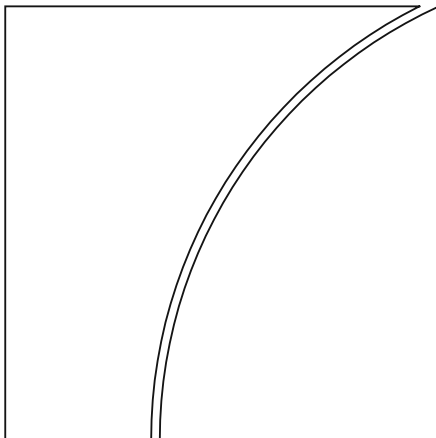


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## Cross-border Crisis Simulation Exercise in Latin America

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Authorised by the Chair of the FSI, Fernando Restoy.

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## Abstract

In February 2024, the Financial Stability Institute (FSI) of the BIS, with the support of experts from the advisory firm Oliver Wyman, conducted a cross-border Crisis Simulation Exercise (CSE) involving authorities with responsibilities for crisis response and bank failure management from seven jurisdictions in Latin America: Costa Rica, the Dominican Republic, Ecuador, Guatemala, Honduras, Mexico and Peru.

During the CSE, participants responded to events in a fictional scenario that modelled the increasing financial distress and eventual failure of a regionally systemic cross-border banking group. The objective of the exercise was to provide an opportunity for authorities to test their crisis management frameworks and arrangements for domestic and cross-border cooperation.

This report was prepared by the FSI and consultants following the CSE. It sets out general observations about the conduct of the exercise, divided into three categories: cross-border cooperation, domestic inter-agency cooperation and resolution frameworks and tools.

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# Cross-border crisis simulation exercise in Latin America

## Section 1 – Introduction

Crisis Simulation Exercises (CSEs) are an important part of contingency planning and preparedness. They give authorities the opportunity to test their crisis procedures and arrangements for cooperation and communication in a controlled environment. As jurisdictions globally make progress in adopting resolution frameworks and in resolution planning, there is increasing focus on the role of simulations in developing authorities' capabilities to execute a resolution. Lack of clarity about who should be doing what, and when, can hamper timely and effective intervention. Exercises of this kind familiarise key staff with procedures and can help authorities to develop or improve their crisis playbooks to support timely and effective intervention.

In February 2024, central banks, supervisory and resolution authorities and deposit insurers from Costa Rica, the Dominican Republic, Ecuador, Guatemala, Honduras, Mexico and Peru took part in a CSE based on the failure of a fictional systemic banking group. Each participating authority had responsibilities under its national framework for managing a troubled international bank operating in its jurisdictions. Each was represented by senior decision-makers (eg directors, Deputy Governors), supported by a team of experts from relevant operational units, and each was assigned an observer who was present at all its internal interactions and meetings. The observers' feedback was one of the inputs for the findings and recommendations in this report.

The fictional scenario used in the simulation was designed to test cross-border cooperation and communication in bank failure management. It was developed with a project team composed of staff from the participating authorities to ensure the exercise was relevant and realistic for their own jurisdictions. It was based around Banco Quetzalcoatl (BQ) – a leading international banking group headquartered in Espalanda, a fictional European country, with a subsidiary in each of the participating jurisdictions grouped under an intermediate holding company (IHC) based in Mexico. Each subsidiary ranked among the top financial players and was considered locally systemic in the jurisdiction where it was established. BQ had a group recovery plan that specified a range of options (eg sale of subsidiaries, raising capital at group level) and a resolution plan that established a preferred resolution strategy (PRS). The global group had a multiple point of entry (MPE) resolution strategy, under which the Latin American subgroup would be resolved separately through open bank bail-in applied at the Mexican IHC. Consequently, in effect, Mexico was to act as home jurisdiction for the purposes of the exercise.

The CSE started with the bank attempting recovery measures and ended shortly after each jurisdiction had decided how it would manage the failure. The exercise was divided into three rounds. Round 1 focused on understanding the bank's situation, overseeing the implementation of the bank's recovery measures and imposing any additional supervisory early intervention measures. Round 2 focused on keeping the bank afloat in distress through liquidity support and preparing for a probable resolution. Round 3 centred on the decisions about the resolution strategy to be adopted, locally and regionally. To stimulate cross-border debate and coordination, the impact of the failure was asymmetric across subsidiaries and a shared service centre increased interdependencies and operational complexity.

Participants managed the simulated crisis well, and the exercise prompted authorities to reflect on their frameworks and cooperative arrangements. At the initial stages of the crisis, most participants took an inward-facing approach, focusing on domestic solutions and limiting cross-border interaction primarily to information-sharing about the condition of the local subsidiary and proposed national measures. Action to coordinate a group-wide strategy took place only in later stages of the crisis. This can

be partly explained by the limited resolution toolkit in some of the participating countries and the different speeds at which authorities started to prepare for failure management. This report compiles the observations made during the exercise and suggests recommendations for reflection by authorities as they continue to shape and improve their internal frameworks and cross-border cooperative arrangements.

## Section 2 – Observations and findings

### Overview

The purpose of the exercise was for authorities to test their ability to manage systemic bank failures, with an emphasis on the cross-border dimension. Effective cross-border resolution requires adequate cross-border cooperative arrangements, appropriate tools and domestic coordination. A coordinated outcome depends largely on whether the measures available to authorities under their national regimes enable them to support and give effect to a group-level approach. Accordingly, the exercise focused on those elements and the authorities' ability to support a group-level resolution where that is an appropriate strategy. However, the exercise was not intended to assess the resolution frameworks of participating jurisdictions against international standards. For this reason, the exercise did not benchmark or grade those frameworks against the Financial Stability Board (FSB) Key Attributes.

The findings are organised into three categories: cross-border cooperation, domestic inter-agency cooperation and resolution frameworks and tools. Authorities are encouraged to review their experience and the outcome of the simulation and consider steps to further strengthen their frameworks and crisis management capabilities. We encourage participating authorities to discuss their experience, the findings and lessons learned internally and with domestic and foreign counterparts and to develop roadmaps to address areas where further refinements are needed.

### 2.1 Cross-border cooperation

Although the exercise was designed to foster cross-border communication and cooperation, most participants focused primarily on local financial stability and domestic solutions. The scenario required actions and decisions with cross-border implications such as developing a strategy at local and regional subgroup level, evaluating offers to purchase subsidiaries from potential acquirers, ensuring the operational continuity of the service subsidiary (ServCo) and, where applicable, providing funding to support the resolution strategy. The exercise was designed to foster communication and coordination (eg the bank's resolution plan set out a PRS that aimed to keep the regional group together and there was an attractive offer to acquire that group as a whole). Nevertheless, cross-border interaction was limited, particularly during the first two rounds of the exercise. Participants focused primarily on addressing the domestic situation and the impact on other subsidiaries was generally regarded as a secondary concern. This might be explained by a couple of factors related to national frameworks. First, as is generally the case, authorities' mandates or statutory objectives require them to select and execute resolution measures having regard to local conditions and indicators, with limited or no consideration of conditions in other jurisdictions. This results in a focus on protecting financial stability in their local markets. Second, the limited resolution toolkit available to some of the participants made it difficult to coordinate and execute a group solution.

