



# GEORGIA

## TECHNICAL ASSISTANCE REPORT— OPERATIONALIZING THE NEW BANK RECOVERY AND RESOLUTION FRAMEWORKS

March 2023

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# TECHNICAL REPORT

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### Operationalizing the Bank Recovery and Resolution Framework—Second Mission

**March 2023**

**Prepared By**

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**Monetary and Capital Markets  
Department**

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**GLOSSARY**

BCL	Business Continuity Plan
BSD	Banking Supervision Department
CCG	Crisis Coordination Group
CoCo	Contingent Convertible Bond
DIA	Deposit Insurance Agency
DIF	Deposit Insurance Fund
EIM	Early Intervention Measures
ELA	Emergency Liquidity Assistance
FOLTF	Failing or Likely to Fail
FSB	Financial Stability Board
FSC	Financial Stability Committee
FTE	Full Time Equivalent
GFSR	Group of Financial Sector Regulators
IADI	International Association of Deposit Insurers
ICAAP	Internal Capital Adequacy Assessment Process
IFSC	Interagency Financial Stability Committee
ILAAP	Internal Liquidity Adequacy Assessment Process
IMF	International Monetary Fund
ISSA	Insurance State Supervision Service
IT	Information Technology
KA	Key Attributes of Effective Resolution Regimes for Financial Institutions
LAC	Loss-Absorbing Capacity
MCM	Monetary and Capital Markets Department
MoF	Ministry of Finance
MOU	Memorandum of Understanding
MPE	Multiple Points of Entry
NBG	National Bank of Georgia
NCWO	No Credit Worse Off
NPL	Nonperforming Loan
P&A	Purchase and Assumption
RLD	Resolution and Liquidation Division
SCG	Securities Commission of Georgia
SIB	Systemically Important Bank
SPE	Single Point of Entry
TPF	Temporary Public Funding
TA	Technical Assistance

## PREFACE

At the request of the National Bank of Georgia (NBG), the Monetary and Capital Markets (MCM) Department is providing technical assistance (TA) to the Georgian authorities, including the NBG, the Ministry of Finance (MoF), the Deposit Insurance Agency (DIA), and the Insurance State Supervisory Service (ISSA). This was the second TA mission, which took place during September 5–16, 2022, and was preceded by an earlier mission during March 17–April 20, 2022. The first mission provided initial assistance to the authorities in operationalizing the new bank recovery and resolution framework described in the Financial Sector Assessment Program (FSAP) Technical Note titled *Financial Safety Net, Resolution and Crisis Management*, September 17, 2021. This second mission deepened that assistance, with respect to operationalizing the key resolution tools. The TA team for both missions comprised Alessandro Santoni (Mission Chief, MCM), and Antonio Carrascosa and David Scott (both External Experts).

The mission team would like to express its appreciation to Governor Koba Gvenetadze and to the staff of the NBG, MoF, DIA, and ISSA for the excellent cooperation and arrangements made to facilitate its work, as well as for constructive and open discussions.

## EXECUTIVE SUMMARY

**While challenges remain, the Georgian authorities have made progress in implementing the recommendations of the first TA mission.** Drafts of resolution playbooks have been prepared, including for operationalizing the bail-in, sale of business, and bridge bank resolution tools, as well as for the overall resolution process and for resolution funding. Second-round resolution plans for systemically important banks (SIBs) are being prepared, and a first-round plan for another bank that might become subject to resolution has been initiated. At the MoF, an outline and the preliminary contents of a playbook for the establishment, operation, and funding of a bridge bank (which would be owned directly or indirectly by the MoF) has been developed. The four agencies jointly have made progress in establishing the Interagency Financial Stability Committee (IFSC) framework by forming a working group to oversee the development of agency-wide and, eventually, a national financial crisis contingency plan.<sup>1</sup> The Resolution and Liquidation Division (RLD) of the NBG continues to face staffing challenges, however, as unit staff leave the NBG for positions elsewhere. A new head of the RLD was recently appointed following the departure of the previous incumbent after the first MCM mission.

