of the effectiveness of the Resolution Board's decisions (or lack of decision) should also be instituted.
- *For the FGDR-UMOA*, strengthened independence is also advisable. The current powers of its board of directors appear too limited in several key areas of the Fund's mandate, to the benefit of the CM. Even more significant, the fund's independence is jeopardized by the participation of active members of the banking industry, whose representatives make up half of the board, and the board's chairmanship by the governor of the BCEAO.

Strengthening the modalities of bank resolution funding is another operational priority. In the event a bank is resolved, the first line of defense should come from internal resources of the failing institution. However, the current inadequate level of such resources makes a resolution by bail-in unrealistic. The FGDR-UMOA's available funds are also insufficient and, at least in the medium term, do not permit it to contribute substantially to resolution funding without compromising its ability to fulfill its core mandate (guaranteeing deposits in the event of a bank's liquidation). Until credit institutions strengthen their loss-absorption capacity, a strategy must be developed to ensure the FGDR-UMOA can quickly attain target ratios and thus accelerate the pace of reserve accumulation (buffers). The strategy should also establish a backstop mechanism for the FGDR-UMOA to tap member states or the Financial Stability Fund (FSF) to ensure quick mobilization of bank resolution funds.

Finally, improving the mechanisms for cooperation and coordination among stakeholders in the financial safety net is another institutional priority. In this regard, the CSF-UMOA, which is already involved in the surveillance of macroprudential risks, would benefit from a strengthened formal role in crisis management. With this extension of its mandate, the CSF-UMOA would turn into the central hub of multilateral coordination in crisis situations. This would also formalize its involvement in the preparation of crisis management plans and simulation exercises at the regional level and, in the longer term, when cooperating with authorities outside the WAEMU. An alternative mechanism, such as a new committee exclusively dedicated to coordination between financial safety net stakeholders, might be contemplated.

The mission also proposed improvements in numerous other areas. These generally relate to the need to strengthen the operational preparedness of the various regional institutions and the legal robustness of their interventions.

Table 1. WAEMU: Table of Recommendations

Recommendations	Authority	Priority*
Finalize resolution plans for systemic banks and financial companies.	CBU	ST
Increase the number of CBU staff dedicated to resolutions.	CBU	ST
Provide the CBU Resolution Board with powers to initiate bank resolutions (to be exercised jointly with the Supervisory Board).	CBU/BCEAO	MT
Strengthen the independence of the Resolution Board by increasing the number of members appointed by the CM based on subject-matter expertise and integrity.	CBU/BCEAO	MT
Submit appeals of resolution decisions to the sole jurisdiction of the WAEMU Court of Justice, while limiting these appeals to claims for financial compensation except in cases where the CBU decision was adopted in bad faith or is contrary to law.	CBU/BCEAO	MT
In the Annex to the Convention, clarify that in the context of a resolution, a creditor should receive treatment no worse than would have been received in a liquidation.	CBU/BCEAO	MT
In the Annex to the Convention, clarify that the application of the resolution measure should respect the priority of claims in liquidation in accordance with international standards.	CBU/BCEAO	MT
Amend the banking law to clarify that in liquidation proceedings, the priority ranking of depositors does not entail a limit.	BCEAO	MT
Initiate a plan to strengthen systemic entities' bail-in buffers.	CBU	MT
Prohibit industry representatives on the FGDR-UMOA's board from holding an active position (or establishing a business relationship) with a member of the fund during their terms of office.	FGDR	MT
Increase the institutions' contributions to the FGDR-UMOA to ensure that it achieves the target ratio in the medium term (three to four years).	FGDR	MT
Include a requirement for a "least-cost" intervention in the FGDR-UMOA's contributions to bank resolution funding, including in determining the contribution amounts.	FGDR	MT
Establish a financial backstop mechanism enabling the FGDR-UMOA to resort to member state or FSF funding for bank resolutions in case of need.	FGDR	MT
Establish the CSF-UMOA, or a new committee yet to be created, as the lead entity on multilateral coordination in crisis situations.	CSF	MT
Incorporate the FGDR-UMOA in the composition of the CSF-UMOA (or the new Committee yet to be created).	CSF	MT

* ST: short term (1-2 years); MT: medium term (3-5 years).

INTRODUCTION

- 1. This note presents the findings and recommendations for the financial safety net and crisis management mechanisms in the WAEMU region.** At a time of banking sector crisis, it is essential for the authorities to be well prepared to take effective actions to maintain financial stability, protect depositors, and minimize fiscal costs and moral hazard. These objectives require a financial safety net that includes an early intervention mechanism, a bank resolution framework, an emergency liquidity assistance (ELA) mechanism, and a deposit insurance scheme. The effectiveness of decisions and measures adopted by participants in the financial safety net depends on their operational capacity and preparedness.
- 2. The scope of this note is limited to the region's banking sector, as defined by the banking law.** Accordingly, it focuses on credit institutions within the meaning of the banking law (Article 2)—banks, bank-like financial institutions, and financial companies within the meaning of the WAEMU's prudential framework adopted in 2016. The note does not consider issues related to insurance companies or microfinance institutions.
- 3. The financial sector has developed considerably since the previous FSAP assessment, conducted in 2008.** The number of licensed credit institutions in operation increased from 116 (including 99 banks) at end-2008 to 152 (including 131 banks) at end-2020, while total assets as a percentage of GDP more than doubled over the period, from 25 percent to 53 percent of the WAEMU's GDP, equivalent to CFAF 48 billion. Banking institutions continue to account for nearly all financial sector assets (99 percent). Bank assets are highly concentrated geographically, with more than half held by the licensed credit institutions in only two countries—Côte d'Ivoire and Senegal (34 percent and 18 percent, respectively). In terms of structure, the number of banking groups has sharply increased, from 18 to 32 between 2008 and 2020, with a high degree of concentration (the 12 largest groups represent 76 percent of assets). Foreign shareholders—including non-WAEMU nationals—have significantly reduced their holdings in credit institutions, which fell from 74 percent in 2010 to 69 percent in 2019. The share of public banks' capital declined modestly, from 13 percent to 11 percent over the same period.
- 4. Since the previous FSAP, the authorities have strengthened considerably the institutional framework for financial stability.** The 2008 FSAP noted that finance ministers were actively involved in establishing corrective measures to enhance financial stability, while warning of serious consequences if implementation was delayed. This concern, combined with reservations about the exclusive reliance on shareholders or industry support to resolve bank failures, prompted the FSAP mission to recommend the creation of a formal early warning system and the establishment of a bank crisis prevention and resolution mechanism. Since then, the institutional reforms of the WAEMU and BCEAO in 2010 have clarified the respective mandates and responsibilities of the BCEAO and the CBU and strengthened the CBU's legal autonomy and enforcement powers. A new banking law, adopted in 2010, established a comprehensive framework for the exercise and supervision of banking activity. The gradual implementation of the Basel II/III framework, beginning in 2016, contributed to making bank supervision more risk based, thereby facilitating more proactive

early interventions. A bank resolution regime was introduced in 2015 and a specific amendment to the convention on the CBU's operations was adopted in 2017. A deposit guarantee fund was established in 2014 and its charter was revised in 2018 to create a resolution fund. A framework for formulating macroprudential policies, which provided for the monitoring of systemic risks to the financial sector, was developed around the BCEAO and the WAEMU Financial Stability Committee (CSF-UMOA), created in 2010.

5. The financial safety net is still under development and has not been tested. Although corrective measures have been imposed on various institutions in the context of early interventions over the past five years. None of these has not been resolved despite serious, persistent violations that have had a lasting impact on their viability. Similarly, no intervention by the deposit guarantee system has been required thus far.

6. The financial safety net generally consists of four elements. The first is the early intervention mechanism, which was evaluated based on the Basel Committee on Banking Supervision's "Basel Core Principles for Bank Supervision" (2012) and "Guidelines for Identifying and Dealing with Weak Banks" (2015), and therefore required close collaboration with the FSAP team's Core Principles evaluators.² The second is the bank resolution regime, which was analyzed with respect to the Financial Stability Board's 2014 "Key Attributes of Effective Resolution Regimes for Financial Institutions."³ The third component is the deposit insurance system, which was reviewed in the context of the International Association of Deposit Insurers' 2014 "Revised Core Principles for Effective Deposit Insurance Systems."⁴ The fourth and final component is the ELA mechanism, which was reviewed in light of best international practice in the absence of an internationally adopted standard. However, this note does not constitute a formal, detailed evaluation of compliance with any of the standards cited above.

7. The note is based on discussions with the authorities and a review of legislation and other documents related to resolution and deposit insurance issues. Ongoing discussions were held remotely (due to the COVID-19 pandemic) between January 2021 (scoping mission) and September 2021 (full consultation). In this context, the FSA team is especially grateful to the authorities for their cooperation and availability in light of the particular challenges inherent to remote missions.

8. This note is organized as follows. Section I provides an overview of the financial safety net and the institutions involved in crisis management. Section II presents the findings and recommendations of three of the four components of the financial safety net, i.e., early intervention,

² Available at <https://www.bis.org/publ/bcbs230.htm> (core principles) and <https://www.bis.org/bcbs/publ/d330.htm> (guidelines).

³ Available at https://www.fsb.org/wp-content/uploads/r_111104cc.pdf.

⁴ Available at <https://www.iaidi.org/en/assets/File/Core%20Principles/cprevised2014nov.pdf>.

bank resolution, deposit insurance.⁵ Section III discusses the fourth component, emergency planning and crisis management mechanisms, including their cross-border dimensions.

OVERALL FRAMEWORK

9. The WAEMU’s financial safety net is primarily based on five regional institutions: the Central Bank of West African States (BCEAO), the Banking Commission (CBU), the Deposit Guarantee and Resolution Fund (FGDR-UMOA), the Council of Ministers (CM), and the Financial Stability Committee (CSF-UMOA). In this context, the ministers of finance of WAEMU’s member states, considered individually, play a subsidiary role.

10. The BCEAO, as the WAEMU central bank, is the monetary authority responsible for ensuring financial stability in the WAEMU. One of the BCEAO missions is to ensure that the laws and regulations on banks and other financial institutions adopted pursuant to Article 34 of the WAEMU Treaty are enforced in each member state (Article 30 of the BCEAO charter). In addition to this regulatory function, the BCEAO executes credit operations with credit institutions to achieve its objectives and in the context of its missions, subject to appropriate guarantees (Article 18), which grants the BCEAO, inter alia, powers as lender of last resort. In addition to its specific statutory functions, the BCEAO also plays a critical role for financial stability via its governor, who is by law a member of the governing bodies of other financial safety net institutions (Table 2).

11. The CBU is specifically responsible for the organization and supervision of credit institutions (Article 23 of the WAEMU Treaty). It is governed by a specific convention signed by the WAEMU member states in April 1990 and amended in April 2007. The key provisions of the convention are set out in an annex on CBU operations (hereinafter the “Annex”), which was amended most recently in September 2017. The CBU is charged with ensuring the soundness and security of the WAEMU’s banking system, notably through the supervision of credit institutions and resolution of banking crises. As the authority responsible both for the supervision and resolution of credit institutions, the CBU has assigned these two functions to two distinct decision-making bodies: the Supervisory Board and the Resolution Board.

⁵ The analysis of ELA and related recommendations is reported in “Analysis of Systemic Liquidity,” a separate Technical Note from this FSAP mission.

