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MOROCCO - FINANCIAL SECTOR ASSESSMENT PROGRAM TECHNICAL NOTE—CRISIS MANAGEMENT, BANK RESOLUTION, AND FINANCIAL SECTOR SAFETY NETS

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FINANCIAL SECTOR ASSESSMENT PROGRAM

October 2016

TECHNICAL NOTE—CRISIS MANAGEMENT, BANK RESOLUTION, AND FINANCIAL SECTOR SAFETY NETS

This Technical Note on Crisis Management, Bank Resolution, and Financial Sector Safety Nets for Morocco was prepared by a staff team of the International Monetary Fund. It is based on the information available at the time it was completed on September 2016.

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September 2016

TECHNICAL NOTE

CRISIS MANAGEMENT, BANK RESOLUTION, AND FINANCIAL SECTOR SAFETY NETS

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This Technical Note was prepared by IMF staff in the context of the Financial Sector Assessment Program in Morocco. It contains technical analysis and detailed information underpinning the FSAP's findings and recommendations. Further information on the FSAP can be found at: http://www.imf.org

CONTENTS

Glossary

ACAPS	Autorité de contrôle des assurances et de la prévoyance socialeME
AMF	Autorité des marchés financiers
BAM	Bank Al-Maghrib
CCSRS	Comité de coordination et de surveillance des risques systémiques
CDVM	Conseil Déontologique pour les Valeurs Mobilières
DIC	Deposit Insurance Corporation (*"fonds de garantie des dépôts")*
ELA	Emergency liquidity assistance
FSAP	Financial Sector Assessment Program
IMF	International Monetary Fund
KA	Key Attributes of Effective Resolution Regime for Financial Institutions
MoF	Ministry of the Economy and Finance

EXECUTIVE SUMMARY[1]

This note elaborates on the findings and recommendations made in the Financial Sector Assessment Program (FSAP) for Morocco in the areas of crisis management, bank resolution, and financial sector safety nets. The mission's findings, undertaken during April 16 to April 30, 2015, are based on a desk review of relevant legal and policy documents, as well as extensive discussions with the Moroccan authorities and private sector representatives.

In order to accompany the expansion of the banking system, the Moroccan authorities have achieved tremendous progresses as regards crisis management, bank resolution, and safety nets. A macroprudential committee composed of BAM, ACAPS, AFM, and MoF has been established to coordinate supervisory actions and manage crisis. Each of the supervisory agencies have various early interventions tools. Sound banking resolution mechanisms have recently been established in the banking law. A financial stability mandate is about to be entrusted to BAM, which shall be formally authorized to take exceptional measures (including the extension of emergency liquidity assistance). The deposit guarantee scheme has also been reshuffled, with the creation of two separate compartments, one for participative banks[2] and another one for conventional banks.

All these mechanisms have been untested so far in a rather stable financial and economic environment. Morocco has not experienced any banking crisis, so the above-described mechanisms could not be tested.

The review of the legal framework for crisis management, bank resolution, and safety nets shows that there is room for improvement, in particular as regards early intervention mechanisms and bank resolution. Early interventions tools available to BAM should be fine-tuned, with a strengthened link between the qualitative triggers (in the banking law) and the quantitative triggers (in the manual of treatment of bank difficulties). Loss absorbance mechanisms, explicit powers to address impediments to firm's resolvability (including ring-fencing measures at the level of bank groups) and synchronized mechanisms of early intervention at sectorial group levels should also be established. Transparency should be achieved in the banking law as regards the objectives of the banking resolution, the triggers for resolution as well as the hierarchy of creditors. Bail-in mechanism need to be established. The law should also clearly appoint one or more banking resolution authority(ies), with a clear mandate, mechanisms for autonomy and accountability as well as appropriate resources. Such banking resolution authority(ies) should enjoy legal protection.

[1] This note was prepared by O. Partsch (LEG external expert), under the supervision of W. Bossu (deputy to the assistant general counsel), and K. Drevina (senior counsel).

[2] Participative banks are defined in Article 54 of the banking law as legal entities authorized to offer Islamic finance products.

Transparent and effective funding mechanisms for banking resolution should be established. As a result of its double mandate (i.e., depositors' protection and open bank assistance) and its ability to raise capital on the markets and levy ex post contributions from banks, DIC implicitly plays a key role in funding banking resolution. Absent depositors' preference and credible preferential treatment of DIC's claims (including in case of open bank assistance), DIC's financial resources are weak, thereby threatening the discharge of its mandate of depositors' protection. As a way forward, DIC should hence no more provide open bank assistance. As a matter of principle, the responsibility of the government for solvency support — which is currently referenced in the convention on the management of financial crisis signed in 2012 between MoF, BAM, and the predecessor of ACAPS as well as in the BAM's "manual of resolution of failure of banks of systemic importance" - should also be formalized. Inserting in the law a provision on a government guarantee extended to BAM, when the liquidity support in the context of emergency liquidity assistance degenerates into solvency support should be a first step in this direction. Another step could be the entering of a formal arrangement between the government, BAM and possibly DIC for crisis management purposes, instead of merely documenting the government obligations in the BAM's "manual of resolution of failure of banks of systemic importance" or the convention on the management of financial crisis signed in 2012 between MoF, BAM, and the predecessor of ACAPS.

The development of resolution tools for market infrastructures, insurance and financial institutions would require further adaptations. At this stage, the resolution tools have been designed in the banking sector, which represents the biggest part of the financial services in Morocco. The development of similar instruments for other institutions (including insurance, financial market infrastructures, and financial market institutions) would require further adaptation of early intervention mechanisms and resolution tools, to ensure a consistent approach among all relevant regulatory agencies for cross-sectorial groups.

This note is structured as follows. Chapter I summarizes the existing institutional framework and coordination arrangements for crisis management — domestically and on a cross-border basis. Chapter II discusses aspects related to crisis preparedness, whereas Chapter III covers early intervention as the "first line of defense" against emerging crises. The toolkit for crisis management — comprising crisis containment measures, emergency liquidity assistance, the resolution regime and arrangements for bank liquidation — is discussed in Chapter IV. Chapter V comments on the Deposit Guarantee Scheme. Finally, observations on the legal protection can be found in Chapter VI.

Table 1. Recommendations on Crisis Management, Bank Resolution, and Safety Nets

Recommendations	Priority 1/	Institution
Institutional framework:		
- Appoint one or more resolution authority/ies and adapt its/their governance accordingly,	MT	BAM/MOF
- Clarify the roles of the other regulatory agencies in crisis management,	ST	MOF
- Address the shortcomings which undermine CCSRS's ability and willingness to act	ST	BAM/MOF
- Expand CCSRS's role for crisis preparedness in normal time.	MT	BAM/MOF
Cross-border coordination		
- with growing bank expansion in Africa, the authorities should strengthen resolution arrangements with host countries for Moroccan banks subsidiaries, especially in Africa	MT	BAM
Early intervention		
- Authorize AMF to request to halt the breach of the law governing financial markets, without the need to involve the court.	MT MT	BAM/MOF BAM
- Synchronize the early intervention mechanisms at the level of a cross-sectorial group	MT	BAM/MOF
- Introduce explicit powers to improve to firm's resolvability (including change to business practices, positioning capital and liquidity in the appropriate levels in the group and segregate critical functions in legally and operational independent entities shielded from group's problems)	MT	BAM
- Adopt loss absorbance mechanisms for banks in addition to the contribution of fresh capital by shareholders with a stake of more than 5 percent	MT	BAM
- Strengthen and disclose the link between the qualitative triggers and the quantitative triggers in the manual in the form of guideline	MT	BAM
Financial support		
- Separate BAM's ELA function clearly from government solvency support	ST	BAM/MOF
- Boost BAM's balance sheet by strengthening its recapitalization process; review the profit distribution mechanism	MT	BAM/MOF
Resolution framework		
- Specify the objectives of banking resolution in the legal framework, in particular "the least-cost principle"	ST	BAM/MOF
- Disclose the triggers for the resolution powers	ST	BAM/MOF
- Organize the temporary stay of set-off, close-out netting, suspension and termination of agreements		BAM/MOF

Table 1. Recommendations on Crisis Management, Bank Resolution, and Safety Nets (continued)