**The focus of this second MCM mission was to support further development of key elements of the resolution regime.** This included presentations and discussions on: (i) playbooks for use of the sale of business and bridge bank resolution tools; (ii) identifying and mitigating impediments to resolution; (iii) data requirements for undertaking the valuations necessary to support resolutions; (iv) resolution funding options, including use of the new Resolution Fund; (v) the preparation of bilateral playbooks to support interagency coordination; and (vi) a simulation exercise on a failing bank.

**In collaboration with the authorities, the mission developed several recommendations** (Table 1) regarding the staffing of the RLD; the build-up of an adequate loss-absorbing capacity (LAC) to make the preferred resolution tool implementable for the two largest banks (bail-in); obtaining certainty on the bail-in-ability of financial instruments issued in foreign jurisdictions (United Kingdom and Ireland); finalizing playbooks on bail-in, sale of business and bridge banks; continuing work on the operationalization of temporary public funding (TPF) and emergency liquidity assistance (ELA); deepening ongoing work on resolution planning; and further clarifying the IFSC's role in individual bank resolution cases.

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<sup>1</sup> See Table 3 for a complete list of actions taken by the authorities after the first mission.

**Table 1. Georgia: Second TA Mission Key Recommendations**

<b>Recommendations and Authority Responsible for Implementation</b>	<b>Priority<sup>1</sup></b>	<b>Timeframe<sup>2</sup></b>	<b>Authority</b>
Increase staffing of RLD while maintaining momentum on ongoing training.	H	MT	NBG
The NBG should require banks to build up adequate levels of LAC.	H	NT	NBG
Seek certainty on the bail-in-ability of financial instruments issued in foreign jurisdictions.	H	NT	NBG
The authorities should hire external legal advice to facilitate the operationalization of the resolution strategies.	H	NT	NBG
Include contractual clauses on bail-in-ability in all new issuances.	H	NT	NBG
Continue steps to operationalize TPF and ELA.	H	MT	NBG, MoF
Finalize the authorities' playbooks on bail-in, sale of business, and bridge bank.	M	MT	NBG, MoF
Continue resolution planning, focusing on operationalization of resolution tools, separability, operational continuity, and liquidity in resolution.	M	MT	NBG
Complete revisions to the creditor hierarchy.	H	NT	NBG, MoF
Clarify the role of the IFSC in individual bank resolution cases.	M	MT	IFSC

<sup>1</sup> H: High, M: Medium.

<sup>2</sup> Near term: < 12 months; Medium term: 12 to 24 months.

## I. INTRODUCTION

### A. Overview of the Georgia Financial System

1. **The financial sector in Georgia is concentrated, with two commercial banks of roughly the same size, TBC Bank (TBC) and Bank of Georgia (BOG), having a combined asset market share of about 75 percent.** Both banks are subsidiaries of parent nonfinancial legal entities listed on the London Stock Exchange and are deemed SIBs by the NBG. Both banks encompass several legal entities licensed and based in Georgia and in a few foreign markets (Azerbaijan, Belarus, and Uzbekistan), some of which are subsidiaries of the bank and others are subsidiaries of the parent entity (sister entities to the bank). The third SIB, Liberty Bank, with a 5 percent share of assets, is a subsidiary of a Georgian company that is a subsidiary of an unlisted Netherlands holding company controlled by three individuals. It has no significant subsidiaries or sister financial entities. There are 11 other commercial banks, including 2 locally owned banks, 7 subsidiaries of foreign banks or financial groups (based in Azerbaijan, Germany, Kazakhstan, the Netherlands, Russia, and Turkey); and 2 foreign-owned banks (in China and the United Arab Emirates). Overall, Georgian banks are well capitalized, liquid, and profitable. See Table 2 for additional details.