Table 2. WAEMU: Functions Performed by the BCEAO Governor	
Functions	Areas of Authority (Not Exhaustive)
President of the BCEAO Board of Directors	Banking regulation
President of the Monetary Policy Committee	Monetary policy (including ELA)
President of the CBU Supervisory Board	Bank supervision
President of the CBU Resolution Board	Bank resolution
President of the FGDR-UMOA Board of Directors	Deposit guarantee and resolution funding
President of the CSF-UMOA	Monitoring of financial stability
<i>Source: WAEMU Treaty, BCEAO Charter, Annex on CBU operations, FDGR-UMOA Charter, and 2010 MoU on CSF-UMOA.</i>	

12. The Deposit Guarantee Fund is a WAEMU institution created in 2014 to provide deposit insurance. It was renamed the FGDR-UMOA when its charter was revised to include resolution funding in its mandate. The FGDR-UMOA is now clearly charged with two principal functions, deposit insurance and bank resolution funding, and with the corollary tasks of promoting the stability of the banking and microfinance sectors and the development of financial culture in the region. These functions are managed by distinct divisions, financed respectively by credit institutions and by decentralized financial systems (DFS). Each division is responsible for the coverage of deposits held by the type of entity it oversees.

13. The CM plays an important role in the regional financial safety net (WAEMU Treaty, Article 5), even though it is not directly involved in bank supervision or crisis management. As a general rule, the CM is charged with management of the WAEMU (Article 10).⁶ With respect to the financial sector, it plays an important role as the regulatory authority and as the body to which appeals, or arbitration matters are submitted. Specifically, the CM can: (i) adopt general rules for the conduct of financial and related activities (Article 17); (ii) approve any convention concluded between the BCEAO and governments, central banks, or international institutions (Article 20); and (iii) assign specific projects or missions to the BCEAO and decide on the BCEAO's participations in special funds, bodies, or institutions that contribute to the diversification and strengthening of the WAEMU financial system. The CM is also responsible for appointing some CBU members, including to the Supervisory Board (9 out of 19) and the Resolution Board (1 out of 4), as well as members of the FGDR-UMOA Board of Directors (2 out of 6). Finally, the Annex to the Convention (Article 43) indicates that "decisions by the Banking Commission may be appealed only to the Council of Ministers of the WAEMU." In practice, this jurisdiction over appeals is not exclusive since individuals sanctioned by the CBU have previously appealed CBU's decisions to the WAEMU Court of Justice

⁶ Each member state is represented by its Minister of Finance and one other minister, with voting rights only accorded to the former.

after they were upheld by the CM. The CM is also the forum for arbitration of disputes between WAEMU member states and the CBU on matters where CBU's consent is required.

14. The memorandum of understanding signed in 2010 by the CM, the Inter-African Conference on Insurance Markets, and the Inter-African Conference on Social Security led to the creation of the CSF-UMOA. The CSF-UMOA is charged with promoting cooperation and coordination among member state authorities whose missions entail financial stability; evaluating financial risks and vulnerabilities that have the potential to impact the system's resilience to external or internal shocks; defining corrective actions and monitoring implementation of these actions; and formulating recommendations for the sound and efficient operation of the financial sector. The CSF-UMOA not only serves as a forum for executive-level exchange of information among the principal financial sector authorities, but is also supported by a network of authorities' experts and specific task forces. Insofar as its mission covers coordination in the areas of supervision and regulation, it is a potential key stakeholder in the prevention and management of crises in the WAEMU (see Section III).⁷

15. The strengthening of regional institutions—particularly the BCEAO, CBU, FGDR-UMOA, CM, and CSF-UMOA—has considerably reduced the role of member state finance ministers. The ministers continue to be responsible for licensing banks in their respective states (subject to CBU approval). However, contrary to what was observed during the 2008 FSAP mission, their power to revoke licenses (which are in any event subject to CBU consent) are limited to situations where the revocation is requested by the credit institution or the institution in question has been inactive for at least one year (Annex, Article 19). In other cases, such as a disciplinary procedure, the CBU has exclusive authority to revoke a license. The minister of the credit institution's home state is merely informed of the CBU's decision and instructed to notify the institution. If notice is not given within seven days, the CBU's revocation decision becomes automatically enforceable. Other key decisions of the CBU—including disciplinary sanctions, the appointment of an interim administrator, or the liquidation of an entity—are automatically enforceable upon the CBU notifying the minister of finance of the relevant member state, who in turn is required to appoint an interim administrator or trustee within seven days. Altogether, the powers of finance ministers—both individually and in the context of their collective role on the CM—have been reduced considerably since 2008.

FINANCIAL SAFETY NET

A. Early Intervention and Recovery Planning

Early Intervention

16. The bank supervision framework of the CBU is based on the traditional model of permanent off-site surveillance and periodic on-site inspections. The capacity for predictive risk

⁷ As provided by Article 3 of the 2010 memorandum of understanding, the CSF-UMOA is chaired by the BCEAO governor and assisted by the presidents of the WAEMU Regional Public Investment and Financial Markets Board, the WAEMU Insurance Company Supervisory Commission, and the Social Security Supervisory Commission, as well as representatives of each WAEMU member state (appointed by the CM based on their expertise).

analysis under the supervisory framework has been improved with the implementation of the WAMU's Rating System for Credit Institutions. That rating system is now used for ongoing monitoring of entities based on a comprehensive evaluation of their risks. Ratings take place either annually or semiannually for the highest-risk entities, absent a significant change in their risk profile and/or a systematic update following an on-site inspection. Encompassing nine risk factors, the rating relies on multidimensional analysis, generally combining evaluations of the degree of risk exposures and the quality of the mechanisms for control and management of these risks.⁸ The risk factors are evaluated on a numeric scale with strict, predetermined criteria. Modifications are permitted pursuant to expert opinion on actual or potential events not yet reflected in the rated institution's prudential reports. The CBU does not, however, conduct stress tests and does not systematically obtain the results of tests carried out by financial institutions. For its part, the BCEAO conducts such tests each year.

17. The development of internal ratings was coupled with implementation of the Basel II/III supervisory review process that serves as a mechanism for early detection and treatment of vulnerable institutions. The internal rating system not only enables the CBU to develop a risk map for the banking system but also constitutes a critical tool for identifying vulnerable institutions and, on that basis, triggering early intervention. Between ratings updates, such interventions may also be triggered via prudential indicators, shifts in credit portfolio quality, or new governance information. The transposition of the Basel II/III Accord into the regional mechanism applicable to credit institutions also led to the introduction of the supervisory review process (Pillar 2), which sets prudential requirements based on the individual institutions' risk profiles. These two components led to the introduction of a more proactive supervisory regime, enabling the CBU to initiate actions that are at once early, proportional, and adapted to the specific vulnerabilities found, and before regulatory or legislative violations occur. However, the current supervision mechanism for liquidity risk surveillance is still mostly based on ex post review of liquidity ratios, with no indications of the existence of an early warning system.

18. From a legal standpoint, the mechanism entails a plethora of measures of varying degree of intrusiveness guided by specific criteria or triggering events; their implementation, while left to the discretion of the CBU, remains subject to strict constraints (Table 3). Prior to a resolution, the CBU is vested with broad powers to: (i) adopt administrative measures; (ii) impose disciplinary or monetary sanctions; or (iii) appoint an interim administrator, depending on the gravity of the situation (Table 3). In exercising these powers, the CBU enjoys a degree of discretion to assess certain criteria that would trigger a resolution, particularly those pertaining to the appointment of an interim administrator. This discretion, however, remains quite limited.

⁸ The rating is based on 11 factors used to determine an institution's risk profile (including levels of credit risk, concentration risk, liquidity and financing risk, operational risk, interest rate risk, and market risks); as well as its capital adequacy and the quality of specific mechanisms (business model, governance, internal controls, and processes to address anti-money laundering and terrorism financing). However, until further data is available, two factors (interest rate risk and market risks) continue to be excluded from the analysis due to their perceived insignificance, a perception which however appears difficult to recognize as a constant characteristic common to all entities.

- Regarding the decision to place an entity under interim administration, the criterion for halting normal management conditions cover a wide range of situations, but in practice it can only be used in extreme circumstances (given the adverse reactions by depositors or market counterparties it is likely to provoke).
- With respect to the other powers, a distinction should be made between administrative measures—which are not subject to the determination of a regulatory violation—and disciplinary or monetary measures—which are subject to such a determination. Failure to implement administrative measures is itself a regulatory violation, underscoring the existing limits on the scope of application of administrative measures, including on preventive basis.
- Importantly, numerous constraints are likely to impact the responsiveness and effectiveness of this mechanism. While administrative measures are accompanied by CBU-determined implementation time limits, these limits usually extend over a relatively long period (six months to one year). Moreover, in the absence of a regulatory limit, they are frequently extended further, as attested by the observation of institutions placed under close surveillance. Procedural delays also constitute an important constraint. The implementation of measures can be delayed by the time requirements associated with the adversarial process (for disciplinary measures), as well as the notification time associated with decisions on license revocations or the nomination of an interim administrator or trustee.^{9,10,11} Finally, in view of the composition of the CM, any appeal brought before that body entails the risk that factors other than prudential considerations may impact its final decisions, which are automatically enforceable.

Table 3. WAEMU: Early Intervention Mechanism	
Criteria or Trigger	CBU Powers
ADMINISTRATIVE MEASURES	
The CBU finds the supervised entity:	The CBU may: <ul style="list-style-type: none"> • issue a warning; • enjoin the entity to take the necessary corrective measures or take appropriate precautionary measures within a specific time period.

⁹ Even if the CBU, in the event of a duly identified emergency, exempts itself from the obligation to serve summons on the interested parties at least 15 days before the Board meeting, it remains obliged to allow the parties to submit their written responses within 7 days of appearance or summons (Circular 1-2011).

¹⁰ CBU decisions are automatically enforceable by interested parties upon notification. The only exceptions are for license revocation decisions or authorizations of establishment, which must be served within 7 days by the relevant minister of finance. At the end of the 7-day period, even in the absence of notice by the competent minister, the license revocation or authorization of establishment is automatically enforceable and notice thereof is given by the CBU itself.

¹¹ The interim administrator (or trustee) is appointed within a maximum of seven days from the date of receipt of the CBU decision by the minister of finance, as provided by Article 34 (or Article 35, respectively) of the Annex.