Recommendations	Priority 1/	Institution
- Apply the forced sale mechanisms to all shares (not only those of the decision-making and controlling bodies)	ST	BAM/MOF
- Formalize the hierarchy of creditors' claims in the context of banking resolution and introduce bail-in powers in accordance with this hierarchy	ST	BAM/MOF
- Make BAM (and any other authority acting as such) the bank resolution authority/ies explicitly and limit its/their legal liabilities in discharging this mandate	MT	BAM/MOF
Funding of firms		
- Review DIC's mandate	ST	BAM/MOF
- Formalize government's responsibility for solvency support	ST	MOF
Bank liquidation		
- Create bridges between liquidation and resolution mechanisms	ST	BAM/MOF
- Review the enforcement of preferential creditors' entitlements	ST	BAM/MOF
Deposit guarantee scheme		
- Remove any type of open bank assistance via the deposit guarantee fund (DIC), of which the primary mandate must be exclusively depositors' protection	ST	BAM/MOF
- Clarify the circumstances triggering the indemnification by DIC of the depositors consistently with the rest of the banking act.	ST	BAM/MOF
- Strengthen depositor protection by granting DIC a higher priority over uninsured depositors and general creditors		
- DIC to support the use of "P&A" as a resolution tool	MT	BAM/MOF
Legal protection		
- As a minimum, limit the liability of BAM's bodies and staff (as well as any other authority acting as resolution authority) as well as the provisional administrator in the context of banking resolution	MT	BAM/MOF
- Consider a more general clause of limitation of liability to BAM, ACAPS and AMF acting their capacity as regulatory agencies	MT	BAM/MOF

1/ Short-term indicates within 18 months; medium-term indicates within 18 months to 3 years.

INSTITUTIONAL FRAMEWORK

A robust institutional framework is paramount to effective crisis management and bank resolution. At minimum, such a framework should provide for clear mandates for the institutions involved, a distinct allocation of tasks and responsibilities across institutions, and explicit coordination mechanisms, including a solid legal basis for the exchange of confidential information in times of distress.

A. Domestic Arrangements

Framework in Morocco

1. The Moroccan financial system comprises the following institution and regulatory agencies, none of which has currently an express financial stability mandate:

- The MoF is the government department responsible for the control and management of the public finance of the State. Its functions include preparing the bill of finance,[3] monitoring its implementation and enforcement, defining the fiscal and customs policies of the State, monitoring their enforcement as well as ensuring the collection of public revenues and payment of public expenditures.

- The BAM is the central bank and prudential regulator and supervisor for the banking sector. The objectives of the BAM are set out in the Law no. 76-03 governing the BAM and its principal objectives include ensuring price stability as well as the good functioning of the monetary market and banking system. The banking law, as recently amended, grants BAM with banking recovery and resolution powers.

- The Deposit Insurance Corporation (DIC) manages the collective guarantee funds for deposits for conventional banks and participative banks (Articles 67, 128, and 129 of the Banking law, as amended). Whilst DIC mainly aims at indemnifying depositors upon unavailability of their deposits or reimbursable funds, DIC may also, under exceptional circumstances and for prevention purposes, extend repayable advances and take a stake in the capital of a failing bank. Such decision is made by BAM, after seeking the opinion of the credit institution committee and provided that the supported bank has adopted recovery measures deemed acceptable. DIC may also act as provisional administrator in the context of bank resolution.

- The AMF (previously the Securities Ethics Council- CDVM) has been created by the Law no. 43-12 as a public legal entity endowed with financial autonomy, subject to the

[3] Article 32 of the organic law of finance.

control of an auditor appointed by the MoF. The objective of the AMF is to ensure the protection of saving invested in financial instruments in accordance with the principle of equal treatment, transparency, integrity of capital markets and investor protection. For this purpose, it controls the activities of the stock brokers, collective investment funds, and FMI's.

- The Insurance Control Authority (previously the Insurance and Pension Supervisor - ACAPS) has been created by the Law no. 64-12 as a public legal entity endowed with financial autonomy to supervise insurance companies and pension funds.

- All above-described institutions take part to the "systemic risk surveillance and coordination committee" (CCSRS), of which objective is "to ensure the macroprudential surveillance of the financial sector." To this end, CCSRS is tasked with identifying, assessing and addressing the systemic risks. Supervisors also meet (without the MoF) in order to coordinate their respective actions as regards the supervision and crisis management, including in the cross-border context. Such committee furthermore serves as a forum for exchange information and documents necessary for the discharge of their respective missions and in the context of macroprudential policy. The governor of the central bank chairs this committee, of which secretariat is also provided by BAM. The financial stability committee, which is an internal committee to BAM, supports the work of the CCSRS.

2. A reform of the central bank act is under preparation to entrust BAM with a financial stability mandate. A draft central bank act would now entrust BAM with a financial stability mandate, whereby BAM could take extraordinary measures under exceptional circumstances, including extending emergency liquidity assistance, which would be subject to the conditions set out by BAM Board. BAM's financial autonomy would also be improved, through more flexible rules on allocation of profits, which would not be the subject of a negotiation with MoF.

Recommendations

3. Viewed from the current sectorial point of view, domestic arrangements for the institutional framework are sound. The mandates of the regulatory agencies are well defined, with no overlap or gap as regards the allocation of tasks and responsibilities across institutions, and there are explicit coordination mechanisms, including a solid basis for the exchange of information and documents in normal and abnormal times. It may be useful, however, to specify that such exchange of information and documents may also relate to individual institution.

4. The authorities should, however, remedy the gaps of the macroprudential framework, which undermine CCSRS' ability to act and the willingness to act. The institutional framework described in the banking law leaves out many issues, thereby undermining the effectiveness of macroprudential policy: (a) the risks of conflicts between the

macroprudential policy with sectorial policies, (b) the lack of clarity as to the instruments available to CCSRS, (c) the lack of clarity as to the frequency of the meetings and voting arrangements, and (d) the lack of disclosure and accountability mechanism. In order to achieve effective macroprudential policy and avoid bias towards inaction, these shortcomings need to be addressed as follows:

- ACAPS and AMF must take financial stability into account when discharging their respective mandate and taking part to CCSRS;
- Clarity must be achieved as regards the instruments available to CCSRS when discharging its macroprudential mandate, be it non-binding (recommendations, opinions, with the principle "comply or explain") or binding instruments (circulars);
- Clear voting rules should be enacted, at least at majority rule;
- Robust accountability mechanism (in the form of disclosure of policy and considerations for policy decisions as well as provision of information to the parliament by the MoF which is constitutionally responsible for ACAPS, AMF and BAM) must be substantiated.

5. The authorities should also designate and empower a/the resolution authority(ies). In line with best practice,[4] the authorities are encouraged to designate an/the administrative authority (or authorities) responsible for exercising resolution powers over firms within the scope of the resolution regime. Where multiple authorities are designated, roles and responsibilities should be clearly defined, with the authorities identifying a lead authority that coordinates resolution actions across different entities of the same group within Morocco. The designated resolution authority (authorities) should have:

- A sufficiently broad mandate with a focus on financial stability, including adequate resolution powers, as part of its statutory objectives and functions,

- Operational independence, including safeguards against undue political or industry influence that would compromise its ability to obtain or deploy the resources needed to carry out its mandate and achieve an effective resolution,

- A robust governance structure that defines the responsibilities, authorities and accountability of its governing body and senior staff,

- Adequate resources and sufficient operating funds to attract and retain staff with sufficient expertise.

6. Following the designation of the resolution authority/ies, the roles of other regulatory agencies involved in crisis-management should be fine-tuned. At this stage, the authorities have focused on banking resolution mechanism as banks capture the biggest part of the financial services. In view of the natural complementary between banking supervision and

[4] KA, 2.5.

banking resolution as well as the prominent role played by BAM, BAM is a natural candidate as a resolution authority. In the medium term, when resolution mechanisms will also be established for insurance undertakings, market infrastructures and financial institutions, the allocation of responsibilities between the different agencies involved in crisis management and bank resolution should be reviewed.

7. In the meantime, CCSRS' role might be expanded to cover crisis preparedness in normal time. CCRSR provides a platform for interagency coordination during the financial crisis. It is recommended that it also serves as a platform to discuss potential improvement of the crisis management framework, coordinate crisis-management simulation exercises aimed at testing, and consequently improving crisis preparedness.