**Table 2. Georgia: Financial Soundness Indicators**

(As of June 30, 2022)

	(in percent)
<b>Assets of banks</b>	1H2022
Loans/total assets	68
Net NPLs/total loans <sup>1</sup>	4.7
FX Loans/total loans	48.6
Securities/total assets	9.4
<b>Liabilities of banks</b>	
Liquid Assets/Total Assets	20.7
Total deposits/total liabilities	71
<b>Capital adequacy</b>	
CET1	14.4
Tier 1	16.5
Total capital ratio	20.3
<b>Profitability</b>	
ROA	2.7
ROE	20.7

Source: Central Bank of Georgia.

<sup>1</sup> Local NPL definition.



2. **The economic environment has improved, as COVID-19 has been brought under control but there are new challenges emerging.** Economic growth is strong, interest rates have risen, the exchange rate is historically high, and credit maintains a high growth rate. Increasing international commodity prices have contributed to rising inflation and inflationary expectations. New challenges are emerging. A sharp inflow of people and funds from Russia has put upward pressure on real estate prices. The increasing interest rates trend and the continuing high level of foreign currency lending has increased credit risks.

### B. Authorities' Progress since the First Mission

3. **The mission reviewed with the authorities the steps taken after the TA mission that took place during March 17–April 20, 2022.** The authorities have made progress in implementing the recommendations of the first TA mission. The supervision function agreed to take full control of recovery plan assessments, while it started working on the identification of early intervention measures (EIMs) and on failing or likely to fail (FOLTF) qualitative and quantitative triggers. The resolution function produced drafts of key playbooks while second-round resolution plans for systemically important banks (SIBs) are being prepared. At the MoF, an outline and the preliminary contents of a playbook for the establishment, operation, and funding of a bridge bank (which would be owned directly or indirectly by the MoF) has been developed. The IFSC held its first meeting, where it reviewed progress in implementing the recovery and resolution regime and formed a working group to oversee development of financial crisis contingency plans.

**Table 3. Georgia: Actions Taken Subsequent to First Mission**

<b>First Mission Recommendation<sup>1</sup></b>	<b>Authorities' Actions</b>
<b><i>Near-Term Priorities</i></b> (Taken from Table 1 of the First Mission's Aide-Mémoire.)	
Adopt clear separation of responsibility for recovery and resolution planning between the supervisory and resolution functions.	Implemented.
Invest in recruiting and training of resolution function staff.	New head of the RLD was recruited from within the NBG, and an additional staff position was added. Staff are attending relevant training offered by the Joint Vienna Institute and others.
Establish a small team of senior supervisors with appropriate experience and knowledge to lead and coordinate review of all recovery plans.	Banks' lead supervisors have been assigned lead responsibility for reviewing recovery plans. The RLD has undertaken a benchmarking analysis of the plans to provide consistent feedback to the supervisors.