Table 3. WAEMU: Early Intervention Mechanism

<ul style="list-style-type: none"> • has violated rules of good conduct for the profession; • has jeopardized financial equilibrium; • has deviated from sound management practices; and/or • no longer meets the conditions required for licensing or authorization to operate. 	<p>In regard to corrective measures, the CBU may:</p> <ul style="list-style-type: none"> • impose capital requirements higher than the minimum regulatory targets; • impose appropriate liquidity requirements in light of the situation; • require strengthening the entity's governance, risk management, and internal control mechanisms; • in case of nonobservance of prudential standards, require the submission of a plan to restore compliance with a detailed implementation schedule; • require that additional provisions on assets be immediately set aside; • require shareholders to increase the entity's capital. <p>In regard to precautionary measures, the CBU may:</p> <ul style="list-style-type: none"> • require the transfer of any activity that could compromise the institution's soundness; • suspend shareholder rights in whole or in part; • limit or prohibit discretionary distributions (dividends, bonuses, etc.); • require that fiscal year profits be allocated in whole or in part to capital; • suspend, restrict, or temporarily prohibit the entity from freely disposing of all or part of its assets; • require implementation of a preventive recovery plan. <p>The CBU may also impose other measures:</p> <ul style="list-style-type: none"> • object to the appointment of an individual to the institution's management or decision-making bodies; • direct an external auditor to conduct any special audits considered necessary in the interests of depositors, creditors, or shareholders; • subject the institution to heightened surveillance in order to closely monitor the implementation of the terms of an injunction or CBU recommendation; • impose any other administrative measure it considers necessary to ensure the safety and soundness of regulated institutions or the banking system.
DISCIPLINARY OR MONETARY SANCTIONS	
<p>The CBU finds the entity has violated banking regulations or any related law.</p>	<p>The CBU may impose one or more of the following disciplinary sanctions:</p> <ul style="list-style-type: none"> • warnings; • censure; • suspension or prohibition of some or all operations; • other limitations on conducting business; • suspension or compulsory retirement of the responsible officers and directors; • prohibition (permanent or limited in time) for responsible individuals to serve as director, officer, or manager of a supervised institution; • revocation of the entity's license or authorization. <p>In addition to disciplinary sanctions, the CBU may impose monetary sanctions.</p>

Table 3. WAEMU: Early Intervention Mechanism (concluded)	
<ul style="list-style-type: none"> • The entity's officers inform the CBU that they are no longer able to adequately perform their functions. • The CBU finds that the entity can no longer be managed under normal conditions. • The CBU has ordered the suspension or compulsory retirement of the officers or directors responsible for a violation of banking regulations. 	<p>The CBU may decide to place a supervised institution under temporary administration and appoint an interim administrator with all necessary powers to administer, direct, and manage the entity.</p>
LIQUIDATION	
<ul style="list-style-type: none"> • The entity's license is revoked pursuant to Article 19 (lack of activity) or Article 31 (disciplinary procedure). • The credit institution has suspended payments to creditors (as a preliminary step toward reorganization or liquidation). • An individual or entity engages in illegal banking activities. 	<p>The CBU may decide to place the institution in liquidation.</p>
<p><i>Source: Annex on CBU operations.</i></p>	

19. Recent experience with the implementation of the early intervention mechanism attests to its limited effectiveness. Despite the considerable number of administrative and disciplinary measures adopted by the CBU since 2019, the share of entities that have been noncompliant with prudential regulations has remained elevated. The rate of persistent violations relates to regulations that are particularly critical for financial stability, such as solvency and leverage, exposure diversification, and liquidity (Tables 4 and 5).^{12,13} Many of these noncompliant institutions have not met regulatory requirements for many years. Their placement under close surveillance to monitor the injunctions imposed on them, even their placement under provisional administration, has been continually extended with no major improvement. A failure of some of these institutions could also have a systemic impact and resolution measures would, thus, have been obviously appropriate. In this context, it is reasonable to put into question the effectiveness and credibility of the early intervention mechanism and the true state of independence under which a resolution procedure could be initiated. An appropriate review should establish time limits on the execution of

¹² A total of 31 injunctions were issued in 2017, 50 in 2018, 31 in 2019, and 10 in 2020; in addition, heightened surveillance was imposed on 4 entities in 2017, 2 in 2018, 4 in 2019, and 3 in 2020.

¹³ A total of 12 disciplinary measures were issued in 2017, 35 in 2018, 24 in 2019, and 7 in 2020.

administrative measures and the placement of an entity under provisional administration, with strict limits on their total duration (including extensions). A system of escalating sanctions that uses the entire range of available measures should also be considered, including the decision to liquidate or resolve an entity (see recommendations issued in connection with the evaluation of Basel Core Principle 11).

Table 4. WAEMU: Proportion of Noncompliant Credit Institutions¹									
Share of Noncompliant Institutions in Total Number of Credit Institutions (in percent)					Noncompliant Institutions' Assets in Percent of Total Assets				
					2017	2018	2019	2020	2020
Minimum Capital					21.1	5.2	2.4	17.5	9.4
Solvency Standards	Ratio of CET1 capital				NA	14.8	15.4	10.3	10.1
	Ratio of T1 capital				NA	16.5	17.9	13.5	10.9
	Capital adequacy ratio				10.5	16.5	17.9	15.1	12.2
Risk Concentration Limit	Risk concentration limit				19.3	28.7	24.4	31.7	31.2
Leverage Ratio	Leverage ratio				n/a	17.4	17.9	14.3	11.5
Other Prudential Standards	Individual limit on investments in commercial entities (25% of the company's capital)				n/a	0.9	11.4	18.3	17.5
	Individual limit on investments in commercial entities (15% of T1 capital)				n/a	0	0	9.5	5.8
	Overall limit on investments in commercial entities (60% of actual capital)				n/a	0	0	1.6	4.5
	Limit on nonoperating assets				n/a	18.3	14.6	21.4	17.7
	Limit on total nonoperating assets and investments				10.5	2.6	4.1	11.9	10.6
	Limit on loans to shareholders, to directors, and to staff				11.8	10.4	6.5	13.5	14.1
	Coverage ratio for medium- and long-term applications through stable resources (medium- and long-term assets)				14.9	17.4	16.3	16.7	14.8
Liquidity ratio				18.0	9.6	8.9	14.3	14.1	

¹ This table presents the share of credit institutions that fail to comply with the respective prudential provisions. For example, it shows that 17.5 percent of institutions failed to comply with the regulation on minimum capital in 2020. It also shows the proportion of total sector assets held by the same institutions (e.g., noncompliant institutions held 9.4 percent of total assets in 2020).

Source: CBU annual reports.
Note: CET1 refers to Common Equity Tier 1 and T1 refers to Tier 1.

Table 5. WAEMU: Proportion of Noncompliant Decentralized Financial Systems					
Share of Noncompliant Decentralized Financial Systems (DFSs) (in percent of total number of DFSs)					
		2017	2018	2019	2020
Solvency Standards	Capitalization	40.3	30.3	29.2	37.4
	Risk limits	1.4	2.1	1.9	1.2
Standard for Exposure Diversification	Standard for exposure diversification	15.8	11.7	11.2	22
Other Prudential Standards	Individual limit on investments in commercial entities (25% of the company's capital)	0.7	6.2	6.8	6.0
	Individual limit on investments in commercial entities (15% of T1 capital)	n/a	n/a	n/a	n/a
	Overall limit on investments in commercial entities (60% of actual capital)	n/a	n/a	n/a	n/a
	Limit on non-operating assets	n/a	n/a	n/a	n/a
	Limit on total non-operating assets and investments	n/a	n/a	n/a	n/a
	Limit on loans to shareholders, directors, and staff	25.9	20.7	20.5	32.4
	Coverage ratio of medium- and long-term assets through stable funding	97.8	49.3	50.9	47.8
	Cash ratio	23.7	43.4	41.0	33.3
<i>Source:</i> CBU annual reports.					
<i>Note:</i> T1 refers to Tier 1.					

Recovery Plans

20. On January 1, 2018, all credit institutions covered by the bank resolution regime were required to adopt preventive recovery plans. This requirement, introduced via an amendment to the Annex adopted in September 2017, applies to systemically important banks (SIBs) and any relevant subsidiaries, as well as to any other credit institution, financial company, decentralized financial system, market infrastructure, or covered entity whose bankruptcy may have a significant impact on the financial stability of one or more WAEMU member states.^{14,14} All such entities are required to prepare recovery plans that identify the measures they would take to address a significant deterioration of their financial position or of the group to which they belong. The plans should be highly focused on ensuring the continuity of the critical functions that the entity provides to the economy.

21. The CBU's Circular 1-2020, adopted in March 2020, detailed the Supervisory Board's requirements for the frequency, content, and review process of bank recovery plans. Regarding

¹⁴ The BCEAO has established a framework for identifying SIBs based on the multidimensional approach recommended by the Basel Committee and adapted it to specific characteristics of the WAEMU. The identification of SIBs is determined by the CBU and based on a multi-indicator score of a bank's systemic importance. It considers its size, extent of interconnection, substitutability, and complexity in accordance with Basel Committee recommendations. The list of SIBs published by the CBU in March 2020 contains 6 regional SIBs and 22 national SIBs.

¹⁴ This coverage does not include: (i) non-financial holding companies; (ii) unsupervised minority-held entities, even if they are significant to the activity of a failing entity or to the continuity of its critical operations; and (iii) other unsupervised subsidiaries within a failing bank group. However, since the recovery plans are required to be prepared on a consolidated basis, WAEMU credit institutions would in effect account for such entities.

frequency, the recovery plans should be updated: (i) in case of actual or expected changes likely to have a potentially significant impact on the implementation of these plans; and (ii) at a minimum frequency commensurate with the institution's characteristics: each year for SIBs, financial companies, and credit institution parent companies; two years for other banks; and three years for bank-like financial institutions, electronic money issuers, and DFS. The plans should take into account the specific characteristics of the various institutions and, if applicable, their respective parent companies, including their size, structure, nature, complexity, and risk profiles. The plans should include: (i) measures to address capital deficiencies and/or refinancing difficulties, with credible recovery options to address a range of crisis scenarios, support mechanisms, and escalation procedures clearly supported by internal indicators; and (ii) measures to ensure institutions' access to financial market infrastructures and their business continuity. In terms of process, the recovery plans must be approved by the entity's decision-making body before they are submitted to the CBU for evaluation.

22. Since the circular was not published until March 2020, and provides for phased implementation through mid-2023, not all covered entities submitted recovery plans yet. To date, only SIBs, financial companies, and credit institution parent companies have submitted their plans to the CBU. At end-September 2021, one SIB had yet to submit its recovery plan in accordance with the terms of the circular. Non-systemic banks were expected to submit their plans in January 2022, and other types of institutions in July 2023. The plans received thus far are being reviewed by the CBU and will serve as the basis for preparing SIB resolution plans. These were initially expected by end-2021 but are now anticipated later this year.

23. The CBU should make use of the phased schedule for submission of recovery plans to refine its key requirements based on its review of the first wave of submissions. Although the circular is appropriately limited to outlining key principles, and the Annex provides more practical detailed guidance, a review of the initial recovery plans will undoubtedly reveal divergent practices in many areas. A review will help the CBU to compare practices on key matters like identification of core business areas and critical functions; the calibration of recovery indicators and trigger levels; the severity of scenarios; the plausibility and timeline of reorganization measures; the integration of plans in sound governance, and the relevance of communication policies. Based on this analysis, the CBU will be better positioned to provide feedback to the industry on future submissions.

B. Resolution Regime and Resolution Plans

24. WAEMU's resolution regime, in place since 2017, can be evaluated from several angles. These include governance; preparation of resolution plans; resolution procedures with triggering criteria and associated powers; and guarantees and the safeguard mechanism.

Governance

25. Nominally designated as WAEMU's resolution authority, the CBU faces limits on the autonomy of its decision-making process. Within the CBU, the Resolution and Supervisory Boards have well-delineated stand-alone authority for resolution and supervision, respectively. However, the

Resolution Board only has limited authority at the time of a resolution decision because this decision lies with the Supervisory Board, which has sole authority to determine that an entity is not viable and has no prospect of returning to profitability. While the Resolution Board regains autonomy at the later stages of resolution, it remains dependent on the Supervisory Board, which is chaired by the BCEAO governor, and from which it draws the majority of its members.¹⁵ Three of its five members are also members of the Supervisory Board. Thus, while the Resolution Board can impose resolution measures, it cannot be truly independent from the Supervisory Board. Moreover, in case of a resolution decision, the Supervisory Board representative of the state that hosts the bank in question is invited to participate in the proceedings as a non-permanent member with voting rights.