B. Cross-Border Coordination

Framework in Morocco

8. The expansion of Moroccan banks in Africa gives rise to domestic and cross-border systemic risks, addressed by BAM internal policy for cross-border supervision. The three main Moroccan banks (which represent 2/3 of the deposits in Morocco) are now present in 23 countries, with a strong representation in French-speaking Africa. Such expansion has an impact on the distribution of credits (15.4 percent of the credit as of end of June 2014 have been extended abroad) and on the net income (16.7 percent as of the end of June) of the three major Moroccan Banks. The subsidiaries created by the three major Moroccan banks are also of systemic importance in various countries,[5] where they represent more than 25 percent of the credit. Adverse financial problems which may be faced by these three major Moroccan banks and could therefore have negative impact in Morocco and abroad, are specifically addressed by the internal policy for cross-border supervision which provides for an ex ante authorization of cross-border activities, coupled with the supervision and control at the level of the group and the cooperation with foreign supervisors.

9. BAM has taken various measures in order to addresses these cross-border risks. First, BAM's authorization is required prior to the creation or purchase of a subsidiary or the taking of any shareholding of more than 5 percent in another bank. In this manner, BAM monitors the impact of such investments on the capitalization and evolution of the solvability ratio. BAM meets with the Central Africa Committee in the conduct of these investigations. Second, Moroccan banks involved in expansion in Africa are the subject matter of an individual and consolidated supervision, supported by the exchange of information with the foreign supervisors. To this end, BAM also conducts on-site inspections, jointly with the foreign supervisors.

[5] Cote d'ivoire, Centrafrique, Niger, and Mali.

10. The Banking Law has established a new legal framework for the cross-border coordination as regards the exchange of information, the conduct of inspection, the creation of college as well as coordinated resolution actions. Article 112 of the Banking Law, as recently amended, empowers BAM to enter with foreign supervisory authorities, into bilateral agreements relating to (a) the definition of the conditions under which information may be shared, (b) the conduct of on-site inspections in the subsidiaries and branches established on the Moroccan and foreign territory, (c) the terms and conditions for the coordinated resolution interventions of subsidiaries and branches established on the Moroccan and foreign government, (d) the creation of supervisory college to coordinate the supervisory actions of Moroccan and foreign supervisors.

11. While existing agreements focus on the exchange of information, conduct of on-site inspections and coordinated supervision between Moroccan and foreign authorities, the agreements recently entered into with Madagascar and Djibouti also address the coordination of crisis management. The existing arrangements with the Banque de France, the Central Bank of Guinea, the Banking Commission of Central Africa and the Banking Commission of the West Monetary African Union are all based on a standard text, organizing the exchange of information on a quarterly basis, conduct of on-site inspections and coordinated supervisions. The agreements recently entered with the supervisory authorities of Madagascar and Djibouti also address the coordination of crisis management.

12. Colleges of supervisors have also been established in order to further strengthen the cooperation set out in the above-described agreements. Colleges of supervisors dedicated to the Moroccan banks involved in African expansion have also been established. Such colleges meet on an annual basis with the banks involved and facilitate the monitoring of the financial and prudential situation of the group and its subsidiaries, as well as the supervision actions conducted and foreseen by the authorities of the jurisdictions involved.

Recommendations

13. Notwithstanding the tremendous progress achieved so far in this area and the continuous efforts to update existing cross-border conventions, the authorities are encouraged to strengthen resolution arrangements with host countries for Moroccan banks subsidiaries, especially in Africa. In view of the additional risks created by the expansion of Moroccan banks in Africa, BAM should leverage the recently amended banking law to adapt all arrangements entered into with foreign supervisors, in order to systematically capture banking resolution. In the jurisdictions where no banking resolution framework exists, BAM would appropriately promote its expertise in this field and encourage the adoption of similar instruments.

EARLY INTERVENTION

Intrusive supervisory practices can minimize the need for the use of more drastic crisis management tools. To act as an effective "first line of defense," the supervisor requires, in particular, (i) a framework for preparing forward-looking assessment of institutions' risk profiles, (ii) an adequate range of enforcement tools to bring about timely corrective actions and address unsafe and unsound practices, and (iii) independence, legal protection, and adequate resources.

Framework in Morocco

14. The Banking Law endows BAM with various powers for the collection of extensive information on banks and the assessment of the latter's risk profiles. BAM may first collect from banks any document or information necessary for the discharge of its prudential supervision. BAM may also conduct on-site inspections, be it in the mother company or any other subsidiary or entities controlled by the banks.

15. BAM has also at its disposal a broad range of tools to bring about timely corrective actions and address unsafe and unsound practices. In case of breach of prudential requirements, BAM may request the management to present its explanations, prior to issuing warnings. If the management or the financial situation of a bank does not offer the sufficient guarantee as regards the solvability, liquidity or profitability or that the internal control presents serious shortcomings, BAM may address an injunction to the effect that this breach be remedied, without the deadline indicated. If necessary, BAM may also require a recovery plan to be established, supported by the report of an independent expert, advising on the measures to be taken and the calendar to be followed. If BAM considers that the financial resources foreseen in the recovery plan are not sufficient, BAM may require that holders of a shareholding of more than 5 percent would contribute the necessary financial resources. BAM may also address to a bank a warning to the effect to improve its management methods, strengthen its financial situation or remedy the shortcomings identified in its internal control system. A temporary administrator may also be appointed when the functioning of the decision-making bodies or the supervisory bodies could no more work properly, when the measures proposed in the recovery plan would be insufficient to ensure the viability of the banks, or if the holders of shareholdings of more than 5 percent have refused to contribute new financial resources. In case of non-compliance with the prudential ratios imposed by BAM or malfunctioning of the internal control system, BAM may prohibit or limit the distribution, by a bank, of dividends to the shareholders or compensation with respect to the corporate units. BAM may also object that a person be appointed in the decision-making bodies, if the latter does not possess the honorability and experience necessary for the discharge of its functions. BAM may finally impose disciplinary measures.

16. In 2006, BAM had adopted a manual of treatment of the banks difficulties, detailing the circumstances triggering the use of the above-mentioned tools. BAM uses

SANEC, a tool of analysis and prevention enabling a risk-based approach for prudential supervision. Based on quantitative and qualitative elements, SANEC provides a rating system for banks from 1 (most favorable rating) to 5 (worst rating). Corrective measures are triggered by a rating of 4 or 5. The banks at stake would then subject to a closer surveillance, implying additional reporting obligations, bolstered on-site inspections as well as periodic meetings with the managers and auditors. More specifically, an injunction is to be addressed to a bank rated 4 for the criteria "solvability and own funds." The injunction could be combined with a request for a recovery plan when some criteria are met (size and complicity of the banks, weak governance, etc.). The manual lists the content of the plan as well as the measures that BAM may adopt. When the bank is rated 5, the list of the restrictions applied by the supervisor would be more stringent, with the possibility to prohibit any activities with affiliates or the payment of subordinate debts.

17. BAM Law, as recently amended, formalizes additional mechanisms of early intervention focused on banks of systemic importance. Article 79 of the banking law, as recently amended, empowers the BAM's governor to designate a credit institution of systemic importance (based on its size, level of interconnectedness with financial markets and other institutions of the financial system). Such credit institution of systemic importance may be subject to more stringent prudential requirements and may be requested to present a so-called "recovery and resolution plan."

18. AMF Law also contains some early intervention tools. By virtue of Article 40 of the ACCM law, in case of breach to the ACCM law which may threaten the rights of the depositors or the good functioning of the capital markets, the president of the Court may, upon motivated request of the AMF, require the relevant financial intermediary to halt the breach or suppress its effects. The President of the Court may also take any conservatory measure in order to ensure the due enforcement of the decision it has issued. AMF law also creates several criminal offenses, which require, however, the involvement of a prosecutor or official agents to gather the proof of infringement.

19. ACAPS also has early intervention powers commensurate with the level of risk involved. Beside the standards instruments of a supervisor (warnings, injunctions, orders, sanctions, suspension, and withdrawal of licenses), the insurance commission may, when the financial situation of the insurance undertaking is compromised, (a) suspend any payment of purchase values or payment of advances in respect of contracts stipulating such advances, (b) require that a financing program be drawn up to fund additional solvability margin, (c) prohibit the subscription of new agreements, and (d) require to draw up a recovery plan, the basis of which the authority may require the injection of capital, the prohibition of transfer of assets and the creation of personal guarantees. When the insurance undertaking does not take the measures prescribed by the recovery plan, a provisional administrator may be appointed with all management powers. The transfer of the contract portfolios and the withdrawal of the license may also be imposed by the supervisory agency. In the event of a failure of a financial institution,

the supervisory agency for financial markets may require the MOF to appoint a temporary manager who may require transfers from client accounts.