**Table 3. Georgia: Actions Taken Subsequent to First Mission  
(continued)**

<b>First Mission Recommendation<sup>1</sup></b>	<b>Authorities' Actions</b>
Undertake further work in resolution planning, in particular the ability to implement the resolution tools, to ensure operational continuity and liquidity in resolution, and to enable separability.	Second-round resolution plans for SIBs are being prepared, a first-round plan for another bank is being prepared, and work on playbooks to operationalize resolution tools is proceeding (see below).
Adopt formal work programs involving revisiting key playbooks to identify gaps and incompleteness, setting priorities for remedying those, and initiating work on contingency plans.	Analyzed which playbooks, policy and procedures were most important based on the first IMF TA mission and the FSAP. Prepared draft versions of key playbooks/procedures (bail-in, sale of business, resolution process, resolution fund, bridge bank). An IFSC Working Group has been formed and has initiated work on systemwide crisis management plans.
Introduce a formal playbook and plan testing programs on an annual cycle.	Not yet commenced.
Redraft the IFSC Charter with sections on its role in normal times and in crisis times.	Further work pending discussion during second mission.
<b><i>Medium-Term Priorities</i></b>	
Strengthen the supervisory measures and EIMs regime by clarifying triggers (qualitative and quantitative) for a graduated escalation process.	Work in progress by supervisory function.
Clarify the escalation process for adoption of supervisory measures and EIMs, and for engagement with the resolution function.	Work in progress by supervisory and resolution functions.
Adopt a formal communication policy addressing the use of EIMs.	Relevant departments and divisions have been identified. Work in progress.
Introduce clear standards or indicators of non-viability to help guide FOLTF determinations.	Work in progress by supervisory and resolution functions.
Provide more guidance to banks for preparing and maintaining up-to-date recovery plans.	Recovery rule amended to require banks to adopt trigger indicators (ratios) far above minimum supervisory requirements. Have maintained ongoing engagement with relevant units in banks to ensure NBG feedback is understood and acted upon. Further written guidance to be developed in the near future.
Analyze alternatives to current TPF policies, especially to consider the deployment of all TPF through the resolution fund and to use the DIF to finance resolution transactions.	Have explored some options to get a fully funded resolution fund trying to avoid the use of TPF.

**Table 3. Georgia: Actions Taken Subsequent to First Mission (concluded)**

First Mission Recommendation <sup>1</sup>	Authorities' Actions
Perform stocktaking of contractual clauses in banks' current issuances of subordinated and senior debt to determine whether the bail-in-ability of the instruments is recognized.	Have identified potentially bail-in able liabilities but an assessment of which liabilities can be bailed-in in practice is a work in progress. Key challenge is that most relevant liabilities are issued in foreign jurisdictions. Have initiated communication with the Central Bank of Ireland and Bank of England. Will undertake further analysis to find possible solutions to potential impediments to foreign debt bail-in-ability.

<sup>1</sup> Taken from Table 1 of the first mission's Technical Assistance Report.

## II. RECOVERY PLANNING, EARLY INTERVENTION, RESOLUTION PLANNING, AND RESOLUTION FUNDING

### A. Recovery Planning

4. **The mission reviewed steps by the NBG to reinforce its internal procedures for the supervisory review and assessment of recovery plans.** First-round plans were received early in 2022, and the first TA mission made several recommendations to strengthen their content. That mission recommended establishing a small team of senior supervisors with the appropriate experience and knowledge to lead and coordinate the review of all SIB recovery plans. Also, that the NBG develop templates covering, e.g., early warning and escalation triggers, recovery options, and scenarios as tools that would help communicate the NBG's expectations. The NBG adopted a clear separation of responsibility for recovery and resolution planning between the supervisory and resolution functions. Banks' lead supervisors have been assigned central responsibility for reviewing the recovery plans. The RLD has undertaken a benchmarking analysis of the plans to provide consistent feedback to the supervisors.

5. **The current mission reviewed the benchmarking analysis and acknowledged the significant work done by the resolution function.** The benchmarking tool allowed a clear comparison of recovery options and scenarios among the different recovery plans. This will be important for the assessment while providing banks with useful feedback. The mission suggested further improvement for the benchmarking tool and advised keeping the instrument simple and scalable.

## B. Early Intervention and FOLTF

### 6. **The mission reviewed progress on enhancing the early intervention framework.**

The first mission recommended, as medium-term priorities, clarifying the triggers for a graduated escalation process; clarifying the escalation process for adoption of EIMs and for engagement with the RLD; and adopting a formal communication policy that addresses the use of EIMs. Since the first mission, the supervision function started working on the identification of EIM quantitative triggers. The function acknowledged that the current EIMs framework is basically limited to the temporary administrator powers and agreed to start working on internal guidance to make the instrument more useful for the supervision function. The NBG would potentially consider a wider range of early intervention measures (even overlapping supervisory measures) that could help give a clear warning to institutions that, if they do not change course, they could start the failing or likely to fail procedure.

