

Maldives: Financial Sector Assessment Program-Technical Note on Financial Safety Net and Crisis Management Arrangements



MALDIVES

FINANCIAL SECTOR ASSESSMENT PROGRAM

TECHNICAL NOTE ON FINANCIAL SAFETY NET AND CRISIS MANAGEMENT ARRANGEMENTS

January 2024

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December 18, 2023

TECHNICAL NOTE

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This Technical Note was prepared in the context of a joint IMF-World Bank Financial Sector Assessment Program (FSAP) mission in Maldives during May 2023 led by Torsten Wezel (IMF) and Natalie Nicolaou (WB), and overseen by the Monetary and Capital Markets Department, International Monetary Fund, and the Finance and Markets Global Practice, World Bank. The note contains the technical analysis and detailed information underpinning the FSAP assessment's findings and recommendations. Further information on the FSAP program can be found at <http://www.imf.org/external/np/fsap/fssa.aspx>.

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Glossary

BOFD	Banks and Other Financial Institutions Division
CMDA	Capital Market Development Authority
DIF	Deposit Insurance Fund
DIR	Deposit Insurance Regulation
DIS	Deposit Insurance System
ELA	Emergency Liquidity Assistance
EWI	Early warning indicator
EWS	Early warning system
FSB	Financial Stability Board
FSC	Financial Stability Committee
FSN	Financial Safety Net
FX	Foreign exchange
KAs	Key Attributes of Effective Resolution Regimes for Financial Institutions
M&A	Merger and acquisition
MBA	Maldives Banking Act
MMA	Maldives Monetary Authority
MVR	Maldivian Rufiyaa
MOF	Ministry of Finance
MOU	Memorandum of Understanding
P&A	Purchase and assumption
RRP	Recovery and Resolution Planning

EXECUTIVE SUMMARY¹

Maldives legislation includes important elements of a financial safety net and crisis management framework but there are areas for streamlining and improvement. Shortcomings in the early intervention and bank resolution frameworks need to be addressed, including internal arrangements on the escalation process from the exercise of the MMA's power to take enforcement actions through to the initiation of resolution. The overall design of the resolution tools is complex - the MBA includes different mechanisms for the same resolution tools - and requires streamlining. MMA should develop an effective emergency liquidity assistance framework. Deposit insurance system should be enhanced.

Institutional and interagency arrangements in Maldives needs to be enhanced. The cooperation across financial safety net participants needs to be strengthened, including tasking the Financial Stability Committee, with responsibilities for crisis preparedness and management. In addition, MMA should establish working relationships with resolution authorities in foreign jurisdictions, reserving the right of discretionary national action and subject to appropriate confidentiality requirements.

The Maldives Banking Act (MBA) provides tools for the MMA to implement early intervention and resolution measures. However, there are shortcomings that need to be addressed to enhance both frameworks and align them with international good practices.

- *MMA needs to establish a clearer and forward-looking set of early intervention triggers and t.* In addition, the MMA should issue relevant regulations or guidelines for operationalizing the early intervention regime comprising preventative and corrective actions.
- *MMA should be authorized to require banks to have a recovery plan that complies with requirements to be specified by the MMA.* Recovery planning should start with a pilot program focusing on the largest bank.
- *Similarly, the MMA should prepare a resolution plan for systemically important banks and perform accompanying resolvability assessments.* Under the resolution plan, the MMA should determine the resolution strategies for the bank based on the assessment of how to preserve financial stability while protecting its critical functions.
- *The triggers for initiating resolution should be strengthened including a forward looking perspective.* The governance trigger should be enhanced by providing links to bank's capacity to maintain adequate systems and controls and to effectively manage its risks.
- *The MBA should be amended to provide a resolution framework incorporating a unified mechanism.* Under this mechanism, the MMA should be empowered to implement different

¹ This Technical Note was prepared by Yesim Aydin (MCM). The analysis benefited from discussions with the staff of the MMA and reviewers at the IMF.

resolution tools sequentially or in combination, and if feasible under the legal framework, without court involvement, subject to relevant safeguards to protect interests of shareholders and creditors.

- *The requirement for the delivery of a conservator's report should not be a prior requirement to implementing resolution powers, as this may jeopardize the timely implementation of effective resolution actions.* The MBA should be amended to empower the MMA to trigger resolution and for resolution powers to be applied immediately for a bank deemed non-viable or likely non-viable.
- *The bridge bank preferably should be owned and controlled by the government.* The bridge bank will be operating under the supervision of the MMA, and in the Maldives context, conflict of interest issues would be best addressed by the government, rather than the MMA owning and capitalizing the bridge bank.
- *The MBA should differentiate the creditor hierarchy by providing reference to insured and uninsured depositors relative to unsecured creditors.* This could take the form of a tiered or general depositor preference. In addition, the legislation should authorize the MMA, under exceptional circumstances (i.e., when necessary to contain the potential systemic impact of a bank's failure or to maximize its value for the benefit of all creditors as a whole) to deviate from the pari passu treatment of creditors of the same class, subject to a no creditor worse off safeguard.