26. Another limit to the Resolution Board's independence arises from ministerial involvement in its decision making, even in the absence of recourse to public funding or a systemic risk threat. This involvement is demonstrated by the large number of member state representatives on the Board (two of the five voting members); and it is reinforced by the jurisdiction of the CM—which is by definition a political body—over appeals of CBU decisions and, accordingly, its power to annul CBU decisions. There is thus a significant risk to the independence of Resolution Board decisions, both internally and on appeal. This risk is strongly exacerbated by the absence of mechanisms to facilitate an independent assessment of the effectiveness of the Resolution Board's decisions.

27. From an operational standpoint, the CBU's supervisory and resolution functions are assigned to different internal directorates, but with common reporting to the deputy secretary general. The bank supervisory function is performed by three different directorates dedicated to "ongoing off-site supervision," "on-site inspection of credit institutions and electronic money issuers," and "on-site inspection of DFS." Resolutions are entrusted to a fourth independent directorate responsible for "resolution and legal affairs," which is composed of two units in charge of "legal affairs" and "crisis resolution and business practices oversight." All directors report to the CBU's deputy secretary general. At present, only one deputy secretary general has been appointed, despite the need for two under Article 12 of the Annex. While the organizational structure seems appropriate for adequate separation of day-to-day tasks related to supervision and resolution, it presents conflict-of-interest risks for the deputy secretary general. Also, inadequate staffing of the "crisis resolution and business practices oversight" unit raises doubts about the autonomy and operational capacity of the CBU's resolution function. The chief of that unit, who is in charge of two different activities—resolution and business practices oversight—currently has only one staff member, a financial analyst. There are plans to hire two legal specialists.

¹⁵ The Supervisory College includes the Governor of the BCEAO, a representative appointed or designated by each of the eight WAMU member states, and nine members appointed by the WAMU Council of Ministers (based on their expertise). The Resolution College includes the Governor of the BCEAO, a representative from the State Supervisory College chairing the Council of Ministers, the Director of the Deposit Guarantee and Resolution Fund, a member appointed by the Council of Ministers of the UMOA (because of his/her expertise), and, in the event of a resolution procedure, a representative from the Supervisory College for the host state concerned.

28. The legal protections afforded CBU members and staff appear consistent with best practices. First, no civil or criminal action can be brought against a member of the CBU for actions taken in the performance of their functions. Second, as employees of the BCEAO, the CBU's secretary general and its staff are immune from legal liability or arrest for actions taken while performing their individual functions or any functions on behalf of the Central Bank (Articles 13 and 16 of the protocol on privileges and immunities of the BCEAO).

29. The governance of the bank resolution regime would benefit from improving certain decision-making and operational mechanisms. Recommendations:

- Like the Supervisory Board, the Resolution Board should be given authority to take decisions on the resolution and the assessment of an entity's viability or non-viability (following consultations with the Supervisory Board). One way to strengthen its independence from the Supervisory Board and finance ministers is to increase the number of members appointed by the CM based on expertise and integrity.
- The jurisdiction of the CM to hear appeals or conduct arbitration against CBU resolution decisions should be revised exclusively in favor of the WAEMU Court of Justice, which has already acknowledged its substantive jurisdiction.
- Accountability mechanisms should be introduced, including periodic independent reviews of CBU-implemented resolution strategies and, more fundamentally, the specific criteria used to decide whether to begin a resolution or not. Such mechanisms would be reported to the CM.
- From an operational standpoint, administrative reporting lines of the supervision and resolution functions within the CBU should be kept separate up to the level of the two deputy secretaries, as provided by the Annex.
- The unit responsible for crisis resolution and business practices oversight should be provided with sufficient human resources without delay.

Resolution Plans

30. Since 2017, the CBU has been authorized to prepare and regularly update resolution plans for each credit institution that is subject to the resolution regime on an individual and, where applicable, consolidated basis. For SIBs or other entities whose failure could have a significant impact on financial stability of one or more WAEMU member states, the plan is prepared by the Resolution Board based on information reported by the entity and includes the measures that would be taken in the event of its failure. The plan is prepared on an individual basis and for financial companies and parent credit institutions, it also covers the entire group and the subsidiaries to which the resolution measures are supposed to apply. If necessary, the Resolution Board would involve the resolution authorities responsible for the subsidiaries or the group concerned. The plans should be updated every two years or whenever there is a legal, organizational, or financial change likely to have a significant impact on their effectiveness or implementation conditions.

31. In developing and updating the resolution plans, the CBU evaluates the entities' resolvability, in particular by identifying potential obstacles to implementation of the planned resolution strategies and, where necessary, requesting measures to eliminate these obstacles.

The Resolution Board's objective is to determine the extent to which an entity can be liquidated or resolved while preserving the continuity of its critical functions or essential activities. Under the terms of a recent circular, the review should consider the organization of an entity's operations and information systems; the internal interdependencies of its business areas and with other entities; its participation in market infrastructures; its internal loss-absorption capacity; and its level of cooperation with foreign resolution authorities. If the Board finds significant obstacles to effective implementation of the resolution plan, it has powers to require the entity to reduce or eliminate these obstacles via a corrective plan that it should submit to the Board, or, failing that, to enjoin the entity to take the necessary measures. Final adoption of the resolution plan is contingent on the implementation of these measures.

32. While the legal framework applicable to resolution plans appears adequate, the pace and modalities of implementation represent a major challenge. The delays in submission of the recovery plans and the resultant delay in the Supervisory Board's analysis of the plans is significantly holding up evaluations of bank resolvability and the preparation of initial resolution plans, which were planned for end-2021 and only cover the SIBs.

33. Numerous key issues with the resolution plans already appear sensitive. These include:

- As a first order of priority, coordination between the Supervisory and Resolution Boards should be optimized once the recovery plans are analyzed to ensure that the recovery plans are consistent with the resolution plans.
- Once an entity has presented recovery options, their impact on resolvability should be carefully scrutinized by the Supervisory Board, including from an operational and financial standpoint.
- Coordination with foreign authorities, which has not yet begun, should be supported by a specific mapping of essential activities and critical functions of cross-border groups; an analysis of the distribution of their capital in regard to the risks assumed; and a review of intragroup financing mechanisms. These elements will help identify the benefits from information sharing or coordination with foreign authorities, and possibly the risks of any "ring fencing" measures they may have adopted.
- Based on these diagnostic assessments of internal loss-absorption capacity, financing modalities, and quality of cross-border cooperation, the key issue will be to select the optimal resolution strategy. Of particular importance is whether to base it on a "single point of entry" or "multiple points of entry," and whether internal restructuring of the group is necessary. In this respect, recent CBU powers (Decision 14-2016, Article 5) could be helpful, whereby a parent company with subsidiary credit institutions licensed in the WAEMU can be required to create an intermediary financial holding company to hold the group's stakes in

credit institutions - only four intermediary financial holding companies were licensed at end-May 2021. The current weakness of institutions' internal loss-absorption capacity and immediately available resolution funding mechanisms will also likely complicate the adoption of resolution plans.

Resolution Powers

34. As the resolution authority, the CBU has specific powers it can use when, on the basis of appropriate indicators, a credit institution is considered no longer viable and with no prospect to return to viability. Under the terms of the Annex, the Resolution Board may, at the request of the Supervisory Board, initiate a resolution process for any entity "deemed nonviable and with no prospect of returning to viability" by the Supervisory Board. The criteria for evaluating non-viability (Circular 3-2020, Article 4) are based on capital or liquidity indicators. These include forward-looking indicators suggesting that protection of depositors or creditors is no longer appropriate and indicators that suggest creditors have lost confidence in the entity. The other triggers relate to an entity's difficulty in accessing market funding, its lack of capacity to mobilize capital at the request of the CBU (or at its own initiative), and whether it has requested exceptional public financial support. These criteria, which are not exhaustive, are not subject to a prior adoption of early intervention measures and could trigger a resolution process before the entity becomes insolvent in terms of net assets or cashflows.

35. After resolution proceedings are opened, the CBU has a wide range of resolution powers that it can use with full legal autonomy. The CBU may use its powers directly and with full independence, as the Resolution Board is released from the obligation to obtain prior authorization or approval from a public authority. The CBU may also intervene through a "special administrator" tasked with implementing the Board's measures and decisions, with the invalidation of any contractual stipulation that such appointment would be considered a case of default. In the absence of explicit prohibitions or requirements on the individual or joint use of resolution measures or on their sequencing, it is reasonable to deem that the CBU has complete discretion to select the combination and sequence of actions. In terms of decision-making, the usual CBU procedures apply to the work of the Resolution Board, on the understanding that the latter may also, in case of emergency, adopt resolution measures on an interim basis without observing due process. Once the resolution measures are adopted, it is just incumbent on the president of the CBU to inform the relevant minister of finance of their implementation. No prior approval by the courts is required.

36. Judicial review of resolution decisions is subject to the usual rules applicable to CBU decisions, with consequences for the mechanism's effectiveness. Neither the appeal period (two months) nor the appeal leads to a suspension of the execution of the resolution decision. Any decision by the Resolution Board may be invalidated following an appeal, but this will not affect the validity of actions taken to implement it if altering these actions could harm the interests of third parties, except in case of fraud by third parties. It is unclear, however, whether shareholders and creditors may seek to annul a resolution decision on the grounds that a resolution measure harms their interests. To avoid such a scenario, it would be advisable to specify that the only available

remedy in an appeal of a resolution decision is financial compensation, unless of course the CBU decision was made in bad faith or was contrary to law.

37. The extent of the CBU's resolution powers is broadly aligned with the recommendations of FSB's Key Attributes. With the recent revision of the Annex, the new range of resolution measures has expanded considerably (Annex, Article 53). In addition to the key resolution measures (e.g., suspension of activity, bridge entity, bail-in), the CBU was granted the powers to: (i) require an entity to issue equity instruments; (ii) temporarily prohibit the payment of any or all claims arising prior to the resolution, or more generally to execute certain transactions; (iii) terminate agreements that entail financial obligations for the entity, with the exception of agreements related to settlement, payment, or clearing systems; and (iv) suspend the exercise of the rights to invoke acceleration clauses and to terminate or set off any or all contracts signed with the entity. The legal framework also allows the CBU and/or judicial authorities to bring claims or collection actions against individuals whose actions or omissions significantly contributed to the entity's failure. Yet, certain measures are still missing from this arsenal, even though they would be useful, as such or in support of the use of key resolution measures that the CBU may now apply.