7. **Further progress is required in two areas.** The current mission reiterated the first mission's recommendation to clarify Article 30 of the Banking Law, which explicitly mentions only the temporary administrator measure as EIMs. The mission understands that the authorities have a more extended view (measures are already included in Article 30, but not explicitly mentioned as EIMs<sup>2</sup>). The NBG also should review its internal supervisory early intervention framework to integrate the activation of recovery plans. The first mission also observed that the authorities have no clear standards or indicators of nonviability/ FOLTF to help guide decisions, and recommended they be adopted. Since the first mission, the supervision function has started working on the identification of FOLTF quantitative triggers.

8. **The mission further discussed the NBG's internal information-sharing arrangements.** As the first mission highlighted, the NBG should ensure that robust arrangements and procedures for the exchange of information between the supervisory and resolution functions are in place. While cooperation is apparently good, it is necessary to formalize that cooperation for times of potential stress, especially with respect to documentation prepared by the supervisory function (e.g., onsite inspection findings, EIMs taken), which will be essential to transmit to the resolution function.

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<sup>2</sup> For example: a) require a bank to implement one or more of the measures set out in the recovery plan; b) require a bank to carry out valuation of a bank's assets and liabilities by an independent valuator approved by the NBG; and c) require changes to a bank's business strategy or to the ownership or to the organizational structure of a bank.

### C. Resolution Planning and Preparedness

9. **The mission delivered a simulation to help the authorities benchmark their progress on resolution planning and preparedness.** The mission gave the authorities stylized information on a failing bank. The authorities were asked to consider: (i) whether the bank should go into resolution or liquidation; (ii) the use of the different resolution tools and their impact on uninsured domestic and foreign deposits; (iii) challenges posed by a large share of retail investors in the subordinated debt issued by the bank; and (iv) the possibility of contagion to other domestic banks and the impact of the different options on risks to taxpayers. Finally, they had to calculate the amount of temporary public funding needed to recapitalize that bank under different scenarios of private burden sharing, and to set safeguards if the use of public funds proved necessary to preserve financial stability.

10. **Recommendations made in the first TA mission on setting up the RLD are still pending.** Within a few months of the first mission, the two highest ranked staff of the division have left; indicative of wider problems with staff retention. Relocating the RLD to the Financial Stability Department, which reports directly to the governor, is expected during the fourth quarter of 2022. As the first TA mission highlighted, the NBG should ensure that arrangements and procedures for the exchange of information between the supervisory and resolution authorities are in place. While good so far, it is necessary to formalize cooperation, especially with respect to documentation prepared by the supervisory function (e.g., onsite inspection findings, EIMs taken), as transmission to the resolution function will be essential.

11. **The NBG is in the process of preparing second-round resolution plans for the SIBs and has begun preparing a first-round plan for another bank, following on the development of first-round plans for the SIBs earlier this year.** The RLD is focused, in its resolution planning activity, on the development of stress scenarios to assess the possible funding gaps in resolution. This is positive, although some assumptions of that analysis should be more realistic, and further work is needed on the implementation of resolution tools, operational continuity, separability, and liquidity in resolution. Interaction with banks is crucial at this stage, especially on the management of information systems, operational continuity, liquidity arrangements, governance, etc. Some (non-substantive) impediments to resolvability can be removed through that interaction. The monitoring process by the NBG should evolve progressively, using more testing, deep-dive exercises, and onsite inspections.

12. **While progress has been made, further steps are needed to implement resolvability assessments.** These include putting in place a clear framework of the RLD's expectations for banks, issuing operational guidance on relevant topics, establishing a phased-in approach to achieving resolvability across the different areas (for example, the capacity of absorbing losses and recapitalizing the bank by means of building up LAC) and prioritizing the resolvability assessment of some categories of banks (for example, the largest

ones). Initial drafts of playbooks for use of the bail-in, bridge bank, and sale of business resolution tools have been developed by the NBG and the MoF has identified the contents of a playbook for bridge banks and resolution funding (use of TPF).