MMA should develop an effective emergency liquidity assistance (ELA) framework. This requires amendments to the MMA Act that to include ELA provisions and safeguards, and to clarify that the ELA can be provided by the MMA on a discretionary basis to banks that have temporary liquidity shortages but are assessed to be solvent and viable. ELA should be provided against adequate collateral and at a sufficiently high rate of interest. A high level of dollarization and the risk of official reserves being depleted pose significant challenges. While the MMA should be vested with the capacity to provide ELA in FX, it should only do so in practice if it has sufficient international reserves and if necessary to preserve financial stability.

The deposit insurance system should be enhanced and aligned with the International Association of Deposit Insurers (IADI) Core Principles for Effective Deposit Insurance Systems.

This would include:

- a. Enhancing the governance by establishing a strong internal control framework,
- b. Deciding on target fund size sufficient to meet the expected future obligations and cover the operational and related costs,
- c. The DIF having a paybox plus mandate, enabling it to provide contributions to bank resolution subject to sufficient safeguards and on a least-cost basis, and allow for ex-post recovery from the

banking system of temporary public financing used to facilitate the orderly resolution of a failed bank.

- d. Providing for emergency funding arrangements for the deposit insurance system, including pre-arranged and assured sources of liquidity funding (preferably a credit line from the government) in law or regulation (IADI CP 9).

Safeguards against recapitalization by public funds need to be strengthened. This should be an exceptional mechanism used as a last resort, only for cases where there is a significant risk of destabilization of the financial system and no other options available. Public funds should be used only after all estimated losses in the failed bank have been allocated to shareholders and, to the extent possible, to unsecured creditors. Any public solvency support should be combined with deep restructuring and management reforms, to enhance long term viability. There should also be pre-defined mechanisms for loss recovery such as ex-post levies from the banking sector.

Table 1. Maldives: Recommendations on Bank Resolution and Crisis Management			
No.	Recommendation	Authority	Time ¹
Institutional and inter-agency arrangements			
1.	Establish a separate Resolution Unit in the MMA; if not practicable, establish an ad hoc team to be converted to a separate unit in due course, with appropriate safeguards to ensure its autonomy and minimize conflicts of interest (¶10).	MMA	NT
2.	Amend the MBA to explicitly include the resolution objectives (¶12).	MMA, Parliament	I
3.	Consider strengthening the independence of MMA's board of directors by removing Government and private sector representatives from it (¶14).	Parliament	I
4.	Enhance the domestic cooperation and coordination across financial safety net participants and task the Financial Stability Committee (FSC) recommended for macroprudential policy with the coordination of activities pertaining to crisis preparedness and management, ensuring that the coordination role of the FSC does not preempt the powers and initiative of the MMA as resolution authority (¶16, 18).	MMA, MOF, CMDA	I
5.	Amend the MBA in line with the FSB KAs in relation to establishment of legal framework conditions for cross border cooperation (¶21).	MMA, Parliament	ST
6.	Establish working relationships with resolution authorities in foreign jurisdictions, reserving the right of discretionary national action and subject to appropriate confidentiality requirements; identify the matters for which legal recognition in Maldives might be needed in order to facilitate the implementation of the home resolution authority's resolution plan for a DSIB with a subsidiary or branch in the Maldives (¶20, 21, 22).	MMA	ST
Early intervention, recovery and resolution planning			
7.	Include clearly defined and forward-looking early intervention triggers in the MBA (¶ 25, 26).	MMA, Parliament	I