Recommendations

20. The new framework for early intervention, although sound and solid, could be further improved for the sake of greater efficiency and transparency.

- ***Greater flexibility for AMF's early intervention tools:*** AMF should be authorized to request to halt the breach of the law governing financial markets, without the need to involve the court.

- ***Introduction of explicit powers to address impediments to improve firm's resolvability*:** power to require removal of impediments to resolution should be introduced, including (a) changes to a firm's business practices, structure or organization with the aim to reduce the complexity and costliness of resolution, (b) positioning capital and liquidity in the appropriate levels in the group, and (c) the ability to segregate critical functions in legally and operational independent entities that can be effectively be shielded from group problems.

- ***Synchronization of early intervention mechanisms at the level of a cross-sectorial group*:** Although there is already some convergence between the tools readily available to BAM and ACAPS, the ability of AMF to bring corrective action is limited and made dependent upon the intervention of a judge or a prosecutor. This may, in turn, disrupt the ability of the three agencies to synchronize early intervention measures within a group consolidating various financial activities. AMF prerogatives would therefore appropriately be reviewed in this perspective.

- ***Loss absorbance*:** BAM should have the power to require an increase in bank loss absorbency. Beside the ability to request holders of a stake of more than 5 percent "to contribute new financial resources," other specific instruments such as the conversion of hybrid capital, the issuance of convertible bonds or unsecured long-term debt that could be bailed-in could also be established.

- ***Early triggers*:** To limit supervisor discretion and regulatory forbearance, the link between the set of measures that may be taken by BAM and the qualitative triggers (described in the banking law) and the quantitative triggers (described in the manual) should be strengthened. It is recommended, in this perspective, to issue the numbers in the (non- public) manual in the form of guideline. It would also be advisable to better reflect in the banking law the distinction of measures taken when bank's capital ratios have declined but solvency is not an immediate concern, to later triggers, where viability is at risk.

CRISIS MANAGEMENT TOOLS

The tools for crisis management and bank resolution should include solid but flexible arrangements for temporary official financial support of banks (emergency liquidity assistance and solvency support), robust resolution powers for banks as a going concern, a mechanism for orderly liquidation as a gone concern as well as a well-designed deposit guarantee scheme.

A. Emergency Liquidity Assistance

The framework for emergency liquidity assistance should allow the state or an official agency (in particular the central bank) to provide rapidly and in a legally robust manner emergency liquidity to illiquid but solvent banks. The liquidity provider should have tools to manage credit risks, including collateral requirements.

Framework in Morocco

21. Although not formalized in the central bank act, a function of liquidity provision exercised by BAM is available but has not yet been used. Such liquidity assistance is currently provided under Instruction No. 24/G/13. It may only be extended, up to a duration of maximum 3 months, to a solvent bank of systemic importance that encounters liquidity problems and against adequate collateral,[6] if necessary to prevent or remedy to any situation which may endanger the financial stability. Upon extension of the emergency liquidity assistance, the bank must establish a recovery plan, identifying the measures to be taken to improve its liquidity situation and the timing for the taking of such measures. BAM may terminate such assistance if the bank becomes insolvent. Such facility has never been used so far, as the banks encountering (limited) liquidity problems could solve them via the standard monetary policy operations.

22. In the draft reformed central bank act, the emergency liquidity assistance would be merely signaled as a "measure to be taken under exceptional circumstances." As part of the (new) financial stability mandate, the Board of the BAM would now be entrusted with the power to enact "any instrument to be used or measure to be taken under exceptional circumstances."[7] Further details would be reflected into an internal circular on the extension of emergency loans, a draft of which is currently under preparation. The fear of creating moral hazard justifies this limited transparency.

23. The (newly) amended banking law also authorizes the company managing the deposit guarantee fund to extend credit to or take a stake in a failing bank, if the failure of

[6] Including treasury bonds, claims guaranteed by the Moroccan State, securities issued by BAM, claims denominated in EUR or USD, issued by OECD governments with a rating of A, the negotiable instruments, parts in monetary investment funds, and units in collective securitization investment funds.

[7] Article 23(1), 7th indent.

the latter would trigger the unavailability of deposits. The Deposit Insurance Corporation (DIC) would enter into such transactions as a precautionary measure and under exceptional circumstances, based on BAM advice and provided that the bank submits recovery measures deemed acceptable. The DIC would also be endowed with a lien (ranking after the lien of the Treasury) guaranteeing the repayment in priority, of the value of the extended loan, in case of liquidation of the bank to which DIC would have extended credit to or in which DIC would have taken a stake. BAM would enact a circular determining the conditions of such transactions.

Recommendations

24. It is recommended that only BAM extends emergency liquidity assistance. Maintaining two streams of liquidity assistance may prove confusing in case of crisis. First, a confusion could arise as to the respective scope of application of these mechanisms, which are intrinsically very similar. As a matter of fact, it is difficult to differentiate between illiquid but solvent bank (to which ELA would be extended) and a bank facing difficulties which may subsequently lead to the unavailability of deposits (which may benefit of the financial support of DIC). Second, in order to protect its own financial resources, BAM may be induced to privilege the use, first, of the DIC. Third, authorizing the use of DIC for the purpose of extending a loan or taking a stake in a failing bank would trigger a conflict of interests between depositor protection and support of failing banks. The granting of a lien to ensure the preferential repayment of the loan would not suppress such conflict as this lien ranks after the treasury department's lien. The organic budget law provides for back-up financing in the case of a systemic crisis. The Prime Minister has the authority to engage expenses without consulting Parliament, provided Parliament is informed ex-post.

25. The central bank act should formalize the emergency liquidity assistance function, together with the principle of a state guarantee for solvency support. It is recommended that the central bank law contains a provision spelling out the main principles of the emergency liquidity assistance, which are currently contained in the draft agreement to be entered into between BAM and a credit institution as well as in the draft procedure under elaboration. In line with the said draft agreement and procedure, it should, in particular, be made clear in the law that BAM has a discretionary power in the granting of such assistance, which would only be available for liquidity purposes. The law should also stipulate that such assistance would be available for any bank, the failure of which could undermine the financial stability of Morocco. Should these liquidity problems degenerate into solvency problems, BAM would have the discretion to extend liquidity but would, in this case, be covered by a guarantee of the government. As this extension of liquidity would hence be clearly connected with the financial stability mandate of the central bank and would be made subject to strict conditions, this should not create moral hazard for credit institutions, which would not find in such text the assurance of receiving liquidity assistance whenever they face liquidity pressure.

26. In order to enable the central bank to discharge its function of emergency liquidity provider, its financial independence also needs to be boosted. In order to be independent, a

central bank needs to dispose of sufficient financial and human resources when discharging its mandate. Should there be a mismatch between BAM current financial resources and its prospective expenditures in the context if its (new) financial stability mandate, it may be appropriate to bolster the recapitalization mechanism, with the indication of trigger, a deadline for the recapitalization and the indication that the recapitalization may take the form of government debt securities (and not exclusively in cash, as this is currently the case). In parallel, some greater flexibility could be created as regards the profit distribution rules. The central bank act currently provides for the automatic allocation of 10 percent of the profits to a general reserve fund, until the latter amounts to the BAM capital. The remaining 90 percent are allocated to the government, unless the board (which counts a MoF representative), upon proposal of the Governor, decides to allocate a part of such profits to a special reserve fund. In the context of the reform of the central bank act, the allocation of the remaining benefits (after allocation to the general reserves and specific reserves as decided by the board upon Governor's proposal) would now be subject to an agreement between the Bank and the MoF. In line with best international practice, it may be envisaged to grant to BAM greater discretion in the build-up of financial buffer in light of its new financial stability mandate.