13. **The mission provided significant inputs and held lengthy discussions on preparing for the use of the bridge bank tool and related funding requirements.** Both the MoF and the NBG need to undertake further work. The MoF's main tasks relate to its role as the direct, or indirect, owner and operator of the bridge bank and as the gatekeeper for the use of TPF to support resolution. The MoF should address the modalities of funding the bridge bank to ensure meeting its capital and liquidity needs, streamlining the decision-making process, and identifying and preparing for steps necessary to pass an amendment of the Annual Budget Law. Parliamentary approval of such an amendment would likely be required to provide TPF.

14. **The NBG's outstanding tasks pertain to the need to develop a viable resolution scheme and to estimate potential funding requirements and sources.** Pre-planning is required for the valuation and transfer of assets, liabilities, contingent claims, staff, operating premises, etc., to the bridge bank. The transfer perimeter—those components of the bank in resolution that will be transferred to the bridge bank—will need to be determined, with the objective of ensuring the resulting bridge bank is adequately capitalized and liquid, and operationally sound and functional. Required structural and operational changes must be identified in advance, as certain contracts may need to be amended to enable their transfer, and potential litigation risks and tax implications would need to be assessed, etc. Arrangements to obtain the MoF's concurrence for TPF and/or to indemnify NBG funding<sup>3</sup> are required. In addition, the RLD will need to prepare a list of pre-selected candidates to undertake valuations,<sup>4</sup> ensure continued access to financial market infrastructures, and ensure banks' capabilities to provide accurate and timely information to support resolution planning, and at the point of resolution.<sup>5</sup> Other tasks include the Legal Department elaborating templates and drafts for all the decisions, addressing the set-up and operation of the bridge bank, including the identification of candidates with an adequate technical profile to serve as supervisory and management board members (in cooperation with the NBG), the approval of internal procedures to specify how various tasks must be completed, and the Communication Department developing a communication plan.

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<sup>3</sup> Under the provisions of the NBG Act, the NBG must also obtain a MoF guarantee in order to provide any ELA to a bank pending or undergoing resolution.

<sup>4</sup> Including a draft Request-for-Proposal.

<sup>5</sup> The mission also provided advice on preparing MoF-NBG bilateral playbooks addressing coordination in the use of the bridge bank tool and in resolution funding.

15. **Requiring banks to build up LAC in a timebound manner will progressively reduce the potential contingent liability of the MoF to provide TPF for resolution funding.** The dollarization of the Georgian economy, including the public sector, could increase the sovereign/banking loop in some circumstances. To reduce that risk is an additional reason to strengthen the banks' internal capacity to absorb losses. The current banking market structure, with two very large banks, raises many resolvability challenges. The preferred resolution strategy for these two banks is bail-in, although its application could generate financial stability concerns in some circumstances. To reduce those concerns, the build-up of adequate LAC is needed. The current high level of bank profitability should encourage the authorities to start the process. The mission provided advice on setting LAC targets for the SIBs.

16. **The authorities should take further steps to minimize legal uncertainty as to whether resolution decisions will be sustained by relevant courts.** This is especially the case with respect to the feasibility of bailing in the significant volume of SIB debt that has been issued in Ireland and the United Kingdom. The NBG has initiated discussions with the bank resolution authorities in Ireland and the United Kingdom. However, until such time as debt contracts contain contractual clauses stipulating their ability to be bailed in at the NBG's sole discretion, legal uncertainty will remain unacceptably high. The mission recommended the NBG seek the advice of external expert counsel and suggested an effective way to obtain this advice would be to require issuing banks to obtain expert external legal opinions. The authorities agreed with this approach.

17. **The high concentration of the Georgian banking market poses distinct challenges to applying the sale-of-business tool.** A way to tackle the problem in an asset sale transaction is to open the bidding processes to large international investors (especially banks) and to make, in general, domestic market more investor friendly.