Cross-border communication was fluid but mainly consisted of exchanging information. During the first round of the simulation, there was barely any cross-border interaction as participants focused on communicating with their national counterparts and developing a domestic action plan. However, as the exercise advanced and the crisis escalated, authorities engaged in frequent cross-border interaction,

including bilateral and college meetings. There was generally a healthy working relationship between participating authorities, even though levels of familiarity differed. However, the extent to which authorities were proactive in cross-border communication varied. While most authorities were conscious of the need to involve others, some were largely reactive, communicating mainly in response to requests from others, and were less mindful of the implications that their decisions could have for other jurisdictions. The primary objective of interactions was to exchange information about the local situation and decisions taken. Nevertheless, at the peak of the crisis communication became more forward-looking, with authorities sharing the decisions and resolution or insolvency approaches they were considering.

College meetings had limited influence on decision-making. There is currently no supervisory college or crisis management group (CMG) that involves all the participating countries, although there are cooperative arrangements that cover a subset of countries such as the (non-firm-specific) Consejo Centroamericano de Superintendentes de Bancos, de Seguros y de Otras Instituciones Financieras (CCSBSO). This led to an interesting contrast in approaches. Members of the CCSBSO quickly established a structured dialogue among themselves and engaged in a forward-looking conversation. At the outset, the CCSBSO determined the bank's recovery options were likely to fail and that deposit insurance funds would be insufficient in each country to deal with the failure of a bank of the magnitude of BQ. It also established the need for engagement with the home authority. By contrast, the fictional college for BQ was generally convened in response to prompts by the exercise facilitators, and the meetings focused on information-sharing rather than functioning as a forum for decision-making. Even in the final round, when the home authority shared the offer to acquire the entire subgroup with the college members, an agreement could not be reached, as some host authorities had already taken local resolution, which prevented that proposed acquisition. Since the CMG or college was fictional, and therefore there were no established procedures to draw on, there was lack of clarity about how it should operate (eg role of the chair, topics for discussion, approach to inviting third parties, criteria for driving decision-making) compared with the CCSBSO. The limited familiarity of participating authorities with each other's resolution frameworks may also have been an obstacle to a coordinated response since the necessary knowledge could not be acquired in the time frame of the exercise.

To the extent that coordination took place, it largely consisted of warning of the implications of local actions on other jurisdictions. Given limitations in national resolution toolkits, in some countries the options for bank failure management were restricted to the discontinuation of operations and/or insolvency with prescriptive triggers or deadlines for such measures. The authorities of those countries were generally aware of the implications of their actions for a group-level resolution strategy. The consequences of such measures were raised at an early stage, and some authorities even delayed the national process (eg by extending deadlines provided to the bank) to facilitate cross-border dialogue. However, information about those measures was generally framed as warnings and there was limited feedback or challenge from other participants. Additionally, there were instances when authorities took unilateral action without explicitly considering the impact of their measures on other jurisdictions.

A group solution was made possible by an offer to acquire the regional subgroup presented in the last round of the exercise. Although the PRS in the group resolution plan, based on writedown and conversion of debt at the IHC, could have generated resources and potentially preserved the Latin American subgroup, there was limited consideration of that plan or a joint resolution strategy at the outset. Each authority focused on developing the approach to be followed for their domestic subsidiary. The offer to purchase the group introduced the possibility of keeping the group together, which had not been discussed up to that point. Most authorities supported this option, apart from a few that had already opened insolvency proceedings since the grounds set out in their framework had been met. In general, authorities showed a strong willingness to collaborate in pursuing the group offer since they perceived that it offered a better solution than the domestically focused alternatives. Interests were aligned in this respect since there were no offers for individual subsidiaries that would have created conflicts of interest by being more attractive than the group offer for a specific jurisdiction. As a result, domestic solutions were treated as backup plans to be pursued if the group sale did not materialise. However, most

participants did not analyse the merits of a group solution in terms of franchise value, financial stability or ease of implementation (although these considerations may have been an implicit motivation for authorities). The explicit reasons appeared to be that the bank management recommended it and the offer price was slightly higher than for individual subsidiaries. Authorities did not discuss in any detail the benefits of preserving the group, the potential negative effects of its breakup, the complexities of separation or the loss of operational interdependencies.

Issues of operational continuity of the shared services provided by the ServCo were not considered extensively, except by the ServCo's host authority. The fictional banking group had a ServCo located in one of the participating jurisdictions that provided (non-financial) critical shared services to all but two of the banks within the regional subgroup. Apart from the home authority and the ServCo's host authority, most participating authorities did not devote significant time to assessing the implications of the breakup of the group for the provision of shared services to former group entities. By contrast, early in the exercise that host authority made efforts to understand the scope of the services provided and raised the issue in negotiations with potential acquirers to ensure services would not be interrupted.

At an early stage, participants identified that the lack of a memorandum of understanding (MoU) could be an obstacle to cross-border information-sharing and, to facilitate the exercise, countries entered into a simulated agreement. Information-sharing MoUs were not in place between all participating countries, and accordingly some authorities could not exchange firm-specific information. The home authority took the initiative of drafting a simulated MoU and asking the other authorities to subscribe to it. In general, they were willing to do so, although one authority pointed out that at the stage of the crisis they were at, there was limited value in the process and it could be a distraction. It is worth noting that authorities with a wider scope of information-sharing agreements already in place had a head start and made use of those existing legal channels and protocols (eg communication management). This demonstrates the value of developing such agreements and arrangements during "peacetime". However, it is noted that since no bank currently operates in all the participating jurisdictions, there is no reason for adopting such arrangements in real life. Since the exercise did not simulate peacetime operations, participants were constrained to negotiate the fictional MoU at a time of stress.

While there were no other evident obstacles to cross-border information-sharing, authorities noted the absence of an explicit provision for cross-border communication in their legal or operating framework. Some participants reported that owing to a lack of guidelines or a protocol on cross-border communication, they were unsure about when and how to involve foreign authorities and the appropriate counterparts to contact at different stages of the crisis. This was exacerbated where authorities did not have the mandate to communicate directly with their foreign counterparts. This was a problem, for example, for deposit insurers responsible for executing a resolution or acting as a liquidator if the framework did not empower them to seek information or communicate for the purposes of preparation. Authorities in that position had to channel communication through other domestic authorities, leading to delays in the process and potential for miscommunication. In general, there was limited awareness of what elements require cross-border coordination and communication.