38. Two gaps in the CBU's resolution powers are especially noteworthy. These relate to the following:

- ***The power to require continued delivery of critical services and essential functions is too limited in scope.*** The CBU is clearly able to exercise this power on a preventive basis in the context of a resolvability evaluation, but during implementation of the resolution, it can only exercise it with respect to the failed entity and only to the extent that some or all of the entity's activities have been transferred (Circular 3-2020, Article 19). This is done to ensure that the entity continues to provide critical services and functions to the assignee of these activities.¹⁶ The CBU may not exercise this power if resolution measures other than the transfer of activities are taken, nor may it exercise them with respect to affiliated entities or unregulated subsidiaries of the failed entity. While such entities could be the providers of services necessary to the continuity of functions performed by the credit institution, they are beyond the scope of application of the resolution regime (in accordance with the Annex, Article 45-2). It would thus be advisable to grant the CBU such powers regardless of the resolution measures taken, either directly with respect to operational entities within the group, whether regulated or not, or with respect to the defaulted institution itself via service contracts that it may have concluded with the group's various internal service providers.
- ***Liquidation is not included in the list of resolution measures (Annex, Article 53) but is instead designated as a supervisory measure (Annex, Article 16) available to the CBU under very specific circumstances.*** In this case, the CBU's power to order the liquidation of

¹⁶ Pursuant to Article 10 of Circular 3-2020, the CBU has the authority to require institutions to take any measure to remove obstacles to the implementation of resolution plans, on the understanding that those plans cover the entire group and include measures pertinent to credit institutions and, as applicable, their subsidiaries.

a credit institution is subject to the prior revocation of its license (Annex, Article 35).¹⁷ Yet except in cases of inactivity for at least one year or a request by the credit institution itself, a license can be revoked only as a result of disciplinary proceedings, which are in turn subject to a finding of regulatory or statutory violation and completion of an adversarial procedure.¹⁸ Yet the CBU's inability to liquidate non-systemic entities deemed nonviable through other than disciplinary procedures raises strong reservations. Whether the context is outright liquidation of an entity in resolution or merely that of the residual entity after transfer of specific activities to a third party, the expeditiousness of the CBU's powers would be inadequate from the standpoint of the requirements of the resolution process.¹⁹

39. Notable is the absence of certain auxiliary measures that could usefully support the implementation of the principal resolution measures now available to the CBU. The absence of such auxiliary powers could reduce the effectiveness of measures the CBU may take in response to a default, such as transferring assets, liabilities, or stock to a third-party entity or taking steps to wipe out shareholders or bail-in its creditors. An important gap relates to the CBU not being explicitly exempt from the obligation to give prior notice to shareholders of measures it intends to adopt or to obtain their consent before exercising its powers.²⁰ Similarly, the CBU does not have powers to terminate the preemptive rights of a failing institution's shareholders. Other gaps specific to the implementation of certain resolution strategies are also worth noting.

40. The power granted to the CBU to fully or partially transfer an entity's business segments (Annex, Article 53-4) is exposed to legal or operational risks. A recent circular clarified that the transfer of a business segment entails a transfer of all assets and liabilities and the associated rights and obligations (Circular 3-2020, Article 14). This transfer power is complemented by a symmetrical power for the CBU to transfer the assets or liabilities back to the institution in resolution, subject to the transferee's consent. However, the transferee type (bank or non-bank) is not specified, so that this power could be associated with the transfer of assets/liabilities to a credit institution, as well as the transfer of extinguished claims to an asset management company (AMC). Despite not being explicitly mentioned in the list of resolution tools in the Annex (Article 53), such recourse to an AMC exists in the region but is placed outside the formal resolution framework. Yet the use of this power could still raise numerous challenges:

- *The measure permitting a transfer of assets and liabilities to an existing institution is unanimously recognized as highly efficient.* This is, in particular, the case for small institutions

¹⁷ With the consent of the CBU (Banking Law, Article 90), a member state judicial authority may also order the liquidation of a credit institution in the context of a collective debt workout process.

¹⁸ In both cases, the license is revoked by decision of the minister of finance after favorable opinion by the CBU (Annex, Article 19).

¹⁹ The liquidation of the residual entity, after the transfer of certain activities, should be implemented in accordance with applicable regulations. Circular 3-2020 (Article 19), for example, refers to the prerequisite of prior revocation of license.

²⁰ The Annex (Article 48) only specifies that the Resolution Board is released from the obligation to obtain the authorization or consent of any public authority necessary to the resolution measure under consideration.

and their depositors. However, to ensure the measure's effectiveness, the CBU must have the capacity to: (i) liquidate the remaining shell of the failing institution once some or all of its performing assets and corresponding liabilities have been transferred to a third-party acquirer; and (ii) raise sufficient financing to cover any gap between the value of assets and transferred liabilities (see section on resolution funding).

- *The measure permitting the transfer of extinguished claims to an AMC is generally assessed as being of more mixed efficacy.* While its advantages are clear if it facilitates centralized, expert management of a portfolio of homogeneous nonperforming loans, an AMC transfer could generate excessive costs if governance is inadequate, the transfer prices are not properly valued, or the host structure loses access to management information on clients. The CBU's preference for this measure should thus be based on a conclusive cost-benefit analysis. In any event, whether or not it is explicitly included in the range of available tools, this measure should be limited to the model of a centralized management company, which is better suited to systemic crisis cases. Moreover, this ability to transfer claims should be supported by sound governance; subject to appropriate and transparent objectives; preceded by an appropriate selection and fair valuation of the assets to be transferred; and mobilization of funding at least cost. It should be used only in the context of a resolution procedure, possibly jointly with other resolution measures.

41. The CBU's authority to include a bridge entity in the resolution mechanism (Annex, Articles 53-5 and 53-6) requires further clarification. The CBU has the authority to create a bridge institution for the purpose of transferring to it, on a provisional basis, all or part of the assets, rights, and obligations of the entity in resolution, or its shares. It is the responsibility of the Supervisory Board (Circular 3-2020, Title IV, Section 2) to promptly issue a license to a bridge institution, approve the members of its board of directors and senior management, and if necessary, restrict the scope of its activities or impose specific prudential requirements. However, it is far from certain that licenses will be issued in a timely manner. Also, the repartition of the bridge institution's capital is still indetermined since all or part of it is subscribed by "one or more public entities or the FGDR-UMOA." Such uncertainties regarding the licensing and shareholding structure of bridge institutions should be eliminated now to ensure that, when the time comes, these institutions can be created quickly and can operate at full capacity.

42. The power to reduce creditor claims has also been incorporated into resolution mechanism (Annex, Article 53-8). The question remains whether the measure is well adapted to the WAEMU's banking system and whether it can be used effectively in the absence of minimum operational clarifications and safeguard measures, as recommended by the FSB's Key Attributes. The CBU may now impose a capital reduction, the write-off of capital or debt instruments, or conversion of debt instruments, thus providing a potential source for bail-in. The bail-in power is only established in principle (i.e., there are no explicitly indicated limits on its scope of application). Given the predominance of retail customer deposits in the funding structure of WAEMU institutions (81 percent of total refinancing), this principle poses a significant but largely undefined threat to this source of funding, which could undermine financial stability. Certainly, this risk of loss to depositors in case of bail-in is similar to the risk they would face in an outright liquidation (or a resolution via

transfer of activities). But this risk should be counterbalanced by adequate safeguards to exclude depositors insured by the FGDR-UMOA from the scope of write-downs or conversion.

43. The lack of transparency on the possible modalities of a bail-in resolution could imperil financial stability. There is still no information on the scope of application of this new resolution power, its terms of exercise (write-downs or conversion), the consideration of the hierarchy of claims in a liquidation, the standards for asset valuation, and the availability of safeguards for creditors. This lack of transparency could significantly affect depositor and creditor confidence, thus exacerbating the financing difficulties not only of the failing institution but of the entire financial system, via a contagion effect. In this context, it is important to re-examine the basic structure of this bail-in power, defining precisely its scope and the conditions for its implementation (see the FSB’s “Principles of Bail-In Execution,” published in June 2018). The inclusion of deposits, especially retail deposits, in the scope of the bail-in power should be reviewed particularly carefully, given their importance in funding the banking system. The conditions of implementation should provide sufficient transparency and legal certainty to ensure full predictability and fairness in the treatment of shareholders, depositors, and other creditors.

44. The resolution of systemic institutions without recourse to public funds should not be considered until these institutions have built up adequate internal loss-absorption capacity. To the extent that, for financial stability reasons, retail deposits generally provide little or no contribution to an institution’s loss-absorption capacity, it would be advisable to begin requiring systemic institutions to strengthen their eligible buffers in case of resolution.

45. Recommendations:

- Clarify that appeals to resolution decisions can only be remedied by financial compensation, except in cases where the CBU’s decision was made in bad faith or illegally.
- Authorize the CBU to require that critical services and essential functions continue to be provided, regardless of the resolution measures taken. This can be accomplished either directly—by the operating entities within a group (regulated and unregulated)—or through the failing institution itself via its existing service contracts with various internal providers.
- Include liquidation in the collection of available resolution measures, without subjecting this measure to the opening of a disciplinary procedure. Liquidation measures should include both the institution placed in resolution and any residual entity after transfer of certain segments of activity.
- Exempt the CBU from the obligation of providing prior notice to shareholders of the measures it decides to take and from the obligation to obtain shareholder consent before exercising its powers.
- Authorize the CBU to terminate shareholders’ preemptive rights in case of resolution.

- Make the inclusion of the mechanism for nonperforming loans transfers to an AMC in the resolution framework subject to a robust cost-benefit analysis, taking into account the need for requiring strict safeguards for its possible implementation.
- Remove legal or operational uncertainties related to the establishment of a bridge facility, and, if necessary, authorize the CBU to transfer back assets or liabilities to the institution in resolution, subject to appropriate guarantees.
- Review the appropriateness of the bail-in resolution measure and, at the very least, specifically define its scope of application and the conditions of implementation.
- Introduce a program for gradually strengthening SIB's internal loss-absorption capacity in case of resolution.

Guarantees and Safeguards

46. The use of bail-in, like any other resolution measure, should be subject to guarantees meant to protect stakeholders against measures that could threaten their fundamental rights, including property rights, freedom of enterprise, and right to an equitable process. Such guarantees, which are recommended by the Key Attributes, appear to be included in the CBU resolution mechanism, albeit only through the interested party's ability to appeal CBU decisions to the CM and the right of any creditor who is wrongfully harmed to receive compensation. The guarantees should be substantially strengthened to prevent potential adverse consequences of improper use of resolution measures:

- *Uncertain compensation.* Under the current resolution scheme, the compensation available to creditors who "do not receive, at a minimum, what they would have received if the entity had been liquidated" is left to the Resolution Board's discretion and is not a general right. The scheme also only provides compensation "if the resolution procedures lead to liquidation of the failed entity" (Annex, Article 54), thereby excluding the specific case of resolution. The language of this article should thus be revised to ensure that the creditor receives treatment at least as favorable as in a liquidation, in accordance with the "no creditor worse off than in liquidation" principle recommended by the Key Attributes. In parallel, the CBU should also be authorized to order the issuance of warrants to shareholders or holders of subordinated debt whose claims were extinguished.
- *Limited protections.* It is regrettable that the resolution mechanism does not appear to provide legal protection (in the form of immunity or a right to compensation) to the directors, management, or personnel of the entity placed in resolution, or to the CBU-appointed special administrator, if they acted in good faith and in accordance with the CBU's decisions and instructions.

- *Unclear priority of claims.* Resolution measures, notably bail-in measures, should be applied in accordance with the priority of claims in liquidation.²¹ The priority of claims should also be clarified: currently, the banking law appears to assign a preferential rank to depositors but subject to limits left to the discretion of the judicial authority.²² Such ring-fencing according to circumstances is likely to alter depositor confidence in this preference mechanism. Also, insofar as the judicial authority has discretion to determine the amount to which the preferential provisions apply in case of liquidation, this amount does not systematically correspond to the compensation limit of the FGDR-UMOA. The FGDR-UMOA could be exposed to greater losses if this ad hoc preference covers only a portion of the rights to which it is subrogated after compensating depositors. For this reason, the law should specify that the preferential rank of depositors in case a liquidation does not entail a limit.
- *Valuations needed.* The guarantees depend on the accurate valuation of a failed entity's assets and liabilities. In this regard, it is regrettable that the resolution mechanism does not mention the requirement of such a valuation when a resolution is initiated—and that it should be conducted according to a thorough, transparent, and independent process.
- *Unspecified limits on suspensions.* The resolution scheme authorizes the CBU, upon initiation of resolution, to suspend the rights of the counterparties to an institution in resolution. It can invoke acceleration clauses or exercise their right to terminate and set off. That said, strict conditions should be attached to such suspensions, in terms of duration, scope of application, or modalities of implementation. In particular, the suspension should be specifically limited to a maximum of two days and should cease if the entity in resolution (or its successor) does not fulfill its contractual obligations (so as to clarify the provisions of Article 32 of Circular 3-2020).