B. Resolution Regime

> *Effective resolution regimes provide authorities with a broad range of powers that can be initiated on a timely basis, i.e., when a firm is no longer viable or likely to be no longer viable and has no reasonable prospects of recovery. The concept of non-viability is supported by clear standards of suitable indicators to help guide decisions on entry into resolution and there are no impediments that could constrain the implementation, or result in a reversal of resolution actions taking in good faith.*

Framework in Morocco

27. With the recent reform of the Banking Law, the tool kit already available to BAM has been further extended to capture valid bank resolution mechanisms. BAM may now appoint a provisional administrator, who analyzes the appropriateness of taking any of the following measures: (a) the liquidation of the bank when its situation is considered as definitively compromised, (b) its partial or whole transfer to another bank, (c) the transfer to a bridge bank, or (d) the split of the bank. The provisional administrator may also, with the authorization of the judge, sell or acquire real estate assets or shareholdings. Under urgent circumstances, such measures may also be taken immediately by the BAM's Governor. If these mechanisms prove ineffective to resolve the credit institution, the latter is liquidated by a liquidator appointed by the BAM's Governor in accordance with the provisions of the commercial code on liquidation.

28. For the sake of their effectiveness, these banking resolution mechanisms are supported by specific deviations from civil and obligation code, companies act and commercial code. In order to act with the necessary speed and flexibility, the banking law dis-applies certain standard mechanisms for enforcement or protection of creditors. First, credit

institutions are not governed by the standard proceedings for prevention and treatment of financially distressed institutions.[8] Second, the appointment of the provisional administrator triggers the automatic suspension of the board of directors and general shareholders' assembly, whose rights are exclusively exercised by the provisional administrator.[9] Third, transfer of credit and assets of the failing bank may be made to a bridge bank, without the need to obtain the agreement of the underlying creditors.[10] Fourth, the appointment of the provisional administrator triggers the automatic suspension of the shares held by the members of the board, executive and audit committees, which may be subject to a forced sale.[11]

Recommendations

29. Assessed against the international best practice,[12] the overall soundness of this legal framework is acceptable but may be further strengthened. Despite the tremendous progresses achieved by the Moroccan authorities since the last FSAP, the legal framework for financial institutions resolution could be improved in the three following respects: (a) the level of transparency as to some of the main building blocks of the bank resolution mechanisms; (b) the clarity as the governance of resolution authorities; and (c) the weakness of the cross-border resolution mechanisms.

30. As a first preliminary remark, establishing a specific resolution regime for banks only, is acceptable at this stage. Although resolution instruments have not been stipulated for insurance undertakings, pension funds and financial institutions, the latter may be subject to various measures commensurate with the risk effectively involved. At this stage, this approach does not hamper the proper coordinated resolution and recovery process in case of cross-sectorial activities within a group or a financial conglomerate, which shall take place at the level of the Systemic Risk Surveillance and Coordination Committee (CCSRS). It is recommended, however, to monitor whether further convergence of the early intervention and resolution mechanisms for both banking, and insurance and financial market activities may be needed to address new risks posed by the future integration of the financial activities within a group or a financial conglomerate.

31. As a second preliminary remark, authorities need to be mindful of the possibly destabilization effect of the appointment of a provisional administrator. Unless the authorities carefully plan the appointment of a provisional administrator and endow the latter

[8] Article 113 of the Banking Law.

[9] Article 117 of the Banking Law.

[10] Article 115.3° of the Banking Law.

[11] Articles 117 and 120 of the Banking Law.

[12] Reference shall be made to the Key Attributes of Effective Resolution Regimes for Financial Institutions (« KA »), which may be considered as a codification of such international best practice.

with appropriate powers, the mere appointment of a provisional administrator could trigger a bank run, thereby further destabilizing the financial sector. In order to neutralize such risks, it is therefore of utmost importance that the provisional administrator acts swiftly and efficiently, for instance, in transferring the deposits to a healthy third party. This hence demonstrates the need for forward-looking strategy at the time of the appointment of the provisional administrator.

32. The overall clarity and transparency as regards the bank resolution framework must be improved. The best international practice applicable to bank resolution recommends clarity and transparency as regards its scope of application,[13] objectives pursued by the authorities,[14] role and responsibilities of the resolving authorities,[15] triggers for resolution[16] as well as treatment of creditors, ranking in insolvency and potential deviation there from.[17] In order not to substantiate moral hazard, the Moroccan authorities have mainly reflected in the banking law the description of resolution mechanisms. The draft (non-public) resolution manual, to be issued by BAM, provides further details as to the principles guiding the recovery and resolution mechanisms, its chronology, the valuation methods as well as the (late) financial involvement of the MOF, once it becomes clear that no other privately-funded alternative could be seriously considered. As this approach may prevent the transparent assessment of the adequacy of the resolution mechanisms effectively enforced with the objectives pursued, it is recommended to reflect in the banking law the objectives of such regime, the triggers for resolution as well as the treatment of creditors, ranking in insolvency and potential deviations.

33. In particular, the objectives of the resolution regime must appear in the banking law. In order to announce to the public at large and the authorities which may have to review the legality of the decisions made by BAM in this context, it is of utmost importance that the banking law clearly describes the objectives pursued by the recovery and resolution regime.

34. The triggers for the resolution powers should also allow for their deployment at an early juncture when the bank is no longer or likely to be no longer viable. Banking law does not contain clear and precise triggers for the implementation of resolution tools. Such tools are implemented in case of "difficulties of a bank [requiring measures to ensure its recovery]" or "assets of a bank considered as compromised"[18] or "serious difficulties of recovery."[19] The manual

[13] See for instance KA 1.1.

[14] See for instance KA 1.2 and 2.3.

[15] See for instance KA 2.1 and 2.5.

[16] See for instance KA 3.1.

[17] See for instance KA 5.1., 7.4.

[18] Under Article 115, the provisional administrator describes in a report "the nature, origin, and importance of difficulties of a bank as well as the measures which may contribute to its recovery." The provisional administrator may propose the transfer of the bank's assets to an ad hoc structure "when such asses are considered as compromised."

for resolution of banks contains additional qualitative triggers: (a) when the failure of the bank is considered actual or foreseeable, (b) when the early intervention tools have not delivered the expected benefits or cannot prevent the failure of the bank, (c) when the bank faces a loss of confidence with a bank run, (d) the bank is not in a position to discharge its debts, and (e) the bank has requested emergency liquidity assistance from BAM or open bank support from DIC. It also contains qualitative triggers (the own assets fall below a critical threshold, e.g., 5.5 percent for risk-weighted assets for own basic funds; the liabilities exceed the assets of the bank; the bank is rated 5 under SANEC). The lack of clear, precise, objective and transparent triggers is sub-optimal. It leaves too much discretion to BAM in the acknowledgment of the moment as of which resolution tools must be implemented. In doing so, it creates the risk that resolution tools be applied too late, when the balance sheet is insolvent and/or equity has been fully wiped out. Furthermore, the request by a bank of emergency liquidity assistance should, in no way, trigger a resolution. This would, otherwise, deter the latter to request a liquidity support which may alleviate the risk of deterioration of its balance sheet. By sharp contrast, BAM's refusal to grant such emergency liquidity assistance or the withdrawal thereof, as far as it signals the non-viability of the corresponding bank, may be a trigger for resolution.

35. The treatment of creditors, ranking in insolvency and potential deviation therefrom must also be disclosed in the banking law, with the organization of a legal review of BAM's decisions made in this respect. In its current drafting, the banking law is silent as to the mechanisms used to allocate the losses incurred in the banking resolution process and the impact on the rights of the creditors. These issues must be addressed in a law (and not in a circular or internal manual), as they relate to the fundamental rights of the creditors, enforceable in front of the civil courts. The law should also formalize the legal review of BAM's decisions made in this respect. Should BAM's decisions be found to have breached the law, BAM's decision should in no way be declared null and void by the court. Only damages may be awarded to the plaintiffs.

36. In particular, a comprehensive hierarchy of creditors' claims should be stipulated in the specific context of the banking resolution. In its current drafting, the banking law expressly stipulates a privilege for the management company of the deposit guarantee funds (DIC), should the latter extend emergency liquidity to an ailing bank, subsequently liquidated. Such privilege is subordinated to the privilege granted to the Treasury on the basis of the law on the recovery of public claim. Article 145 *in fine* of the banking law refers to the title III of the book V of the commercial code, which organizes the sharing of the proceeds among all creditors, after privileged allocation to the holders of privileges, mortgages, and pledges. For the sake of transparency, it would be strongly recommended that the banking law contains a clear and comprehensive hierarchy of claims, with express indication of *all* privileges to be taken into account and their respective rank (including the privilege of the Treasury department, the DIC,

[19] Article 116 stipulates that BAM may decide to continue to exploit the bank if it encounters serious difficulties of recovery.

the BAM,[20] the social security, the costs of the resolution and of the provisional administrators, etc.). For instance, the draft central bank act provides that BAM's special lien over all financial assets of borrowing banks would prevail over any other lien. It is not clear, however, how such prevalence would fit with DIC's and Treasury lien, which seems to also benefit, in the banking law, of a preferential treatment. Further details among the category of non-secured creditors (depending on whether they are subordinated or not result from other specific instruments such as the conversion of hybrid capital, the issuance of convertible bonds or unsecured long-term debt used as early intervention mechanisms – see No. 20 above) could also be established.