## 2.2 Domestic inter-agency cooperation

While coordination between authorities at a domestic level was fluid, in some countries there was less clarity about roles and responsibilities, particularly in the early stages. In all countries, communication between domestic authorities was open and all parties demonstrated a strong willingness to keep each other involved. All applied a clear division of tasks in accordance with each authority's mandate. In some cases, a lack of internal protocols establishing when and how to communicate led to situations where the fictional banking group was approached by several authorities from the same country, or to uncertainty about when the resolution authority should participate in meetings with the bank prior to its failure. Where



one authority within a country had an internal communication protocol and another did not, the former was observed to take a more proactive stance and had a clear view of its responsibilities at different stages of the evolving bank failure. While in some countries, authorities activated a “crisis protocol”, in others it appeared that the authorities had no shared understanding of crisis indicators or signs of distress. As the crisis escalated and, where relevant, specified regulatory thresholds were breached, communication became more structured and authorities’ respective roles and responsibilities were clear under the legal framework.

The purpose of meetings between domestic authorities was largely to exchange information. In general, at the beginning of the process, inter-authority meetings were not regarded as a forum for jointly developing a solution. Rather, authorities focused on sharing the information that each had available and their interpretation of the situation it revealed. In some cases, participants identified discrepancies in the type of data required by each authority to undertake their function. For example, some indicators used by resolution authorities differed from that monitored by supervisory authorities. Additionally, authorities often used their interactions to explain the process or evaluation framework they would apply. However, having shared and compared information, some authorities did then focus on creating forums to develop a joint solution.

Some authorities felt that they had not been duly involved in decision-making or provided with sufficient information by their domestic counterparts. For example, some central banks reported that the resolution authority did not share operational details of the resolution strategy that would have been useful for their internal analyses. Authorities also identified potential conflicts in decision-making. This was particularly relevant in cases where liquidity assistance had not been granted or was limited, and the resolution authority considered access to liquidity a key element in stabilising the bank. While this could have been driven in part by the format and time limitations of the exercise, it also points to the merits of developing a shared understanding of the procedures that will be followed and the information needed by individual authorities to pursue those procedures. Participants noted the usefulness of developing documented processes to facilitate properly considered and rapid decision-making.

Existing coordination forums, such as crisis management committees, were used during the exercise although in some cases their utility was hindered by a lack of clarity and structure. Communication between domestic authorities was generally conducted under formal arrangements. Where such arrangements were not already in place, the exercise highlighted the need to establish a forum for coordination. Nevertheless, existing forums were found to have certain shortcomings. For example, in some cases participants identified a lack of clarity in the scope of the committees, when a specific committee should be convened or which authority was responsible for doing so. Furthermore, some participants reported a lack of internal protocols or structure, with the result that discussion topics were set ad hoc. In certain cases, the exercise demonstrated that it would have been useful for the arrangements to include additional authorities. Nonetheless, crisis management committees proved to be an effective tool and participants agreed on the desirability of strengthening them to facilitate coordination and decision-making.

Communication with the public was a key area for domestic coordination. Most participating authorities launched a communication strategy early in the exercise, often coordinated by a designated lead authority. This strategy for some authorities involved not issuing public communications until a resolution had been completed to avoid exacerbating public or market concerns. In some cases, the strategy was supported by an internal protocol and participants had access to prepared materials such as templates for press releases. Authorities coordinated communication activities and aspects such as the timing of any communications, decisions not to issue a public statement or how to frame certain messages. Several countries, particularly those without internal protocols, identified communication as an area for improvement. For instance, in one such country the only public communication was made unilaterally by a single authority without informing the rest.

## 2.3 Resolution framework and tools

The CSE provided an opportunity for participants to test their crisis management frameworks. The primary objective of the exercise was for authorities to practice failure management and decision-making with imperfect information in a situation of mounting time pressure. While the agreed purpose was not to test the adequacy of jurisdictions' frameworks and tools, participants were able to assess how they took resolution decisions based on the options available under their current frameworks and used the available tools to manage the simulated failure of a large cross-border bank.

During the first round, the absence of a playbook affected some authorities' approaches to early supervisory intervention. All jurisdictions increased supervisory intensity, but only some took precautionary measures. One reason for this divergence in approach was the lack of internal guidelines in some jurisdictions, meaning that decisions were based solely on supervisory judgment. At the start of the exercise, all authorities evaluated the situation of the entity. In most jurisdictions, the relevant authorities engaged in an assessment of critical functions, interconnectivity and the possible sources of financing in the event of a liquidity shortfall. In one jurisdiction where the failing bank had a material role in market making for sovereign and corporate bonds, the central bank analysed the implications for market liquidity of its potential withdrawal from those functions. Supervisory authorities focused on forming a view about the situation of the bank and its ability to restore viability through recovery measures. In some cases, supervisors imposed precautionary or corrective measures (eg austerity plan, request to de-risk portfolio, communication plan, limitations to cross-border transfer of assets, no bonuses or dividends, requirement for a regularisation plan).

There was a discernible contrast between the actions of authorities that had a playbook or protocol for early stages of a bank failure and those that did not. The former reviewed the facts of the case against established indicators and determined whether and when to activate their early alert system and crisis management protocol, along with the associated communication plan. In these cases, a first step was to establish that the entity was systemic based on established criteria. In jurisdictions where authorities lacked a crisis protocol or did not follow it, the supervisory authority took the lead and actions were guided largely by experience-based discretion. There was a positive correlation between the authorities that had a more structured approach to crisis management and the degree of detail of the precautionary measures adopted. Some participants with a less structured approach simply intensified supervisory pressure on the entity. One of the participating authorities mentioned that the exercise had demonstrated the need to extend its crisis management protocol to early stages to reduce dependence on officials' judgement.

In general, jurisdictions had a well defined framework for dealing with requests for emergency liquidity assistance (ELA). During the second round, all participants had to evaluate whether to grant ELA to the ailing entity, and no major deficiencies were identified in their decision-making. The procedure and criteria for granting ELA appeared to be well established in all the participating jurisdictions. In most instances, central banks opted not to grant ELA given the deterioration of the entity and the fact that capital had fallen below prudential requirements. One of the authorities that granted ELA required the bank to provide its shares as collateral. Besides ELA, central banks explored other options for liquidity, such as launching a liquidity programme (repo covering credit portfolios) or other options for exceptional liquidity provision.

When the failure of the bank was considered inevitable, participants took preparatory actions that demonstrated a solid understanding of the tools available. In contrast to early intervention, the actions to be taken in preparation for resolution were clearly established in most countries. In general, there was a good understanding of the available tools, although some authorities mentioned there was less clarity about how they would be put into operation or prioritised. Protocols established clear triggers and deadlines for intervention, which were typically legally binding. However, there was less guidance on the evaluation criteria supporting decision-making. In some cases, authorities focused on short-term implications (eg addressing the capital shortfall, avoiding a deposit run) and did not evaluate the longer-

term impact. In other cases, there was a more thorough assessment of the implications of the exit of the entity on the broader economy. Overall, decision-making was largely based on judgment and discussion, often in reaction to external events. Preparatory work proceeded at two different speeds among the participating countries. By the middle of round 2, some had engaged in thorough preparatory work and were ready to initiate resolution, while others took longer to consider the situation critical. This difference was in part driven by the existence of less precise crisis management protocols in some jurisdictions, although it also reflected variations in thresholds or regulatory triggers under national frameworks.