47. Recommendations:

- In the Annex to the Convention, clarify that in a resolution context, a creditor receives treatment at least equal to what it would have received in case of liquidation.
- Authorize the CBU to order the issuance of warrants to former shareholders or former holders of subordinated debt whose claims were extinguished (see EC 3.11 (iv) concerning Key Attribute 3).

²¹ This requirement also implies that the CBU uphold the principle of equal treatment of creditors of the same class. However, the CBU should also be able to depart from this principle to: (i) protect financial stability; or (ii) maximize the entity's value for all creditors.

²² Under Article 95 of the Banking Law, in the liquidation of a credit institution's liabilities, bank account holders are reimbursed immediately after creditors of legal fees and creditors of highly preferred wages (*salaires super privilégiés*). However, the judicial authority can set a limit to such reimbursements based on available resources and after deducting debts to the credit institution.

- Institute legal protection for directors, executives, and employees of the entity and resolution, and for the special administrator appointed by the CBU, if they act in good faith and in accordance with the CBU's instructions.
- In the Annex to the Convention, clarify that any resolution measures should be applied in accordance with the priority of claims in liquidation, allowing for departure from the general principle of equal treatment of creditors of the same class, if necessary to contain the potential systemic impact of a firm's failure or to maximize the value for the benefit of all creditors as a whole.²³
- Clarify in the Banking Law that the preferential rank of depositors in case of liquidation does not entail limits.
- Introduce an explicit requirement in the legal framework for valuations to be conducted at the inception of resolution and thereafter according to a thorough, transparent, and independent process.
- Limit the conditions under which the CBU may suspend the right to invoke acceleration clauses or the right of termination and set-off by counterparties of the entity in resolution.

C. Deposit Insurance and Resolution Funding

Deposit Insurance

48. The primary mission of the Deposit Guarantee Fund, renamed the FGDR-UMOA in 2017, is to protect deposits received by credit institutions and DFS. The FGDR-UMOA has independent legal status and financial autonomy, and is composed of two distinct, standalone funds dedicated to the two types of institutions and funded by their respective contributions. At end-2019, 73 percent of total deposits and over 90 percent of depositors were eligible for guarantees. Given the CFAF 1.4 million and 0.3 million compensation limits for credit institutions and DFS, respectively, the share of total insured depositors is a combined 61 percent, or 70 percent and 50 percent, respectively. In terms of deposits, the share of covered deposits represented 68 percent of total deposits, leaving 32 percent of deposits in the system exposed to market discipline, well below the average on the African continent or the deposit share implicitly associated with the 80/20 rule.²⁴ Ineligible deposits are clearly defined in the revised FGDR-UMOA charter and include foreign currency deposits, which are negligible in the WAEMU.

²³ Key Attribute 5.1 of the FSB,

²⁴ At end-2020, the median coverage of deposits observed by the IADI throughout Africa was 26 percent (2020 IADI Annual Survey), leaving the share of deposits exposed to market conditions at 74 percent. Within WAEMU, the exposure was 32 percent, a level closer to the share observed in Europe (about 38 percent). As per the rule of thumb, 80 percent of depositors are fully covered, but only 20 percent of deposits are fully covered (see IADI's "Enhanced Guidance for Effective Deposit Insurance Systems: Deposit Insurance Coverage," published in March 2013).

49. Since the FGDR-UMOA was established relatively recently and its role in resolution funding is new, its mechanisms still need to be strengthened from a legal, regulatory, and operational standpoints. As of this date, the legal framework does not yet appear to guarantee optimal internal governance or complete independence for the FGDR-UMOA. Its financial capacity and operational preparedness, both with respect to deposit insurance and resolution funding, are uncertain.

Governance

50. As underscored by the IADI, good governance of a guarantee fund should be built on the foundations of operational independence, integrity, transparency, and accountability. The FGDR-UMOA should improve its structures and processes in each of these areas.

51. Despite the existence of two different windows (for credit institutions and DFS), the governance of the FGDR-UMOA is unified, with ultimate authority granted to a single Board of Directors; however, the Board's independence appears to be significantly limited. The operational independence of the FGDR-UMOA is limited by the Board's mandate to issue proposals (but not take decisions) on key aspects of the Fund's areas of responsibility. This has a bearing on decisions to: (i) determine member contribution rates, which are set by the CM; and (ii) establish the modalities of compensating depositors, which is also within the purview of the CM.

52. The composition of the Board of Directors does not adequately protect against conflict-of-interest risks. Importantly, there are conflict-of-interest risks for industry representatives if they continue to perform duties at member institutions. Such risks are inherent to the composition and internal regulations of the Board since industry representatives account for half of the Board and decisions are adopted by a simple majority.²⁵ This risk also is exacerbated by quorum rules, which require two-thirds of members to be present (or represented) for Board decisions to be valid. The prevention of conflicts of interest is thus of utmost importance. The 2018 Charter contains provisions to prevent conflicts of interest due to decisions related to entities represented on the FGDR-UMOA Board. Yet, they do not prevent other types of conflict of interest, such as transmission to institutions' representatives sitting on the Board of potentially confidential information about their competitors.²⁶ The involvement of active bankers could also hinder cooperation with foreign banking authorities. Finally, the FGDR-UMOA's independence could be weakened by the role of the BCEAO governor as an *ex officio* chair of the Board.

²⁵ The Board of Directors includes six members: the BCEAO governor (*ex officio*), two representatives of the banking sector, one representative of DFS, and two representatives of WAEMU member states appointed by the CM. The Board members are subject to fixed but not necessarily staggered terms unless the terms of certain members are renewed. They cannot be removed during their terms, except for industry representatives should it be found that they have not fully and accurately disclosed their relationships with member institutions.

²⁶ Pursuant to Article 10 of the 2018 Charter, industry representatives are required to disclose any professional activity or business relationship with an insured institution during the preceding five years. For the duration of their terms, the representatives abstain from voting on any decision related to such an institution or an institution for which they currently work. Under Article 11, WAEMU member state representatives cannot hold a position in a credit institution or DFS during their term, nor receive any compensation from any such entity.

53. The gaps in legal protections accorded the FGDR-UMOA and its officers or employees can also weaken its independence. While the Fund cannot be liable for losses incurred as a result of the assistance it provides, except in case of fraud (see 2018 Charter, Article 36), it does not receive protection in other cases, including cases where it abstains in good faith from providing assistance. Likewise, no legal protection is provided for current or former directors (members of the Board of Directors), or for executives (director and deputy director) and employees if legal action is brought against them following actions taken in good faith in the normal course of their functions. Ratification of the memorandum of understanding between the FGDR-UMOA and the WAEMU member states, in accordance with Article 44 of the Fund's Charter, is intended to cover this gap.

54. The integrity and suitability requirements applicable to the directors and officers of the FGDR-UMOA should be tightened. The process of appointing and removing directors and officers of the FGDR-UMOA is transparent and is set out in the 2018 Charter. The representatives of the WAEMU member states and the industry must demonstrate expertise in banking, monetary, financial, economic, or legal matters. However, the suitability tests (regarding fit and proper criteria) only apply to WAEMU member state representatives, not the industry representatives. There are also no appropriate requirements for the FGDR-UMOA Management (director and deputy director). At most, the director is selected based on a call for applications by the BCEAO and the deputy director is appointed by the FGDR-UMOA Board of Directors on the recommendation of the BCEAO governor from among the members of the BCEAO staff.

55. The integrity of FGDR-UMOA operations would be considerably improved by strengthening its governance. The charter currently does not include a requirement about internal control or internal audit, and the latter function is not staffed at this date. These functions, however, are critical for good governance since they provide for ongoing independent surveillance of the Fund's operations. Good governance spans minimal checks and balances, independent operational risk management functions, and periodic independent validation of internal control mechanisms, with the auditor reporting directly to the Board of Directors.²⁷ The ability to request external audits, independently from the certification of financial statements by chartered accountants, would also be desirable to ensure that the FGDR-UMOA conducts its operations in accordance with its mandate.

56. Improved governance should go hand in hand with promoting external transparency, which would help strengthen FGDR-UMOA accountability. Unfortunately, the law does not specify the FGDR-UMOA's mandate or the extent of its powers. The FGDR-UMOA's right to contribute to resolution funding is only embedded in the revised 2018 Charter. However, the FGDR-UMOA's notable efforts to increase transparency should be recognized, particularly the recent launch of its website and the online publication of all regulatory provisions that are of relevance to

²⁷ For example, under the terms of the charter's investment management procedure, the "officer in charge of management and finance" (*Chargé de l'Administration et des Finances*) is responsible for an extensive range of functions that would traditionally be assigned to an independent front office, middle office, back office, or even risk management unit (e.g., prospecting market conditions with counterparties, proposing investment operations to the director, implementing operations if the director approves, preparing transaction tickets, compiling all legal documents required to execute investment operations, dealing with settlement failures and enforcing guarantees, reporting on performance analyses, etc.).

its work; its missions and financial education program; and its annual reports. A critical gap is the lack of information for depositors on indemnification procedures, which should be corrected by the pending publication of a circular that is currently being validated. Importantly, it is desirable for the legislation itself to clarify the FGDR-UMOA's mandate and powers. This would increase transparency about its responsibilities and support recurrent reviews of its actions. Such reviews would hold FGDR-UMOA accountable to various stakeholders and the public, including on the basis of independent evaluations of the performance of its missions.

Operational Preparation

57. Growing the operational capacity of the FGDR-UMOA is a work in progress, and indications are that the mechanism is coming up to speed. The progress is especially evident in terms of human resources, with staffing recently increased to seven persons (including the director) and ongoing training efforts (including staff participation in international seminars). There have also been important advancements in logistical matters, notably the implementation of an information and reporting system, initiated in 2018 with assistance from the BCEAO. The system aims to automate: (i) the collection of data on deposits; (ii) the calculation of contributions from member institutions; and (iii) the creation of a platform for depositor compensation, which will provide, *inter alia*, a single consolidated view by institution of covered deposits held under each customer's name.²⁸ However, without internal resources assigned to develop and maintain the information system, the FGDR-UMOA will continue to be highly dependent on the BCEAO in this area. Another project, also underway since 2018, aims at introducing a system of premiums differentiated by member risk profiles, based on a methodology similar to that of WAMU's Rating System for Credit Institutions. Future rapid implementation of this project will be critical for reducing the moral hazard inherent in the operation of the FGDR-UMOA.

58. The FGDR-UMOA's capacity to promptly compensate depositors in the event of a member institution's default does not yet appear to conform to best practices. Legally, the BCEAO or the CBU makes the determination that deposits are unavailable and then refers the matter to the Fund for reimbursement of depositors up to the regulatory limits. The modalities of the reimbursement are established by a circular which, however, is still pending validation. The circular is expected to set the reimbursement period at three months, greatly exceeding the seven-day period recommended by the IADI. To enhance its credibility, the FGDR-UMOA thus needs to make rapid progress in determining the compensation terms and reducing the reimbursement time. This is all the more necessary since the FGDR-UMOA's intervention capacity has not been tested in theory or practice. Actually, the absence of an actual bank failure (since the inception of the guarantee fund) has meant FGDR-UMOA has not had to go through the process of compensate depositors. Nor has such a process been simulated. Such a simulation exercise was expected, however, to be conducted jointly by the BCEAO and a pilot institution by end-2021. In this case, strengthening the Fund's operational capacity would require developing its reporting, not only on the consolidated amount of covered deposits per customer at each institution ("single customer view") but also of member risk

²⁸ Only the first phase of the project was completed—and for credit institutions only—by end-September 2021.

profiles, based on reports submitted by the members or based on the profiles transmitted by the CBU to the Fund under a recently signed protocol on information exchange.