37. Insured creditors must be granted priority ranking The banking law does not create any preferential position for the bank depositors, who are therefore uninsured creditors for their whole claim (be it covered by the DIC, which shall be subrogated to the latter's rights, or for the surplus). In view of this banking model which gives rise to an inherent liquidity mismatch, it is essential to ensure deposit confidence and take all possible actions to avoid deposit runs. It is hence strongly recommended to award a preferential treatment to insured creditors, in order to maximize DIC's recoveries on the assets of the failed bank and rebuild quickly DIC financial capacity, should the crisis hit more than one bank at a time.

38. A sound legal framework on financial collateral arrangement would also be desirable, including in the context of banking resolution. Collateral arrangements remain governed by the provision of the Civil and Obligation Code as well as the Commercial Code, which require specific enforceability measures and well as cumbersome enforcement processes. Creditors are only secured if they benefit of one of the collateral expressly recognized by the Commercial Code, namely, a mortgage, a pledge or a lien. Any other mechanisms which may produce effects similar to a collateral arrangement (such as the set-off, compensation, close-out netting, acceleration and termination of obligations) are not recognized under Moroccan law and may hence not be enforced upon appointment of the provisional administrator.[21] This may seriously undermine the solidity of the interbank market, as other credit institutions would be hit by the resolution of a failing bank. It is therefore strongly recommended to strengthen the overall soundness of the framework governing the creation, enforceability and enforcement of financial collateral arrangements.

39. In the same vein, set-off, close-out netting, suspension and termination mechanisms of agreements should be merely stayed, rather than excluding such mechanisms at all. In line with best practice,[22] exercise of contractual rights achieving the same effects as a collateral arrangements (such as acceleration, early-termination, set-off, and netting

[20] In the draft central bank act, Article 95 provides that "for the recovery of its claims in the context of its missions relating to monetary policy or financial stability, BAM has a special lien over the financial assets of the borrowing banks that prevail over any other lien."

[21] See Article 122 of the Banking Law.

[22] See KA 4.1, 4.2., 4.3.

rights) should hence be temporarily stayed during banking resolution, but not suppressed, as this is currently the case under Article 122 of the banking law.

40. The forced sale of shares should apply to all shares of a resolved bank. Articles 117 and 120 currently provide for the possible suspension and forced sale of the shares of a resolved bank, held by the members of its decision-making and controlling bodies. In order to enforce banking resolution mechanisms (be it in the form of a transfer of all or part of a resolved bank to another bank, a bridge bank or a bad bank), the mechanism of forced sale should be applied to *all* shares, thereby achieving a full suspension of shareholders' rights, which are exercised by the provisional administrator. This would however amount to a sort of expropriation for public cause, to which the proceedings stipulated for the forced sale of shares held by decision-making and controlling bodies would be generalized. The involvement of an independent and officially registered expert and a decision by the court, as currently prescribed in Article 120 for the sole shares held by the decision-making and controlling bodies would ensure the due protection of private interest. An additional limited legal review should remain available, but without the possibility to rescind or annul *ex post* the transfer of shares.

41. Bail-in mechanisms need to be established to determine the impact of loss-absorption of the creditors' entitlement. In providing for the liquidation, transfer or split of the resolved bank or the sale of part of its assets, the banking law implicitly haircuts the claims of shareholders and unsecured creditors of such bank, without however defining the impact of the latter's respective entitlements. It is recommended to entrust the bank resolution authorities with the power to carry out bail-in in accordance with the hierarchy of claims in a variety of form (be it in such a way to write down equity, unsecured and uninsured creditors' claims; convert into equity all or parts of unsecured or uninsured creditor claims; or convert or write-down any contingent convertible or contractual bail-in instruments required as early intervention mechanisms).[23]

42. Clarity and transparency must also be achieved as regards the governance of the banking resolution, for the sake of their effective autonomy and accountability. Despite the numerous references made in the banking law to the active involvement of BAM[24] (or its

[23] See KA 3.5.

[24] Articles 112 (cross-border bilateral conventions), 115 (fixes the delay within which the report of the provisional administrator is due on the banking resolution option), 116 (decides on continuation of the ailing bank), 118 (refers to the court the appointment of a proxy-holder for exercising the voting rights of the board members), 120 (refers to the court the decision to transfer the securities of the board members), 121 (authorizes the sale or acquisition of assets of the ailing bank), 123 (receives the report of the provisional administrator), 124 (agrees on the convening of the shareholders' meeting), 132 (adopts the agreement with the managing company of the DGF), 134 (approves the articles of incorporation of the managing company of the DGS), 136 (issue the opinion on the provision of emergency liquidity to the ailing bank by the DGF), 138 (adopts the conditions of payment to the depositors from the DGF), and 140 (determines the content of regular reporting by the provisional administrator).

Governor)[25] and DIC in the banking resolution mechanisms, BAM and DIC have not been formally appointed as the banking resolution authority. This, in turn, creates confusion as to the status and governance of BAM and DIC when acting in the context of the resolution, including as regards the internal allocation of powers between the Governor, the Management Committee and the Board. While other options might be envisaged (including a stand-alone resolution authority or the managing company of the DIC), the complementarities between corrective measures and early intervention under the BAM supervisory mandate would be good arguments in favor of a formal banking resolution mandate of BAM. For the discharge of this mandate, BAM may be assisted by the company managing the DIC, which would act as a service provider. In this manner, BAM would appropriately leverage its status of independence and accountability in order to promote the credibility of this new mandate. To address conflicts of interest, the central bank's, supervisory agency's and resolution authority's mandates could be exercised through different decision-making and reporting line within the BAM.

43. The framework for cross-border bank resolution, which is organized in bilateral agreements in accordance with BAM internal policy for cross-border supervision, needs to be strengthened. At this stage, the banking law and the said BAM internal policy provide for the execution of bilateral agreements between BAM and foreign supervisor, which may relate to the coordination and intervention in the field of crisis resolution impacting on the subsidiaries or branches established in foreign countries. In order to be effective, such approach presupposes, however, that the foreign country has similar toolkit as regards the early intervention mechanisms, the bank resolution and liquidation tools. As the subsidiaries of the main banks have been created in Sub-Saharan African countries, this condition is not met, thereby undermining the soundness of the cross-border bank resolution mechanisms.

C. Funding of firms in resolution

Jurisdictions should have arrangements in place to provide (temporary) financing to facilitate the effective implementation of a chosen resolution strategy. Any provision of temporary public support should be subject to strict conditionality to minimize the risk of moral hazard.

Framework in Morocco

44. Funding arrangements fulfill an essential function in effective banking resolution regimes. Resolution authorities may require funding at different stages in the resolution process, inter alia to provide liquidity to firms under liquidation, bridge banks, or asset management

[25] Articles 114 (appointment of the provisional administrator), 126 (appointment of the provisional administrator under urgent circumstances), 127 (decides of the resolution tools under urgent circumstances), 135 (chairs the meetings of the managing company of the DGF), 137 (requests additional contributions from banks to finance the DGF), 142 (sets out the conditions for the management of the DGF), 145 (appoints liquidator), 147 (adopt circular on exemption from claim declaration process for depositors).

companies, and contribute resource to facilitate a transfer of insured deposits (subject to a least cost test). While cross-country experiences point to significant variation in design modalities, it is widely accepted among policy makers and standard setter that the banking industry, rather than the taxpayer, should ultimately shoulder the burden of a resolution. In this context, access to financial resources readily available should be secured, be it in the form of private or public resources, with the ability to recoup any outlays from the industry on an *ex post* basis.

45. The Moroccan resolution scheme comprises a mix of public and private funding elements, which are not fully disclosed however. Private funding elements indirectly result from the *ex ante* and *ex post* contribution paid by banks to DIC as well as the issuance of bonds and sukuk by DIC, which may, under exceptional circumstances and for prevention purposes, provide open bank assistance. Public funding elements result from the internal manual of resolution, whereby the government may either provide financial support in the context of a private sector solution (including in case of partial or full transfer of the failing bank to another bank, the creation of a bridge bank or a bad bank) or take temporary control of the failing bank, be it directly by the treasury department or a public undertaking.