The resolution or insolvency path adopted was largely limited by the tools available. In most participating countries, the resolution frameworks are not currently aligned with the Key Attributes. Many participants reported that the CSE provided evidence of shortcomings in both the resolution tools available and the sufficiency of funding for bank failure management. The impact of such deficiencies was particularly acute when some countries considered options such as a bridge bank or had access to different sources of funding, but these were not available throughout the region. Even where tools were available, the exercise revealed challenges in their application. Given the various offers to acquire the group or specific subsidiaries, a transfer strategy was chosen by most participants, although one country was obliged to proceed with insolvency in accordance with procedural deadlines in their legal framework. A similar rigidity in the crisis management framework was seen in several countries: there were often clear regulatory thresholds which, if breached, would require the closure and winding-up of the entity. For a systemic bank, there is a strong risk that such a process would be disorderly, with a negative impact on market and financial stability.

The resolution strategies pursued depended on available purchasers for individual subsidiaries or the regional subgroup. The preferred option for most countries was to sell the bank to ensure continuity of functions. However, some authorities did not have a well established transfer mechanism. It was unclear how to effect a transfer under their resolution framework, as statutory deadlines required that the sale occur either before the bank was put into an insolvency procedure, when the decision largely depended on the bank itself, or within insolvency as part of the winding-up, which was a slower process and harder to coordinate. In such circumstances, it was not evident which authority was responsible for conducting the sale, as the resolution or liquidation authority often had a narrow mandate focused on managing the insolvency process and could only intervene once the bank had been put into resolution or insolvency. During the exercise, these obstacles were generally overcome through creative pragmatism and communication between authorities. Authorities with clear transfer powers in their resolution framework were generally able to implement the solution more effectively (including in cases where this power had not yet been used) and gave some consideration to practical aspects such as the negotiation process and competition issues.

Where national frameworks were tilted towards insolvency, participants assessed the feasibility of deposit payouts. In the early stages of the exercise, deposit insurers in all jurisdictions reviewed the sufficiency of funds and capacity to respond in the event of the bank's insolvency. Some also assessed options for accessing additional funding given that existing funds were insufficient to cover BQ's insured deposits (and in cases, where it was decided to extend the protection, all its deposits). For most countries, authorities reached the early conclusion that the deposit insurance fund would be insufficient given the size of the entity. Additionally, in some cases the fund was still being built up to its target level. Some also noted that the fund lacked a timely and efficient procedure for repaying depositors, which could lead to a loss of confidence and instability. The country that initiated insolvency proceedings discussed how to undertake a payout to an estimated one million depositors. They decided to structure it as three payment windows, with depositors assigned to each based on the final digit of their account to avoid crowds at the bank appointed as payment agent. Given time limitations, it was not possible to explore the feasibility and implications of the chosen approach.

In general, authorities contemplated an early resort to the use of public funds. Many authorities considered the possibility of providing financing to the failing entity or to cover deposits. When the

provision of such funding was at the sole discretion of the central bank, it was generally drawn on swiftly to protect financial stability. While there was some reference to monetary implications, consideration of the fiscal impact was limited. Where the Minister of Finance was required to authorise or approve the provision of funding, the process for seeking that consent did not always appear clear to participants within the format of the exercise, since it was not set out in legislation or in internal protocols. However, Ministers of Finance did not participate in the exercise and were instead represented by role players who generally had instructions in their engagement with participants to resist early recourse to public funding. There was also an expectation that such funding would not be made available within the time frame required within the narrative of the exercise. In reality, Ministers of Finance are likely to participate in national coordination arrangements (such as financial stability committees) where the question of public funding would almost certainly be discussed in the round with other options.

In most jurisdictions, authorities adopted a crisis communication strategy, although many also identified it as an area for improvement. Most authorities developed a communication strategy and engaged in actions to execute it (issue press release, organise a press conference, request the local bank to prepare a communication plan) and, overall, there was clarity about the role each authority should play in crisis communication. However, in many instances the approach in practice was reactive and unstructured. Authorities discussed internally the best approach to communications (eg when to communicate, whether to organise a press conference, their approach to interviews), and this sometimes led to delays in communicating with the public. Some observers reported that the exercise demonstrated authorities' communication strategies to be outdated, as there was limited consideration of social media. There were some exceptions to the above, particularly where authorities had an established communication protocol and materials they could resort to.

## Section 3 – Recommendations

This section sets out recommendations that build on the findings of the exercise. The recommendations are offered for the consideration of authorities, and focus on the following aspects:

- Crisis preparedness
- Recovery and resolution planning
- Cross-border cooperation in resolution planning
- Resolution frameworks and tools

### Engage in crisis preparedness activities

Most participating authorities would benefit from the development of crisis management protocols. Clear documentation setting out triggers for action at various phases of a bank's deterioration help guide authorities' actions. A framework with qualitative and quantitative indicators can provide common definitions for the authorities to guide their responses as a bank's situation worsens. The framework should link intervention measures, tools and communication expectations to those indicators, with the aim of creating consistent and coordinated proceedings during the run-up to and execution of a resolution or insolvency procedure.

Procedural arrangements should be clearly outlined to facilitate coordination among authorities. Detailed roles and responsibilities should be formalised among authorities, clearly delineating who should intervene in a specific process and when. RACI matrices outlining the four key roles in relation to a specific task or decision – responsible, accountable, consulted and informed – can perform this function as they help define and clarify roles and responsibilities within and between authorities. The extent to which

existing crisis management committees facilitate decision-making should be reviewed. Authorities' data and information requirements need to be mapped out in advance and should be clear to all parties to ensure accuracy and consistency in their decision-making. Additionally, infrastructure (eg data rooms or joint IT platforms) and key contact points are essential for quick and efficient information exchange.

Internal protocols should include decision principles and/or evaluation criteria to facilitate decision-making. A framework for evaluation can support decision-making. This should not be a prescriptive and detailed checklist, but rather a set of overarching principles derived from the existing frameworks, which ideally are developed jointly by the authorities that are involved in or affected by the decision.

Protocols for internal and external communication should ensure robust and consistent messaging by authorities and banks that is appropriate to the circumstances. Communication protocols, covering both traditional and social media, are important to give authorities guidance on the level of engagement, content and level of complexity depending on circumstances and the audience targeted. They often include templates or draft materials to facilitate rapid production and standardise communications where appropriate. The general aim of public communication in connection with a banking failure is to support financial stability by establishing public trust and minimising the risks of panic among depositors and markets. The spread of false information poses a significant risk to a bank and the financial system. Communication protocols must address this risk and help ensure that the public has access to accurate data and is aware of trustworthy sources of information.