Financing Capacity

59. The FGDR-UMOA's intervention capacity is highly dependent on its financial strength.

A comprehensive target of CFAF 100 billion in available reserves, which was set in 2018, is to be built over a 10-year horizon. It was calibrated on the assumption of a simultaneous failure of eight medium-sized banks in the WAEMU. To meet the target, the choice of horizon allowed for a relatively small contribution from member institutions, representing on average 0.7 percent of financial institutions' net banking income. Clearly, the investment policy adopted by the FGDR-UMOA Board is marked by low risk tolerance and gives preference to investment vehicles with low risk and high liquidity, permitting a rapid mobilization of reserves when necessary.²⁹ The target appears insufficient, particularly in light of the ambitious level of desired coverage and the recent extension of the FGDR-UMOA mandate to include resolution funding (see paragraph 60). Importantly, the target should be set as a percentage of eligible deposits.³⁰ The timetable for building up reserves also appears too slow: at end-2020, the available reserves of the Fund's two windows stood at CFAF 34.6 billion (for credit institutions) and CFAF 6.5 billion (for DFS)—representing only a small proportion of eligible deposits.³¹ For credit institutions, the reserves cover eligible deposits for the 16 smallest firms reporting at end-2020, or only 4.9 percent of total assets held by all institutions. In the context of potential inadequacy of available reserves, use of further ex post contributions is not deemed desirable in view of their obvious procyclicality.

60. The slow build-up of available reserves calls for the specification of a more ambitious target ratio for funding them. In general, it would be advisable to reconsider the terms of arbitrage between, on the one hand, the coverage level (typically high) and, on the other hand, the target level (typically low) for funding available reserves and the pace (still slow) of accumulation of these reserves: such a new arbitrage should aim to ensure the FGDR-UMOA's capacity to fulfill its mandate over a shorter horizon. A preponderant share of this readjustment would likely come from an increase in current contributions, which would raise the target ratio and reduce the time needed to effectively fund it. Conceptually, it should be possible to base this recalibration on information provided by WAMU's Rating System for Credit Institutions. This information would enable FGDR-UMOA to estimate the members' probability of default and the criticality of associated losses—net of recoveries—that it could face. The methodology underlying the exercise should be transparent and

²⁹ This policy results, inter alia, in limitation (to less than five years) of the average life of portfolio investments and the specification of intervention limits by state and by credit institution, to be set after discussion with the BCEAO. In addition, the Fund has begun discussions with the BCEAO to obtain a backup financing line and to access the BCEAO refinancing window.

³⁰ Based on end-2019 data, the target resolution funding level of CFAF 100 billion would correspond to coverage of 0.45 percent of eligible deposits, which is on the low side of the range observed by the IADI (see IADI's "Enhanced Guide for Effective Deposit Insurance Systems: Ex Ante Funding, published in June 2015).

³¹ The collection of contributions should be stepped up for DFS (on the publication dates of the Fund's annual reports in 2019 and 2020, collections rates stood at 74 percent and 84 percent, respectively.) If members fail to pay these contributions, late payment sanctions and penalties (provided by the charter) should be applied.

publicly accessible. That effort would be part of an overall capacity strengthening strategy for resolution funding in the region.

61. Recommendations:

- Confer decision-making authority to the FGDR-UMOA Board on key aspects of its terms of reference, including member contribution rates and modalities of depositor compensation.
- Prohibit active representatives of industry associations to carry out business activities (or enter into business relationships) with any member of the Fund for the duration of their terms.
- Strengthen the Fund's internal governance (internal controls, internal and/or external audits, transparency mandate, and independent performance review mechanisms).
- Put in place an information system that: (i) provides an up-to-date, consolidated view of covered deposits by customer at each institution; and (ii) incorporates the CBU analysis of member risk profiles; and introduce a differentiated system of contributions based on risk profiles.
- Implement an action plan to reduce the compensation period to seven days and conduct operational feasibility tests of the process.
- Reconsider the terms of arbitrage between: (i) the level of deposit coverage; and (ii) the funding target available. This recalibration should be part of an ambitious action plan based on a transparent, publicly accessible methodology and meant to quickly build the Fund's reserves needed to compensate eligible depositors in case of a concurrent failure of multiple medium-size entities.
- Raise member contributions to enable the FGDR-UMOA to achieve the target ratio over the medium term (in three to four years), while also covering its operating expenses.

Resolution Funding

62. The issue of resolution funding is critical, particularly for a financial system with a weak internal loss-absorption capacity such as the WAEMU's, given the critical importance of minimizing taxpayer costs, as emphasized by the Key Attributes. With an average capital ratio of 11.6 percent at end-2020, which masks a strong heterogeneity across member state entities and high concentrations of loan portfolios, the banking system faces capitalization pressures. A detailed analysis of individual bank data reveals numerous vulnerabilities, where the lack of internal loss-absorption capacity would be striking in the event of a resolution (Tables 4 and 5). This weakness is exacerbated by scarcity of refinancing other than deposits eligible for bail-in. Use of the resolution measure—or even the mere threat of its use—would probably trigger a massive run-on deposits and likely adverse contagion effects throughout the financial system.

63. Given the scarcity of available internal resources within the banking system, it is essential to set up resolution funding mechanisms, with an important potential role for the FGDR-UMOA. Careful planning of resolution funding modalities is an integral part of the resolution planning process at the level of individual institutions but also in the context of preventive work on systemic crisis management. At the system-wide level, a quick mobilization of the resources required for an orderly resolution of a systemic or medium-sized institution failure is not feasible. The legal framework does not provide an option other than recourse to the FGDR-UMOA, nor does it clarify the type of support (e.g., liquidity or solvency support) that the Fund could provide.

64. The FGDR-UMOA's operational capacity to contribute to resolution funding currently appears uncertain and should be strengthened and better aligned with international standards. The FGDR-UMOA is currently charged with financing resolution actions at the CBU's request (2018 Charter, Article 6), which can only take place after all private financing solutions have been exhausted. The FGDR-UMOA Board then considers the request and determines the intervention modalities. But the FGDR-UMOA is not informed until late in this process (i.e., only when the CBU requests its participation in a particular resolution), and consequently is not necessarily involved in the preliminary stages of deciding on the appropriate resolution measure and funding.^{32,33} Moreover, there is no indication of the modalities of the FGDR-UMOA's contributions to resolution funding. In particular, there is no requirement for a "least-cost" intervention in which the Fund's contributions to the resolution would be limited to the costs it would have incurred to compensate depositors in a liquidation, net of expected recoveries. These gaps call for clarification of the legal provisions applicable to the FGDR-UMOA's participation in resolution funding, if only to ensure it is more rapidly available and conforms to international standards.³⁴ The Fund has recently begun reviewing these issues, which could lead to the publication of a procedure.

65. The FGDR-UMOA's capacity to provide compensation is limited, greatly compromising its potential role in resolution funding. As noted above, the Fund's available funds represented only 0.12 percent of total insured deposits at end-2019. Its funding base could, of course, be supported by grants, subsidies, loans, and in case of insufficient resources, even supplemental contributions from member institutions. But it is doubtful that such additional resources could be mobilized on an urgent basis. Accordingly, the more immediate priority for the FGDR-UMOA is to strengthen its credibility. To this end, best practices suggest that FGDR-UMOA demonstrate its capacity to compensate depositors should a significant number of small institutions or several medium-size institutions fail. Until it achieves this objective, the Fund's potential contribution to the financing of any bank resolution will therefore remain highly conjectural.

³² Under the 2018 Charter (Article 37), the BCEAO and CBU must provide the Fund with any information it deems necessary on entities whose resolution it is asked to fund.

³³ While the FGDR-UMOA director sits on the CBU Resolution Board (see Article 5.2 of the Annex and Article 16 of the 2018 Charter), the board is not consulted by the Supervisory Board until the commencement of the resolution, i.e., after the entity is deemed nonviable and with no prospects of a return to profitability.

³⁴ In particular, see IADI Essential Principle 9 (Essential Criterion 8). Based on these standards, the FGDR-UMOA's contribution to resolution funding should also be accompanied by increased accountability (including a requirement for independent audits and ex post review of its interventions).

66. These reservations about the current modalities of resolution funding underscore the need for an action plan that would define ambitious objectives for ensuring adequate FGDR-UMOA resources and establish credible support facilities. Given the Fund's currently limited cash flow, the priority should be to boost its capacity to fulfill its primary function of deposit insurance. But reaching its target ratio—one that provides a fully pre-financed cushion that lends credibility to the funding of a resolution—is doubtful in the short to medium term. Given the uncertainty in the Fund's access to capital markets during a crisis, a prudent approach would be to immediately introduce a backstop mechanism to allow rapid mobilization, thereby avoiding the need for pre-financing, including via a resolution fund separate from the FGDR-UMOA and funded by specific contributions. Actually, the creation of a second fund financed *ex ante* is not in line with the optimal allocation of resources in the region's financial system.³⁵

67. The establishment of a backstop mechanism should be accompanied by robust safeguards to mitigate moral hazard. Given the critical need for rapid availability in an emergency, large-scale financial support can only be provided from public sources and should involve the member states. In this context, it is essential to establish strict guarantees to minimize moral hazard, in line with international best practices.³⁶ This would mean, *inter alia*, that any public financing should be provided: (i) as a last resort after all sources of private financing have been exhausted and solely for the purpose of preserving financial stability; (ii) subject to modalities (e.g., on pricing, maturity, collateralization, and/or intrusive surveillance) to encourage prompt repayment; and (iii) in combination with a mechanism to recover potential losses from shareholders and unsecured creditors, or from the financial system. Certainly, even with such mechanisms for *ex post* loss recovery, determining the distribution of contributions of each member state is a highly sensitive matter. A preferred approach is to pool such contributions across states (to mitigate the bank-sovereign nexus in the WAEMU). This approach would unquestionably need to be implemented gradually until the distribution of financial risks in the region is more homogeneous.³⁷ An alternative could be to negotiate backstop assistance from the FSF, but its mandate would need to be extended to include the mitigation of the risk of propagation not only of sovereign but also banking crises.³⁸

68. Recommendations:

- Integrate the FGDR-UMOA in the early warning process for vulnerable institutions and their potential resolution.

³⁵ See “Managing Systemic Banking Crises—New Lessons and Lessons Relearned” (IMF Department Paper 2020/003) and “Using the FSB Key Attributes to Design Bank Resolution Frameworks for Non-FSB Members” (World Bank, 2020).

³⁶ See “Guiding Principles on the Temporary Funding Needed to Support the Orderly Resolution of a Global Systemically Important Bank (‘G-SIB’)” (Financial Stability Board, 2016) and “Resolution Funding: Who Pays When Financial Institutions Fail?” (IMF Technical Note 2018/001).

³⁷ The distribution could be based, in particular, on criteria relating to the relative importance of the member states' banking system.