18. **Another potential impediment to resolvability is linked to the banks' capacity to provide the necessary data for many resolution purposes in a timely manner.** As templates provided by the NBG are crucial to promoting banks' preparedness, the mission provided examples for valuation, preparation of a resolution scheme, and setting up a virtual data-room.

#### **D. Resolution Funding**

19. **The mission discussed resolution funding options with the NBG and the MoF.** The first TA mission had suggested that, to the extent practical, all resolution funding by the MoF be delivered through the conduit of the new ex post-funded resolution fund, repaid by levies on the banking industry following a resolution, and that the authorities explore the potential for creating a source of ex ante funding. The MoF's policy position was that the

MoF's direct funding would only be provided for the purpose of capitalizing a bridge bank,<sup>6</sup> and the mission recommended that mechanisms be explored so that even this funding could be channeled through the resolution fund, where the banking industry would ultimately be responsible for covering any losses incurred. The MoF is considering the options in this regard and the NBG has begun exploring the potential of creating an ex ante fund as a complement to the resolution fund. Ex ante resolution funds are becoming common in several jurisdictions (e.g., in Europe), but there are still some challenges that would need to be taken into consideration.<sup>7</sup>

20. **The operationalization of the use of the TPF has institutional implications.** First, the MoF and the NBG should develop an internal contingency policy framework that will help ensure a shared understanding of situations that might arise and facilitate rapid decision making. Second, still to be determined by the MoF are the budget accounting and reporting implications of the provisions of TPF, and whether parliamentary approval would be required. Third, if the provision of TPF by the MoF is subject to parliamentary approval, the MoF should prepare templates for the documentation that would need to be sent to the government and to the parliament to secure approval.

21. **The need to ensure adequate funding for liquidity pre- and post-resolution was discussed.** The NBG can lend to a bank pending or undergoing resolution against a wide range of collateral. To do so, it must obtain an MoF guarantee, which is at the MoF's discretion. The MoF can provide liquidity funding directly, too, but also indirectly. Here again, the budget accounting and reporting, and parliamentary approval implications, are still being assessed. The mission recommended that the MoF should rely as much as possible on the NBG's expertise.

22. **The mission emphasized that operationalizing ELA in resolution requires prior institutional arrangements.** A formal joint agreement between the MoF and the NBG for the execution of the MoF guarantee for ELA is needed. This agreement should also address the MoF's expectations regarding the NBG's additional collateral requirements for ELA.<sup>8</sup> The agreement should define in detail the procedures for putting in place the guarantee, and

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<sup>6</sup> The legal framework provides for a broader range of potential uses of direct MoF funding.

<sup>7</sup> For example, opportunity costs through lower bank profits (potentially reducing capital or dividends, and lending) with resources invested in low return safe assets; it may need to be large to cover systemic risks—earmarking a large pool of (scarce) national savings; a paid-in fund may fuel the perception that uninsured creditors will be bailed out, increasing moral hazard (more than an ex-post fund). *“Resolution Funding: Who Pays When Financial Institutions Fail?”* Oana Croitoru, Marc Dobler, and Johan Molin, Technical Notes and Manuals 18/01, 2018, IMF Monetary and Capital Markets Department.

<sup>8</sup> As of Art 33.d Organic Law of Georgia on the National Bank of Georgia.



for calling upon the guarantee in the event of a default on the ELA and a consequent loss, including the roles of both parties in the different steps of the decision process.

23. **Another potential source of funding for resolution should be the Deposit Insurance Fund (DIF).** There are arguments for using the DIF to support bank resolutions and not just for paying out depositors in liquidation; bank resolution and deposit insurance have closely aligned roles in preserving financial stability and preventing bank runs. There are significant efficiency gains by maximizing value and reducing disruption when transferring deposits from the failing bank to another bank. This approach requires robust safeguards (e.g., “least cost” test relative to the alternative of bankruptcy and a payout) and adequate resourcing.