Authorities should continue to engage in tabletop and simulation exercises to test elements of the resolution framework and to further enhance crisis preparedness and identify weaknesses. Such exercises provide the opportunity to gain practical experience and to identify opportunities for enhancing frameworks and tools. Existing playbooks can be tested and refined, and informal networks among participating departments, authorities and jurisdictions will be strengthened. Exercises could be included in the annual workplan of authorities and be tailored in content and scope to current needs. It is recommended that exercises be conducted to regularly test and update tools. For example, tabletop or wargaming exercises can be conducted annually and cross-authority simulations every three to five years depending on needs and resources. Topics that can be tested in CSEs include operationalisation of a specific tool (eg purchase and assumption or bridge bank), inter-authority coordination, interaction between the board and senior management of a specific authority, interaction with service providers or market infrastructure in executing a resolution etc. Exercises could also test the capabilities of banks, for example to set up and populate a data room or rapidly provide the information required by authorities for contingency planning or resolution execution.

## Engage in bank-specific recovery and resolution planning

Banks should be required to develop credible recovery plans during business as usual, which can serve as roadmaps for action when the bank encounters stress. The requirement for recovery plans should have regard to proportionality in scope of application and contents of the plan, although a plan should be maintained, at a minimum, for entities that are potentially systemic. A banking group should have a group-level plan. Where host authorities also require individual recovery plans for local subsidiaries, those plans should be compatible with those for other entities within the group. Home and host authorities should discuss the group recovery plan as part of their college activities, whereas recovery plans for individual group entities are generally reviewed by the relevant host supervisor.

Bank-specific resolution plans setting out the PRS should be developed and maintained, at a minimum, for banks that could be systemic if they fail. Where not already in place, national frameworks should include explicit requirements for resolution planning to ensure that authorities can impose obligations on banks and require their support (for example, by provision of information). Resolution authorities should have primary responsibility for resolution planning since the plan sets out the actions

that the authority would expect to take, using powers under the resolution framework. Nevertheless, resolution planning requires detailed information from the bank. Developing a firm-specific resolution strategy and operational plan in advance of any failure should give a common starting point for discussions and a shared understanding of the implications of the strategy, such as risks and contagion effects. For a banking group, the strategy would indicate whether it should be resolved at the level of the parent entity (single point of entry (SPE)), or through a coordinated application of resolution powers to several group entities in different jurisdictions (multiple point of entry (MPE)). The strategy is highly dependent on the legal, financial and operational structure of the banking group, the nature of its activities and how they are organised in the group, operational dependencies between group entities or with third parties, and the nature of its funding arrangements.

Box 1

### Essential elements of a resolution plan<sup>①</sup>

Authorities should develop potential resolution strategies and assess the necessary conditions and operational requirements for their implementation, including arrangements for cross-border coordination. In addition, a resolution plan should identify:

- (i) the resolution powers and tools that would be used to execute the resolution strategy and any restrictions on their use
- (ii) regulatory thresholds and legal conditions that provide grounds for the initiation of official actions (including thresholds for entry into resolution) and scope for authorities' discretion (eg the extent to which authorities can refrain from taking actions or not avoid acting under certain conditions)
- (iii) the internal processes and systems necessary to support the continued operation of the firm's critical functions
- (iv) the critical interdependencies and the impact of resolution actions on other business lines and legal entities (would other entities be able to continue to operate?), financial contracts (do authorities have powers to limit or suspend termination or close-out rights?), markets and other firms with similar business lines
- (v) the processes for preserving uninterrupted access to payment, clearing and settlement facilities, exchanges and trading platforms
- (vi) the range of sources available for resolution funding and a comparative estimate of losses to be borne by creditors under possible resolution strategies
- (vii) the process for disbursements by deposit insurance funds and other insurance schemes (including, for example, identification of insured and uninsured depositors)
- (viii) processes for their cross-border implementation
- (ix) communication strategies and processes to coordinate communication with foreign authorities

<sup>①</sup> Financial Stability Board, *Key Attributes of Effective Resolution Regimes for Financial Institutions*, I-Annex 4 – Essential Elements of Recovery and Resolution Plans, 2014, p 48 f.

A resolution strategy should take account of bank characteristics and different potential scenarios. For example, host authorities should be prepared for the event that the parent bank cannot provide funding to subsidiaries and that strong operational interdependencies within the group are likely to complicate any strategy based on separating subsidiaries. As banks increasingly make use of outsourced and digitised services, this can increase or complicate those inter-group dependencies.

The description of the resolution strategy should be accompanied by an operational resolution plan that details how the strategy would be implemented. This includes the resolution tools that will be used to execute the strategy and how they will be applied, assumptions about sources of liquidity and

funding for the bank while in resolution, the intragroup and third-party support arrangements needed to ensure that the bank's critical functions can continue to operate during and immediately after resolution, and obstacles to the effective application of those tools that have been identified and how they will be addressed. The operational plan might also consider how the authority's general valuation policy would apply to the asset classes the banking group is exposed to and expectations of how the resolved bank will be managed or restructured in the period following the application of resolution powers.

Authorities should monitor institutions' capacity to support the implementation of the resolution strategy as part of the ongoing process of resolution planning and resolvability assessment. Authorities should ensure that banks build the appropriate capabilities and can mobilise them quickly as stress increases. For example, authorities can work with banks to ensure their information management systems are capable of supporting resolution. This may involve testing the ability to provide detailed and accurate information in the format and (short) time frame needed by the resolution authority, to conduct different types of valuation in the run-up to resolution (or supporting external parties in doing so), or to assess the funding and liquidity situation and accessibility of collateral. Banks should be required to demonstrate they have governance and funding arrangements to support protection of critical functions and services in any resolution strategy.

Recovery and resolution plans should be reviewed regularly to ensure the plan remains credible and could be feasibly executed as market and banks' circumstances change. This process generally includes conducting regular resolvability assessments and addressing identified gaps. Resolution plans should also be reviewed following any changes to material aspects of the banking group, its business model, legal entity structure or risk profile. A key objective is to identify potential obstacles to the bank's resolvability. Authorities should have adequate powers to require banks to make changes in their legal or capital structure or business organisation that are necessary to address those impediments. Such assessments are carried out by the responsible resolution authority, in coordination with other authorities in CMGs or resolution colleges where relevant. For larger, complex banks, resolution planning and resolvability assessments are an iterative process.

## Enhance cross-border cooperation in resolution planning

The exercise underscored the importance of having in place appropriate institutional arrangements to support cross-border cooperation and information sharing for planning and executing resolution. Where banks have a significant cross-border presence, cooperative resolution planning is imperative. This is currently undeveloped within the region. Authorities should consider whether there are cross-border banks for which institution-specific cooperative arrangements should be put in place to support resolution planning and information-sharing and to build operational readiness to manage their failure. Within the exercise, authorities that participate in the CCSBSO used that structure as a forum to discuss the condition of the fictional bank and options for managing its failure. However, a regional committee of this nature is not designed for firm-specific resolution planning and the exchange of confidential, firm-specific information that this entails.