³⁸ Created by the CM in May 2012, the FSF provides emergency assistance to member states and supports the harmonious development of regional financial markets. The FSF's funding currently stands at CFAF 67.8 billion.

- Introduce a requirement for a “least-cost” intervention in the FGDR-UMOA’s contributions to bank resolution funding, including in determining the contribution amounts.
- Establish a public backstop mechanism for the FGDR-UMOA—involving the member states on a pooled basis or the FSF—to ensure that the resources required to finance a bank resolution can be rapidly mobilized if needed. This mechanism should be subjected to strict safeguards to mitigate moral hazard.

EMERGENCY PLANS AND PREPARATION FOR CRISIS MANAGEMENT

69. The financial safety net consists of multiple stakeholders with well-defined mandates, thereby facilitating an effective network. A number of BCEAO units, in particular the Directorate of Financial Stability, the Directorate of Banking Activities and Alternative Financing, the national directorates, and the CBU Secretariat General are involved to varying degrees in monitoring systemic risks and financial stability, as well as managing bank crises. The other oversight authorities—including the WAEMU Regional Public Investment and Financial Markets Board and the WAEMU Insurance Company Supervisory Commission—have similar mandates in their respective sectors, but also geographic perimeters that extend beyond the WAEMU. The FGDR-UMOA also plays a key role in the liquidation of credit institutions and funding of bank resolution measures. Finally, foreign supervisory and resolution authorities are of critical importance in light of the preeminence of cross-border groups in the WAEMU banking landscape. An appropriate institutional framework should be established among all actors in the financial safety net both to facilitate cooperation in crisis situations and establish better operational preparedness.

A. Institutional Framework

Intra-Regional Mechanisms

70. The financial safety-net participants are individually invested with broad powers to exchange information, which facilitates policy coordination. The legal framework grants the CBU access to any information deemed useful for the exercise of its powers, including the preparation of resolution plans and the preparation or implementation of bank resolutions. It also permits the CBU to provide information to other supervisory or resolution authorities, subject to cooperation agreements that safeguard the reciprocity and confidentiality of these exchanges. The CBU has signed a convention with the WAEMU Regional Public Investment and Financial Markets Board, a memorandum of understanding with the FGDR-UMOA, and a charter with the insurance and pension regulators (Inter-African Conference on Insurance Markets and Inter-African Conference on Social Security). If needed, the CBU may also establish a crisis management committee for entities covered by the resolution regime. The FGDR-UMOA, in turn, is also authorized to enter into cooperation agreements with any other authority as needed for the performance of its functions. In addition to these inter-institutional exchanges, the current framework permits information sharing among key

stakeholders. These include permanent members of the CBU Resolution Board—the BCEAO governor, the member state representative who chairs the CM, and the FGDR-UMOA director—and the minister of finance affected by the implementation of the resolution measure.

71. The creation of the CSF-UMOA in 2010 also provided a framework for multilateral discussions which, while still under development, would enhance information sharing and coordination among participants in the financial safety net. The CSF-UMOA could serve as a relevant forum for crisis preparation and management, given its broad mandate that includes information sharing in support of risk and vulnerability assessments, recommendations on corrective measures, and implementation monitoring. While the CSF-UMOA generally meets on a semiannual basis, its internal regulations require its members to exchange information continuously. This is especially important when significant surveillance measures are imposed on the covered entities, including banks, insurance companies, and pension funds. Appropriate guarantees are instituted to protect the confidentiality of any non-public information received by the CSF-UMOA, permitting it to play a lead role in a crisis. To date, the Committee has issued numerous banking sector-related recommendations (mostly aimed at strengthening risk monitoring), but it is not expected to play a full-fledged operational role. Accordingly, it has not prepared a crisis management plan or conducted a crisis management simulation exercise.

72. The framework for information exchange and cooperation should be optimized to ensure timely, effective, and legally sound interaction among financial safety-net participants. Certain legal gaps must be closed. The FGDR-UMOA is authorized to receive information from the BCEAO and the CBU but only for entities whose resolution it has been asked to fund (i.e., at a late stage of a potential crisis).³⁹ The FGDR-UMOA is also not a member of the CSF-UMOA, despite its potential central role in resolution funding, hence crisis management.

Cross-border Mechanisms

73. The legal framework recognizes the general principle of cross-border information sharing and coordination among the competent authorities. The general power to conclude cooperation agreements with other institutions to support the performance of their respective missions, which is legally conferred on the CBU and the FGDR-UMOA, does not rule out the conclusion of such agreements with foreign authorities. Actually, the CBU has already signed agreements with nine supervisory authorities, while the FGDR-UMOA has signed only one (with a foreign guarantee fund).

74. These mechanisms can be improved to better align the implementation modalities with international standards. In particular:

³⁹ As provided by Articles 6 and 37 of the revised charter. Under the terms of the October 2020 protocol between the CBU and the FGDR-UMOA, the Fund is only entitled to receive the risk profiles of its members by December 31 of each year. The implementation of this exchange of information, however, is contingent on finalization by the Fund of a differentiated fee structure.

- The obligation of confidentiality and reciprocity in information sharing should apply not only to the CBU, but also to the FGDR-UMOA.⁴⁰
- The legal framework should require the CBU to consider the impact on financial stability in other jurisdictions whenever it imposes a discretionary national measure.
- The legal framework should specify how resolution measures imposed by a foreign resolution authority are applied to a foreign entity's subsidiary established (and licensed) in the WAEMU. Such measures might be directly recognized, or specific transposition measures might have to be adopted. These gaps in the legal framework require more attention when there is no provision encouraging the CBU to reach a joint solution with the relevant foreign resolution authorities (Key Attributes 2.3 and 3.9) and when no resolution plan has yet been prepared, including for cross-border groups. In this context, there are two major areas of uncertainty. The first concerns CBU's capacity to justify a resolution strategy (single point of entry or multiple points of entry) and adapt it to cross-border group modes of operation and financing. The second concerns the degree to which various authorities involved can coordinate in the context of a resolution plan.

75. The accords signed by the CBU with foreign authorities reflect these gaps in the general legal framework. All nine signed agreements—seven of which were signed prior to the amendment of the Annex on resolution—mention shared recognition of the "mutual benefit to be derived from close cooperation," but only four include an explicit requirement to coordinate on addressing financial market difficulties and resolving crises. While most agreements specify that any shared confidential information may be used only for legally justified supervision, only one provides for coordination on the preparation of resolution plans or possible cooperation on participation in a crisis management committee for a relevant global systemically important banking (G-SIB) group. These agreements should thus be amended to incorporate resolution-specific requirements, and, in any event, many agreements with other authorities still be negotiated.⁴¹

76. Coordination among international colleges has also proved weak insofar as it is still only limited to issues of supervision. The CBU has not yet established resolution colleges for groups of which it is the home country authority. It also does not participate in any resolution college as host country authority and is not a member of any crisis management group established by foreign (home country) authorities, despite the systemic character of certain subsidiaries of G-SIBs in some member states. These weaknesses affect cooperation on preparing resolution plans and conducting resolvability reviews of SIBs belonging to cross-border groups and should be addressed in the preparation of initial resolution plans (which were previously expected by end-2021).

⁴⁰ Even for the CBU, the legal framework should be strengthened to protect the confidentiality of non-public information received from other authorities, both national and foreign (see Key Attribute 12.3 – EC 12.3).

⁴¹ In particular, the agreements between the European Central Bank and the British, South African, and Mauritanian authorities.

77. Recommendations:

- Include the FGDR-UMOA in the composition of the CSF-UMOA.
- Amend the FGDR-UMOA charter to introduce obligations of confidentiality and reciprocity in information sharing within the framework of exchange agreements with foreign authorities and conclude the necessary agreements with the relevant authorities.
- Introduce in the legal framework a recommendation that the CBU assess the impact on financial stability in other jurisdictions when adopting a national resolution measure.
- In information exchange and coordination agreements between the CBU and foreign resolution authorities, introduce an explicit obligation to cooperate and coordinate on addressing bank difficulties and resolving crises, as well as an obligation to cooperate in the preparation of resolution plans, at the very least plans for SIBs.
- If CBU does not participate in crisis management groups for G-SIBs (e.g., when their WAEMU-licensed subsidiaries are not material for these groups), strengthen and institutionalize the CBU's cooperation with home country authorities, particularly in analyzing resolvability and the potential implications of a particular resolution strategy on WAEMU's financial stability.

B. Crisis Management Plans and Crisis Simulation Exercises

78. Sound preparation for crisis management also calls for the preparation of emergency plans to make the network of financial safety net stakeholders more operational. The preparation of a bank crisis scenario takes different forms based on the gravity and nature of the crisis. An idiosyncratic crisis of limited scope should only involve a limited number of stakeholders (e.g., the CBU and the FGDR-UMOA). In contrast, a systemic crisis would likely involve a wider range of stakeholders. In cases where a crisis affects an entity whose failure could have a significant impact on the financial stability of one or more WAEMU member states, the CBU Resolution Board has already defined a nine-step procedure.⁴² However, this procedure only involves the CBU and the FGDR-UMOA. If ELA is necessary, the BCEAO should also be involved. Similarly, the importance and sensitivity of resolution funding issues clearly supports the need for an early dialogue with member state representatives. The potential implications for related entities operating in other financial sectors would also necessitate cooperation with relevant oversight authorities.

79. Faced with these multiple demands and in the absence of a dedicated entity that still needs to be created, the CSF-UMOA—expanded to include the FGDR-UMOA—could offer an appropriate framework for preparing a crisis management plan involving all stakeholders.

⁴² The nine steps include: (i) resolution preparation; (ii) request for resolution of an entity; (iii) initiation of resolution procedure; (iv) takeover of the entity; (v) request for FGDR-UMOA intervention; (vi) consultation and selection of potential acquirers; (vii) application of resolution measures; (viii) monitoring of the resolution procedure; and (ix) close-out of the resolution procedure.

Given the primary macroprudential role of the CSF-UMOA, plan preparation could still be conducted by dedicated committees or task forces, with the participants' geographic scope of authority strictly aligned with that of the WAEMU and based on the model envisaged by the CSF-UMOA internal regulations (Article 7). The Committee's goal should be first to ensure the consistency of respective authorities' roadmaps. It should also ensure that their available human resources (and those of advisory firms) are adequate to assume special administrator functions; undertake tasks related to the valuation and transfer of assets and liabilities; search for third-party acquirers; and create bridge entities. The development of a centralized communication policy would also be part of this planning effort.

80. As an extension of the planning process, it would also be desirable to conduct crisis simulation exercises. No such simulation has yet been conducted by the authorities. The objectives of such exercises would be to test the operational aspects of crisis management plans mentioned above and the internal procedures manuals of the different authorities; the adequacy of their respective mandates; the legal robustness of their information exchange and cooperation agreements; and the interoperability of their information systems. The ultimate goal would be a "hands-on" evaluation of the feasibility of resolution strategies, such as the resolution plans theoretically adopted in 2021 for SIBs, financial companies, and parent credit institutions. In the interest of pragmatism, it is advisable to first conduct these exercises in a regional context and to draw initial lessons at the regional level. Afterwards, the effectiveness of relationships with non-WAEMU authorities in the context of a more complex exercise could be evaluated.

81. Recommendations:

- Establish a crisis management plan, preferably in a multilateral context under the auspices of the CSF-UMOA or a dedicated committee that is yet to be set up.
- Conduct crisis simulation exercises at the regional level and in the longer term extend these to account for cooperation with non-WAEMU authorities.