24. **In Georgia, the Deposit Insurance System works as a paybox only, and allowing alternative uses of the DIF would require a change in legislation.** As noted in the 2021 FSAP Technical Notes on Financial Safety Notes, the power to transfer assets and liabilities to an acquiring bank is explicitly available under the liquidation legal regime. The authorities should amend the legal regime to enable the DIF to be able to fund P&A transactions in liquidation, if it is a lesser cost for the DIF. In addition, the authorities should consider amending the DIA legal regime to make available the P&A/transfer tool for use with smaller banks.

### III. CREDITOR HIERARCHY IN LIQUIDATION AND RESOLUTION

25. **The authorities provided the first mission with a proposal for a revised legal text for the creditor hierarchy and the second mission discussed the authorities’ remaining questions and concerns.** The main concern held over from the first mission was the status of the Pension Agency. The Pension Agency collects mandatory pension premiums and is a large depositor in the banking system. The authorities raised a new question regarding the proper status of nominal accounts, which are single deposit accounts in which the accumulated funds of many individual clients are held, for example, by law firms and e-money providers. The mission reiterated the view expressed in the first mission that the Pension Agency should rank higher in the hierarchy than it does currently. The authorities committed to undertake further internal discussions on the matter.

26. **The mission discussed the nature of nominal accounts, including their status under the deposit insurance regime.**<sup>9</sup> While sponsors of nominal accounts are required to be able to identify daily the holdings of individual clients, there is no separate deposit insurance coverage for the individual clients. The mission recommended, in line with the

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<sup>9</sup> Nominal accounts are the deposit accounts of, for example, a notary, lawyer, law office, securities market intermediary, the Pension Agency, or payment service provider, which holds collectively the funds of multiple clients.

IADI general principles, that nominal accounts not be provided any special treatment in the creditor hierarchy. The remedy to the authorities' concerns is for the owners/sponsors of nominal accounts to enter security arrangements with the banks with which they do business, to ensure that the funds are collateralized, and to consider arrangements eventually to extend deposit insurance protection to the individual clients within a nominal account.

#### IV. INTER-AGENCY CRISIS PREPAREDNESS AND COORDINATION

27. **The mission provided additional guidance on the nature and content of the various bilateral playbooks that were identified during the first mission.** Bilateral playbooks are required to address joint NBG-MoF coordination in the context of potential use of the bridge bank resolution tool, and in the provision of resolution funding in the form of TPF and ELA. The NBG and the MoF should consider whether a broader coordination framework addressing a systemic crisis scenario involving, for example, the potential failure of several banks simultaneously, should be documented by means of a joint playbook. The joint playbooks for bridge banks, TPF, and ELA could potentially be incorporated into such a broader coordination framework playbook. The NBG and the DIA require a joint playbook for coordination in case a bank might be declared FOLTF and put into liquidation. The DIA and the NBG require a joint playbook that addresses the eventuality that the DIA needs to liquify the DIF investment portfolio. The DIA and the MoF require a joint playbook for coordination in the event the DIA needs to borrow from the MoF to replenish the DIF.

28. **The mission focused on the role of the IFSC in individual bank failure resolution cases.** The IFSC held its second meeting in June 2022, where it reviewed progress in implementing the recovery and resolution framework as well as the recommendations of the first TA report, among other agenda items. As recommended in the first TA mission, it formed a Working Group to oversee development of individual agency financial crisis contingency plans, leading eventually to a national plan. The current mission observed that the provisions of the NBG Law, the MoF-NBG Joint Regulation on Temporary Public Funding and the Resolution Fund, and the IFSC Charter all address a potential IFSC role in individual bank resolution cases. We envisage for the IFSC a coordination and consultancy role, rather than a decision-making role within the resolution process, as members should retain their independent decision-making authorities according to their mandates. The mission highlighted the need to consider revisions to the MoF-NBG Joint Regulation and the Charter, based on agreements reached by the MoF and the NBG in developing the bilateral playbook(s) on resolution funding and bridge banks, which in turn would be based on the MoF and NBG internal playbooks.