Resolution colleges are a suitable forum for building and maintaining a high level of trust and establishing a pattern of cooperation at all stages of resolution planning or execution. In addition to information exchange and coordination on resolution planning, they can be used for advance consideration of the implications of a resolution decision for the jurisdictions where the bank has material operations. A resolution college is generally bank specific and may be a free-standing arrangement or an extended formation of a supervisory college that includes the resolution authorities of all the countries material to the bank's resolution). Effective colleges typically consist of the relevant authorities from the bank's home and material host jurisdictions and are chaired by the home authority, with a clear agenda and guidance on information sharing. It would be beneficial to establish resolution colleges with a CMG-

like formalised structure for any groups with material cross-border operations that could be systemic if they fail, even if non-GSIBs are not formally required to have a CMG.

Colleges can be used to build shared understanding and knowledge of other jurisdictions' frameworks and tools, and the impacts of the firm's PRS. Authorities should invest time in educating members about the resolution frameworks of the participating jurisdictions, including the conditions for entry into resolution or grounds for insolvency and any conditions relevant to the implementation of the resolution strategy. College members should have a clear understanding of how a resolution would proceed and the tools available in other jurisdictions. The exchange should also increase members' understanding of impacts of the preferred strategy on the participating jurisdictions and their financial stability concerns in the event of a resolution. This is to foster a mutual understanding of and trust among the host jurisdictions in the actions that may be taken.

Box 2

## Good practices for cross-border cooperative arrangements<sup>①</sup>

### Structure and operation

- (i) Membership reflects the specificities of the firm, its business model and geographic footprint. In "business as usual" and when working to enhance crisis preparedness, cooperative arrangements generally include the resolution authorities and prudential authorities of the home and relevant host authorities. Some also include central banks, deposit insurers, ministries of finance and other regulatory bodies, largely reflecting the allocation of responsibilities for bank crisis management in the jurisdictions represented. Some home authorities have supplemented the core arrangements with broader regional structures that involve other host authorities.
- (ii) Members' representation in meetings combines appropriate decision-making capacity and relevant expertise. Meetings are generally attended by key decision-makers and technical experts from each authority.
- (iii) It is helpful if the arrangements are underpinned by an institution-specific cooperation agreement setting out expectations about roles, functions and information-sharing between the member authorities.

### Resolution policy, strategy and resolvability assessments

- (i) Members are kept informed of firm-specific and regulatory resolution planning-related developments in home and participating host jurisdictions.
- (ii) Members should review the resolution strategy and operational resolution plan annually or when there are material changes to a firm's business or structure.
- (iii) The arrangements serve as a forum for coordinating resolvability assessments, sharing findings and discussing any remaining barriers to resolvability and plans to remove them.

<sup>①</sup> This box summarises selected practices set out in the FSB paper [Good Practices for Crisis Management Groups](#) (2021). While that paper is based on the experience of home and host authorities that are involved in CMGs for G-SIBs, many of the practices highlighted are relevant to other forms of cross-border cooperative arrangements for regional banking groups.

The process of building knowledge can be assisted through the preparation of college playbooks. Those playbooks could detail decisions and actions to be taken, conditions that must be met and procedures and time frames. Relevant information on resolution regimes of material jurisdictions includes the following.

- Triggers for escalating resolution contingency planning
- Resolution powers available (with timely notification of any changes to those powers)



- The authorities responsible for exercising those powers and time frames for decision-making (eg consultation requirements or approvals that need to be accommodated)
- Conditions for entry into resolution and use of those powers, and any constraints on the exercise of powers
- Domestic procedural requirements (eg any requirements for court approval, information needs) required for the resolution actions to be effective
- Other matters relevant to implementing the resolution strategy (eg possible public disclosures, requirements under securities regulation or rules of trading venues, required regulatory approvals, communication protocols, valuation frameworks)

The process of compiling this information and incorporating it in a playbook is a good discipline that promotes detailed understanding and exposes gaps and uncertainties. The preparation of a procedural playbook, in conjunction with an operational resolution plan, is an opportunity to focus on the practical dimensions of a resolution. This will be beneficial in any bank failure even if the plan and playbook need to be modified in the circumstances of an actual failure.

Informal networks are important for effective coordination in a resolution, and authorities should attempt to build those networks further. This can be done both by building on existing supervisory structures and colleges and by creating further arrangements for engagement, such as non-firm specific regional study groups and knowledge-sharing sessions on crisis management-related topics. Additionally, authorities should continue to engage in testing activities to enhance crisis preparedness.

Authorities should review domestic resolution regimes to ensure that they can support the PRS. Any features that may hinder the successful execution of a firm's resolution plan of relevant entities should be identified to understand and, where possible, remove any obstacles to group solutions.

## Review of resolution framework and available tools

The FSB Key Attributes should inform any improvement of local legal frameworks and tools. While this report is not intended to provide legal advice, the Key Attributes are the international standard for resolution frameworks, and it is generally beneficial for frameworks to be aligned with that standard to the extent appropriate,<sup>1</sup> since the core tools and arrangements set out in that standard are considered international best practice irrespective of the country. While participating countries have tried and tested frameworks to deal with bank failures, in some cases they are mostly centred on liquidation. Authorities should be empowered to develop resolution strategies and adopt measures tailored to market conditions and the circumstances of the bank at the point of failure. Thus, jurisdictions not aligned with the Key Attributes should review their resolution frameworks and toolkits to assess whether they give authorities a sufficient range of powers. The standard specifies that these should include:

- Powers to take control of and operate the bank, either directly or through an administrator; purchase or sell assets; terminate or continue its contracts, or enter into new ones to ensure the continuity of essential services and functions; and restructure or wind down its operations
- Powers to transfer all or selected assets and liabilities of the failed bank to a third party (such as a private sector purchaser or a bridge bank)

<sup>1</sup> Several Key Attributes are specific to G-SIBs, but most of the provisions are applicable to any bank that could be systemic if it failed. While some resolution tools, such as bail-in, may not be appropriate for countries with a banking system that is predominantly deposit-funded, the transfer-based tools, funding arrangements and provisions on administrative resolution authorities, recovery and resolution planning, domestic and cross-border cooperative arrangements and information-sharing are relevant and can be adapted for all jurisdictions.

- The power to establish and operate a bridge bank to take over and continue operating certain critical functions and viable operations of a failed bank
- To power to write down unsecured liabilities of the failed bank or convert them to equity in the bank or a successor institution to absorb losses and/or general capital (ie powers to carry out bail-in within resolution, without putting the failed bank into insolvency)
- Ancillary powers to support a resolution, such as powers to remove and replace senior management, powers to ensure continuity of essential services provided by affiliated entities or third party providers, and powers to prevent or stay enforcement actions by creditors of the bank in resolution
- Powers to secure the orderly wind-down and liquidation of parts of the failing bank

Authorities must be able to exercise any resolution power without needing the consent of shareholders or creditors of the failed bank.