Recommendations

46. DIC – which allegedly plays a pivotal role in the resolution funding – is exposed to losses. While DIC simultaneously serves the purpose of depositors' protection and open bank assistance, it benefits of a preferential treatment only for the recovery of bank repayable advances in the form of a lien, which is subordinated to the lien of the treasury department. DIC may furthermore levy ex post contribution from banks occur "when DIC's resources are insufficient to indemnify depositors." It is doubtful, however, that in case of major financial crisis, banks would have the financial resources to recoup losses incurred by DIC in the discharge of its double mandate. This, in turn, contributes to the financial weakness of DIC, which may provide open bank assistance, without being properly insulated against losses and being able to rebuild its own financial resources.

47. The open bank assistance function of DIC must be suppressed. Open bank assistance provided by DIC not only creates conflicts with its main mandate of depositors' protection but also undermines its financial situation. It must therefore be suppressed.

48. The responsibility of the government for solvency support should be formalized. As a rule, the government shoulders the responsibility for solvency support. This principle is currently referenced in the BAM internal manual for resolution of banks of systemic importance and the convention on the management of financial crisis signed in 2012 by MoF, BAM and the predecessor of ACAPS. The recommended stipulation in the central bank act of a government guarantee to BAM when extending solvency support would be a good starting point in this respect. A formal arrangement with BAM and possibly DIC could also be established. This could take the form of a back-up credit line to the DIC in order to give the means, to the latter, to effectively discharge its mandate.

D. Bank Liquidation and Insolvency

Authorities should develop procedures that allow for liquidating banks in an orderly manner. This involves rapidly transferring insured deposits and critical banking functions (payment services, trade finance) out of the insolvent estate before the remainder is liquidated in the traditional fashion. Thus, those critical elements continue to operate in going concern, while the remainder of the failed bank is liquidated and removed from the market.

Framework in Morocco

49. BAM opts for the liquidation of a bank when its situation is considered as irremediably compromised. Such conclusion can first be reached by the provisional administrator, be it up front, upon its appointment by BAM's governor or at a later stage, after implementing other banking resolution mechanisms. In this latter case, the provisional administrator would have transferred insured deposits and critical banking funds out of the insolvent estate prior to liquidating the remainder, as part of the banking resolution process. In case of emergency and when circumstances threatening the stability of the banking system, the BAM's Governor may immediately decide himself of the liquidation, without appointing a provisional administrator.

50. The banking law organizes a specific regime for the liquidation of banks. According to Article 113 of the banking law, banks are not governed by the standard insolvency proceedings set out in the Commercial Code.

51. First, the filing of a liquidation request against a bank must be reported by the court to the BAM's governor, who appoints the liquidator. Liquidation may be requested by the bank itself or by an unpaid creditor. The fact of bringing first such liquidation request to the knowledge of BAM enables the latter to take any step deemed appropriate in view of its capacity as banking supervisor and the tools available for early intervention, recovery or resolution of a bank. The liquidator is, beside, appointed by BAM's governor.

52. Second, the banking enumerates exhaustively the grounds for liquidation. A bank may first be liquidated if its license has been withdrawn (a) upon the request of the bank itself, (b) when the bank has not used its license within the 12 months following the issuance of such license, does no more exercise its activities since more than 6 months or does not more comply with the licensing criteria. It may also be liquidated further the withdrawal of such license in light of a situation that is irremediably compromised or as a disciplinary sanction following the breach of warnings or injunctions as regards its management methods, financial situation or shortcoming in the internal control.

53. Third, specific claw back rules apply to banks. Article 148 allows the liquidator to request from the court that payment, transfer of assets, creation of guarantee or collateral in the

6 months preceding its appointment be declared null and void it such operation exceeded day-to-day management or aimed at distracting assets from the creditors. Article 149 protects nevertheless all cash and securities transfer orders that have taken place within market infrastructures prior to the date of publication of the withdrawal of the license of a bank.

54. Other standard rules for liquidation of the commercial code applies. The liquidator shall proceed to the liquidation of the bank in accordance with the title III of the Book V of the Commercial Code, which stipulates the disinvestment of the liquidated bank, the appointment of a trustee representing all creditors and the rules for the distribution of the assets among (secured and non-secured) creditors. By virtue of Articles 625, 626 and 628, the trustee in liquidation may compromise on any challenge of interest to all creditors (including the preferred creditors) and may liquidate assets subject to preferential treatments during 3 months following the liquidation. The preferred creditors may proceed individually to the enforcement of their rights only after these 3 months and if the trustee in liquidation has not taken any step in this respect.

Recommendations

55. The banking law should create bridges between the liquidation and resolution regimes. The banking law and the internal manual for banking resolution adopt a chronological approach, whereby private sector solutions are (in principle) first investigated prior to liquidating the bank, if its situation is irremediably compromised. Such is, however, not always the case, as the BAM's Governor may, in case of emergency and when the financial stability is endangered, moves immediately to liquidation, without even appointing a provisional administrator. The trustee in liquidation should have the option of using any of the resolution tools (such as partial or full transfer of assets to a bridge bank, bad bank or asset management company), as these might be most appropriate to deal with the component parts of the bank.

56. It is strongly recommended to review the enforcement of the preferred creditors' entitlements. Currently, the trustee in liquidation may take action as regards assets subject to a collateral arrangement during a period of 3 months, after which, absent any initiative, the preferred creditors may enforce their rights themselves. This cumbersome and time-consuming regime may prove extremely damageable, especially in time of a crisis when value of assets may depreciate very fast. It is therefore recommended to authorize the preferred creditors to act immediately, possibly in consultation with the trustee in liquidation.

DEPOSIT GUARANTEE SCHEME

Deposit guarantee schemes (DGS) seek to promote public confidence by clarifying the authority's obligations to depositors (or if it is a private system, its members), and limiting the scope for discretionary decisions. Moreover, DGS can help to contain the costs of resolving failed banks, and can provide countries with an orderly process for dealing with bank failures and a mechanism for banks to fund the cost of failures.

Framework in Morocco

57. The newly amended banking law act creates two autonomous compartments in the DIC. One is for the conventional banks, the other for the participative banks. Both compartments are financed by pre-funded bank contributions and may respectively issue debt instruments and sukuk. Additional contributions may also be required, *ex post*, should the DIC resources be insufficient to cover the depositors.

58. As a main function, DIC indemnifies the depositors in case of unavailability of their deposits and reimbursement funds. DIC's guarantee applies to all deposits and other reimbursable funds (such as a deposit up to 1 year) collected by banks, to the exclusion of (a) deposits received from other banks, (b) deposits received from subsidiaries, members of its board of directors or controlling bodies, its shareholders with a stake of more than 5 percent, (c) deposits received from other financial institutions or providers of payment services, (d) offshore banks and the "caisse de dépôts et de gestion de la Caisse centrale de garantie," and (e) BAM, the treasury department of Morocca, the post office, the insurance and re-insurance undertakings, the non-profit organizations, Hassan II fund and the international financial institutions and public organizations for cooperation.

59. DIC may also act as provisional administrator in the context of banking resolution. DIC may be appointed by BAM's Governor as provisional administrator in the context of a bank resolution. In this capacity, it establishes a report to the attention of BAM on the nature, origin and significance of the difficulties encountered by a failing bank and the measures which may ensure its recovery. It also reports quarterly to BAM on the evolution of the financial situation of the bank. When acting as provisional administrator, DIC may defer to the court a request to declare null and void any payment or transfer of assets, creation of a guarantee or collateral within the six months preceding its appointment to the benefit of any natural or legal entity, when such operation exceeded the day-to-day management or aims at subtracting one or more items of its assets. The mission of DIC, acting as provisional administrator, ends when (a) new decision-making bodies are appointed by the general assembly of the bank, (b) the situation of the bank is irremediably compromised, (c) the provisional administrator can no more discharge its functions or fails to comply with its duties.