Box 3

## Resolution transfers

Transfers are a flexible tool for the swift resolution of failing banks. There are two mechanisms for achieving them: share deals and transfers of some or all assets and liabilities. Share deals (used in the CSE) are considered comparatively simpler and faster as transferable and non-transferable assets and liabilities can be passed on to a third party. Transfers of assets and liabilities are likely to involve greater complexity in structuring the transaction, but also permit greater flexibility to design marketable transfer packages. Resolution frameworks should allow bulk transfer of asset and liabilities without creditor consent.

Transfers allow authorities to maintain access to deposits and lending capacity, and other critical functions where relevant, thus reducing the risk of spreading a crisis, preserving franchise value and avoiding fire sale liquidation. This tool is also flexible as it can be combined with a partial bail-in or a bridge bank.

Preparation for a transfer is important to ensure that it can be executed swiftly in resolution. Certain preparatory activities can be undertaken in advance of any failure to facilitate the search for potential purchasers and to increase the likelihood of achieving a reasonable price. Banks should be required to prepare for such transactions, including through adjustments to the legal entity and business structure and by ensuring they can rapidly provide the required information and documentation. Considering the complexity and time pressure of sales transactions, authorities should prepare for handling such negotiations by developing guiding principles and procedures, and ensuring the necessary capabilities and skills are available in-house or on call externally.

Timely and meaningful access to the bank's information is key for achieving plausible offers. Authorities should gather information on a bank's operations, details of its balance sheet and the nature of its assets and liabilities to create accurate marketing material and allow bidders to complete accurate due diligence. Where a bank's PRS is based on a transfer transaction, the bank should have the capacity to set up a data room when resolution is contemplated, to enable potential purchasers to examine and assess the options offered. Access to information should be subject to strict confidentiality undertakings on the part of the potential bidder.

A key element is identifying a pool of suitable bidders in advance. The market of buyers should be properly analysed to identify eligible parties based on willingness and suitability. Factors to be considered include:

- Amount and quality of capital held by buyer
- Size of the acquirer' target bank compared with failing bank
- Assessment of long-term viability and profitability of the combined entity
- The bidder's ability to carry on the transferred business, including appropriate licensing status
- Compliance standings
- Competition or antitrust implications (exceptions may be allowed for bigger banks)

The time for starting preparation varies depending on the methods used by jurisdictions to achieve a pool of potential bidders that can be contacted at the time of resolution. In large markets, automated tools are essential to create that pool and track suitable bidders efficiently. US resolution authorities maintain an ongoing list of interested acquirers (filtered in accordance with failing banks' characteristics) to quickly identify bidders when the need arises. In some circumstances, there may be benefits in expanding the pool of bidders (for partial or full acquisition) to include other interested entities such as foreign banks or private equity, subject to licensing requirements and suitability criteria. The process is usually done by resolution authorities with the support of valuers or investment banks which are contracted to assist the authority.

Source: FSI, "Bank transfers in resolution – practices and lessons", *FSI Insights on policy implementation*, no 55, December 2023.

Authorities should consider formalising the conditions and procedures for the use of public funds more clearly, even if it is an instrument of last resort and only used in exceptional cases. Irrespective of the range of tools and privately sourced funding arrangements that are available, it cannot be excluded that public resources might be required to address a systemic failure. This is particularly the case if the safety net capacity is not sufficient for that purpose or full use of that capacity could risk fully depleting the deposit insurance fund or imposing stress on the banking sector through increased contributions to replenish the deposit insurance fund. Situations where fiscal authority support may be needed should be identified in advance, ideally as part of resolution planning. Measures should be taken to limit the probability and size of such support. Crisis management protocols should account for those situations and ensure procedures are clear (eg what funds are available, who needs to approve the support and the process for doing so), not excessively burdensome or time-consuming. When designing public support tools, consideration should be given to how losses incurred by the state would ultimately be recovered.<sup>2</sup>

<sup>2</sup> The Key Attributes specify that, to minimise the moral hazard associated with public support, there should be arrangements to recover funds as far as possible from the shareholders and creditors of the failed bank and, where appropriate, from the industry more generally through mechanisms such as ex post assessments or levies. The Key Attributes Assessment Methodology for the Banking Sector further specifies that the mechanism for recovery from the industry of losses arising from the provision of public funding should be based on explicit provisions in the legal framework.

## Annex

### Participants

The participating authorities comprised central banks, supervisory authorities, resolution authorities and deposit insurers. This composition was based on the roles of those authorities in bank failure management under their domestic frameworks. Central banks participated given their role as macroprudential authorities with financial stability mandates and providers of emergency liquidity (in addition to supervision or resolution functions, where relevant). Where banking supervision is separate from the central bank, the supervisory authority also participated.

Each participating authority was represented by a team assembled from those departments that would be involved in a real crisis. Participants also used established management frameworks such as coordination committees. All authority teams included members of the top leadership that would take the critical decisions in the event of a real banking crisis. This was important for several reasons. First, the decision-making structures and operational setups within the simulation mirrored reality, which strengthens the robustness of the simulation findings. Second, the direct experience of senior officials will foster understanding of the issues and high-level support for any follow-up action. Third, the involvement of top officials facilitated the authorities' decision to make significant resources available for the preparation and execution of the exercise. And finally, the exercise allowed senior decision-makers of various authorities to cooperate, which will strengthen confidence and mutual trust.

Finance ministries did not participate in the exercise. Despite significant progress on bank liquidation and resolution frameworks, it is still likely that fiscal resources would be required if a systemic banking crisis exceeded a certain scale. Existing sources of funding (such as the deposit insurer) might not be sufficient to preserve financial stability. However, this should be the exception, not the norm. For this reason and to limit the complexity of the exercise, it was decided that ministries of finance and treasuries would not be represented. This also helped to increase incentives for participants to work out a solution that would not require the use of public solvency backstops.

The private sector did not participate. Effective crisis management requires engagement with and cooperation by banks. Industry participation could have further increased the realism of the exercise, and simulations do take place between banks and authorities. However, such exercises are of a very different nature. For example, they typically involve fewer authorities and are generally more limited in scope than this exercise – for example, focusing on technical competencies to carry out operational procedures rather than official sector decision-making and cooperation. The inclusion of banks in this exercise would have been inconsistent with the stated objectives of testing the crisis management frameworks and arrangements of the public sector participants.

Stakeholders that did not participate directly were incorporated in the exercise through written material (for example, memos) and role players provided by the FSI, Oliver Wyman and members of the project team. Role players represented the ministries of finance (for questions related to public backstops, but also to put political pressure on participants), bank executives (for questions about the situation of the bank) and potential acquirers (for sales negotiations). Exchanges with role players allowed participants to ask questions and introduced a necessary element of interactivity.

The simulation was orchestrated and supported by a team that consisted of:

- An operations team composed of representatives of the FSI and Oliver Wyman, which ran the exercise
- Role players, as described above, to interact with participants as required

- Observers, one for each participating authority team, who were present at all interactions and compiled observations on the conduct of the exercise in accordance with a checklist. That information was one basis for the findings

## Operational aspects

The simulation was conducted in a virtual format, although participants from individual authorities in most cases gathered physically on-site or opted for a hybrid setting. Within this format, interaction within authorities and between domestic authorities took place physically for those that gathered on-site and virtually for those that chose a hybrid setting. Physical meetings were, however, also linked to video conferencing facilities and accessible virtually by members of the operations team and role players. Interactions across borders and with the operations team took place virtually.

Videoconferencing was used for cross-border discussions and negotiations. In addition to a “plenary room” where all participants gathered for introductions and debrief for each session, virtual “breakout rooms” were used to provide group rooms for each authority and additional “meeting rooms” for bilateral or multilateral discussions between authorities. Overall, the videoconferencing facilities worked well. Although assigning the ~200 participants to virtual meeting rooms gave rise to logistical challenges, participants did not experience material dropouts, and communication was mainly clear aside from occasional audio issues in physical meeting rooms’ conference systems.

A messaging tool allowed participants and the operations team to exchange written messages and documents. The tool provided multiple “channels” so that messages could be exchanged within defined groups, such as all participants of a single authority or jurisdiction. This was also the channel by which the operations team disseminated material and authorities recorded their decisions. The tool came with two important advantages: all interactions were recorded, so that the operations team could rely on these records in their analysis; and textual communication was confined to the platform, clearly separating simulation-related from real life.

The exercise was tested with a dry run with project team members and other representatives of participating authorities. This was necessary to verify that the exercise would work as planned and that the material for participants did not include unintended ambiguities. While the dry run did not reveal substantial problems, it helped identify issues that were addressed to make the exercise smoother, and increased the operations team’s confidence that the exercise was tightly scheduled with no material margin for error.

## Structure

The exercise was divided into three rounds, each focusing on a phase in a stylised trajectory of a bank failure. Real banking failures develop as a sequence of events over days, weeks or months, and actions and the pace of authorities’ response and actions will vary over that period. However, time, resource and conceptual constraints do not allow a simulation to fully replicate this, nor is it necessary to do so to achieve the stated objectives. For that reason, the team opted for a themed, round-based approach. Round 1 focused on early intervention strategies. Round 2 centred on keeping the bank afloat in distress and preparing for resolution. Round 3 focused on the decisions to go ahead with resolution.

Each round took around three hours and started with the operations team providing material to participants, setting the scene for required analysis and decision-making. Information, including financial statements and mock media reports, was released at the start of each round. Additional information was provided during each round to increase the dynamism of the exercise and to nudge participants in certain directions. Most of the information released was pre-scripted, although certain ad hoc adjustments were made to reflect the flow of the simulation or prior decisions by participants (eg reflecting ELA decisions in simplified balance sheets that were provided for each round). Authority teams usually took some time to

review and internalise the information received. In doing so, they generally relied on the relevant subject-matter experts included in their teams. Based on that, participants discussed and decided the course of action. Authorities also had the option of meeting other domestic and foreign authorities to deepen their understanding of the situation, get additional insights on issues that might not have been conveyed to them by the material provided and to discuss and coordinate actions. Authorities could take any decisions within their legal powers. The decisions were communicated to the operations team, generally at the end of each round.

## Details of the scenario

The scenario centred on the failure of a regionally systemic bank – the fictional Banco Quetzalcoatl (BQ). It was designed to be relevant and realistic for all participating authorities, and to achieve a similar level of engagement for all jurisdictions. The scenario included a background story that framed the events in the simulation, including macroeconomic and geopolitical circumstances. BQ was a regional banking group headquartered in a fictional European country, Espalanda, with a strong presence in each of the seven participating jurisdictions, where the local subsidiaries ranked among the top financial players and were considered locally systemic. BQ had a group recovery plan that specified a range of options (eg sale of subsidiaries, raising capital at group level) and a resolution plan that established the PRS. The global group had an MPE resolution strategy, under which the LatAm sub-group would be resolved through open bank bail-in at the IHC based in Mexico. Consequently, Mexico acted as home jurisdiction of the regional sub-group for the purposes of the exercise.

The crisis was rooted in a deterioration of regional macroeconomic conditions that caused the bank to lose viability in all countries represented in the exercise. While several crisis triggers were considered, a macroeconomic scenario that led to a broad recession and corresponding losses in the bank's loan book proved to be the most feasible, as all participating countries could credibly be exposed to it. The balance sheet weakened and equity was consumed, due mostly to a growing share of non-performing loans and increasing provisions. As in real life, participants were confronted with a significant degree of uncertainty about asset quality deterioration. The profitability of the group also diminished, undermining the bank's ability to absorb losses through internal capital generation.

Idiosyncratic crisis events were included to add further challenges to the exercise. Real banking failures are often accompanied by exogenous shocks and unforeseen events – which may be unrelated to the root cause of the crisis – that increase urgency, limit room for manoeuvre or require modification of agreed resolution strategies. For this reason, the simulation also included events such as deposit withdrawals, bankruptcy of large corporates and negative media.

The scenario did not have an ideal outcome. However, it was designed to make cooperative solutions less costly from a broader perspective and better able to deal with intra-group operational dependencies. The objective was to trigger cross-border discussions and decision-making, whilst acknowledging that group-wide action must meet local objectives such as protecting domestic depositors, preserving jobs in the local entity, or containing spillovers to other banks in the system.

The design of the scenario was guided by the following principles to accommodate the constraints of a simulation.

- The purpose of the CSE is to provide an opportunity for participating authorities to test existing crisis management and cooperation frameworks.
  - The CSE is not intended to constitute a test that participants pass or fail. Rather, the aim is to provide independent insights for participants' consideration.

- The CSE is not intended to test the capacity of internal toolkits to perform technical analysis. Any technical analysis required is simplified, since the focus is on testing policy and decision-making frameworks.
- The scenario should be realistic though not overly complex to focus on critical decision-making and cooperation.
- The exercise is based on a fictional banking failure scenario leading to regional systemic crisis.
- To simulate real-world experience, the design incorporates a significant degree of complexity and uncertainty, including gaps in information.
- Participants are expected to act in the same way as in reality (while recognising that the exercise was a simulation) – eg maintain a sense of urgency, act in accordance with own functions and within actual statutory powers, legal constraints and safeguards.

Scenario and exercise dynamics were designed jointly with teams nominated by the participating authorities, who worked closely with the team from the FSI and Oliver Wyman to ensure the exercise was relevant and realistic for their jurisdictions.