60. Finally, DIC may offer direct bank support. Under exceptional circumstances and for prevention purposes, DIC may grant to a failing bank repayable advances or take a stake in the latter's capital. DIC's claim arising from the extension of repayable advances is privileged on the assets of the failing bank, by means of a lien, that is subordinated to lien of the Treasury department. Such direct bank support is extended in accordance with the conditions set out by BAM and upon opinion of BAM. The failing bank to which such support is extended must establish a recovery plan deemed acceptable by DIC.

61. The two funds are managed by a private limited company, in which BAM is involved as shareholder, manager and policy-setter. DIC is a limited company, incorporated

under private law and owned by BAM and all banks incorporated in Morocco (be it as domestic banks or subsidiaries of foreign banks). DIC discharges its functions in accordance with an agreement to be entered into with BAM, which determines (a) the duties arising from the functioning of DIC, (b) the conditions under which DIC may contribute to the recovery of a failing bank, (c) the ethics rules applicable to the board of directors and the staff of DIC, as well as (d) the conditions for exchange of information between BAM and DIC. DIC's articles of incorporation are approved by BAM. DIC's board is composed of the BAM's governor, two independent administrators and three representatives of banks. The Board of directors is competent for the internal matters, such as the budget, the annual accounts and the management of human resources of DIC. A separate "intervention committee" "(comité d'intervention)" – composed of the BAM's Governor and the two independent administrators - decides on any disbursement by DIC. BAM also determines the conditions under which DIC discloses to the public the conditions of its intervention.

62. DIC is a pre-funded scheme financed by banks, with a maximum coverage of DH 80,000 per depositor. DIC currently covers about 2 percent of eligible deposits and bank contribution is limited to 0.25 percent of total deposits. It gives a maximum coverage of DH 80,000 which may be increased up to DH 100,000.

63. DIC may cooperate and exchange information with foreign deposit guarantee schemes. The banking law provides for such cross-border cooperation.

64. The acknowledgment by BAM of the non-ability of a bank to reimburse the deposits or other repayable funds triggers DIC's duty to indemnify the depositors. BAM, acting as prudential supervisor, monitors the liquidity and solvability of banks and regularly informs DIC of any evolution which may triggers the unavailability of the deposits. DIC's intervention is triggered by the acknowledgment, by BAM, of the non-ability of a bank to reimburse the deposits or other repayable funds. Depositors are exempted from the declaration of claims.

65. DIC is subrogated in the depositors' entitlements and rank pari passu with general creditors. BAM determines the amounts of the coverage as well as the deadlines within which the payment to the depositors takes place. Such payment triggers the subrogation by the same amount of DIC's in the depositors' entitlement. Absent the stipulation of any express privilege to the benefit of depositors, DIC does not enjoy any preferential treatment in the sharing of the proceeds of the resolved bank.

Recommendations

66. The circumstances triggering the indemnification by DIC of the depositors should be clarified, in a consistent manner with the rest of the banking act. Article 137 provides that "when BAM acknowledges that a bank can no more reimburse the deposits and repayable funds for reasons linked to its financial situation and that it cannot be foreseen that such repayment

may take place in a near future, it informs the members of DIC's board to the effect of indemnifying the depositors." It is unclear however, whether such moment would necessarily coincide with the moment when the liquidation of the bank is requested or decided, as this may be induced by the provision according to which depositors are exempted from claim declaration. This needs to be clarified in the law, which, in accordance with best practice, needs to define the trigger for DIC's intervention in a transparent and objective manner, leaving as little discretion possible to the bank supervisor.

67. DIC's overall financial soundness needs however to be strengthened. On the one hand, DIC may extend repayable advances and take a stake in failing banks, with a mere lien for the repayable advances that is subordinated to the lien of the Treasury department. On the other hand, DIC, which is subrogated to the depositors in the proportion of the covered deposit rank *pari passu* with general creditors. This may, in turn, seriously jeopardize its ability to discharge its mandates if more than one bank is hit bank the crisis and that DIC's intervention is simultaneously needed for depositors' protection and open bank assistance purposes.

68. To this end, the extension of repayable advances or the taking of stake in failing banks by DIC should be suppressed. Such function – which is not in line with best practice - triggers an intrinsic conflict between the DIC objectives. Suppressing DIC's open bank assistance function would suppress such conflict of interests as well as the financial risks for DIC's funds.

69. Simultaneously, depositors (and hence DIC) must enjoy a preferential treatment in the insolvency of the failing bank. The funding model of Moroccan banks reinforces the importance of effective deposit insurance, whose objective should be to prevent bank runs by protecting small depositors and promptly reimbursing insured depositors in the event of a bank failure. To this end, the deposit protection should be strengthened. It is hence strongly recommended that the portion of the deposits protected by DIC enjoy a higher priority over general creditors. In this manner, DIC would be in a position to rebuild swiftly its financial resources and cover simultaneous or successive bank failures, if any.

70. Should DIC financial soundness be bolstered, it may also use "P& A" as a resolution tool. Currently, there are no dedicated funds available for bank resolution purposes. Without prejudice to the "least cost solution" principle, DIC may be allowed to participate in bank resolution up to the amount that would have been expended for insured depositor reimbursement in a liquidation, including for purchase and assumption ("P & A").

LEGAL PROTECTION

Framework in Morocco

71. Under the banking law, the civil liability of BAM's staff when conducting on-site inspections may not be incurred. Under Article 80, BAM's staff may conduct on-site inspections

in banks, in order to assess the adequacy of the latter's administrative and accounting organization as well as internal control and ensuring the quality of the latter's financial situation. Article 80 *in fine* excludes that the civil liability of BAM's staff, when conducting such on-site inspection, be incurred.

72. Absent further express exclusion or limitation, BAM's liability may be incurred for its other supervisory tasks, be it in the context of civil or administrative review. Article 85 of the Code of Obligations and Contracts provides for the principle of tort liability, according to which any person (including public authorities) is responsible for the damage caused to a third party by its action or inaction. On this basis, the civil liability of BAM may be engaged in front of judicial courts by any disgruntled creditor of a bank, who would avail himself of a damage in causal link with a breach by BAM of laws, negligence or willful misconduct. BAM's decisions – which are to be regarded as administrative decision – may also be subject to administrative review in front of an administrative court, which may annul, suspend or withdraw such decision. Administrative courts conduct legal and opportunity review of BAM's decisions.

73. The deviations from companies act and commercial code stipulated in the context of the banking resolution do not insulate BAM and the provisional administrator against the risk of their decisions being challenged by the ailing bank's creditor. The creation of out-of-court resolution mechanisms, coupled with the suspension of the decision-making bodies during the mandate of the provisional administrator, do not exclude legal challenges of the decisions made by the central bank and the provisional administrator. BAM's decision to authorize the transfer or acquisition of assets[26] or to proceed itself to the resolution of the bank, without involvement of the provisional administrator[27] may therefore be deferred by an aggrieved creditor to administrative review. The civil liability of the provisional administrator (which may be the managing company of the deposit guarantee fund created in the form of a limited company) could also be engaged in front of civil courts.

Recommendations

74. As a minimum, the legal protection of BAM's bodies and staff as well as the provisional administrator should be strengthened in the context of banking resolution. Resolution activities – which involve large sums of public money - are more intrusive and publicly scrutinized than regular supervisory decisions. In accordance with best practice,[28] it is therefore recommended to limit the liability of BAM's staff and bodies as well as provisional administrator, when implementing the banking resolution mechanisms. Various mechanisms may be considered to this end:

[26] Article 121 of the Banking Law.

[27] Article 127 of the Banking Law.

[28] See in this respect KA 2.6.

- A monetary cap on the liability of BAM's bodies and staff may be stipulated (possibly aligned with the liability insurance which may be taken to cover BAM's liability).
- The legal grounds for review of their decisions would appropriately be restricted. It may, for instance, be required that the plaintiff positively demonstrates the inadequacy of the resolution tools used with the objectives pursued by such framework, by means of an independent third party valuation.
- Such proceedings should in no way constrain the implementation of, or result in a reversal of measures taken by resolution authorities when acting within their legal power and in good faith. Instead, it should provide for redress by awarding compensation, if justified on the basis of a report of an independent expert.

75. A general limitation of BAM, ACAPS and AMF's liability when acting as regulatory agencies may also be considered. Following the examples of other countries, the laws governing the regulatory agencies could also contain a provision restricting BAM, ACAPS and AMF's liability, when acting as regulatory agencies, including for the early intervention mechanisms. It may, for instance, limit their respective liability to the case of gross negligence, fraud and willful misconduct.