Table 1. Maldives: Recommendations on Bank Resolution and Crisis Management (Continued)			
8.	Issue relevant regulations or guidelines for operationalizing the early intervention regime comprising preventative and corrective actions, including the guidance for setting out the parameters and governance and develop a formalized EWS (¶ 27)	MMA	ST
9.	Develop contingency plans for how the MMA would respond to emerging stress and weakness in a bank and noncompliance with regulatory requirements and undertake regular testing of MMA capacity to apply early intervention (¶27).	MMA	MT
10.	Authorize the MMA to require banks to prepare recovery plans and require the MMA to prepare resolution plans and undertake resolvability assessments. (¶29, 30).	MMA, Parliament	ST
Bank resolution and liquidation			
11.	Amend the MMA to: <ul style="list-style-type: none"> • enhance resolution triggers and empower the MMA to trigger resolution and for resolution powers to be applied immediately for a bank deemed non-viable or likely non-viable (¶33, 36). • provide a resolution framework incorporating a unified mechanism under which different resolution tools can be implemented sequentially or in combination, and where feasible under the legal framework, without court involvement, subject to relevant safeguards to protect interests of shareholders and creditors (¶42). 	MMA, Parliament	I
12.	Include necessary provisions in the MBA to expedite the Court approval for the P&A tool in section 72 of the MBA (¶37).	MMA, Parliament	I
13.	Amend the MBA to ensure that the bridge bank is not owned and controlled by the MMA, ensure that the MMA is legally empowered to provide the basis for an effective control over the bridge bank (¶38, 44).	MMA, Parliament	I
14.	Enhance the operational preparedness of the MMA for bank resolution; prepare guidelines or manuals for the operationalization of the resolution tools; prepare valuation guidelines (¶43, 44, 45).	MMA	MT
15.	Provide teared or general depositor preference in the MBA; include the NCWOL principle in the legislation; empower the MMA to deviate, under exceptional circumstances, from the pari passu treatment of creditors of the same class (¶48, 49).	MMA, Parliament	MT
Emergency Liquidity Assistance			
16.	Amend the MMA Act to legally empower the MMA to provide ELA within a well-designed framework, aligned with international best practices. (¶50, 51, 53).	MMA, Parliament	I
17.	Develop the legal and procedural documentation regarding the provision of ELA to solvent and viable banks with temporary liquidity shortages (¶52).	MMA	I

Table 1. Maldives: Recommendations on Bank Resolution and Crisis Management (Concluded)			
18.	Empower the MMA to provide liquidity support in resolution, subject to adequate safeguards (¶154).	MMA, MOF, Parliament	ST
Deposit Insurance and Resolution Funding			
19.	Establish a separate, dedicated unit responsible for the management of the DIF, ensuring operational independence and sound governance arrangements (¶156).	MMA	MT
20.	Increase the submission frequency of deposit data (¶159).	MMA	I
21.	Determine a target fund size on the basis of clear, consistent and transparent criteria and a reasonable timeframe to reach the target fund size (¶158).	MMA	MT
22.	Enhance MMA's IT capacity to have access to online depositor accounts and adopt a plan to reduce the reimbursement period for insured deposits to seven working days (¶159).	MMA	MT
23.	Adopt a long-term strategy to promote public awareness of the DIS (¶160).	MMA	MT
24.	Give DIF a paybox plus mandate (¶161).	MMA, Parliament	MT
25.	Ensure that the DIF has a clear back-up emergency funding from the government in cases where the resources are insufficient to cover its responsibilities; ensure that the legislation (MMA Act and DIR) does not allow for any borrowings and contributions from the MMA in case of a shortfall of funding from the DIF (¶162).	MOF, MMA, Parliament	I
26.	Strengthen the safeguards against recapitalization by public funds need to be strengthened to minimize the risk of moral hazard (¶163).	MMA, MOF, Parliament	I
Contingency Planning and Crisis Management			
27.	Enhance MMA's role in contingency planning and crisis preparedness by developing an overarching crisis-management plan and conducting regular domestic crisis exercises (¶164).	MMA	ST
28.	Ensure that FSN participants have regularly updated contingency plans (¶164).	MMA, MOF, CMDA	MT
¹ Timing: I–Immediate: within 1 year; ST–short term: 1 to 2 years; MT–medium term: 3–5 years.			

INTRODUCTION²

1. This technical note presents findings and recommendations regarding Maldives' financial safety net and crisis management arrangements. It covers an assessment of the institutional framework, early intervention and recovery and resolution planning, bank resolution and liquidation regimes, arrangements for emergency liquidity assistance (ELA), deposit insurance and resolution funding as well as contingency planning and crisis management arrangements. Since the legal framework does not differentiate between public and private banks, the analysis and recommendations apply to both types of banks. In addition, they are equally applicable to institutions providing Islamic banking services. The technical note does not cover other financial institutions or financial market infrastructures. The findings and recommendations are based on analysis of relevant legislation and policy, the authorities' responses to a questionnaire, and discussions with authorities and the private sector during the main FSAP mission (May 8–23, 2023). The note is guided by international standards, notably the Key Attributes of Effective Resolution Regimes for Financial Institutions (KAs) and the Core Principles for Effective Deposit Insurance Systems, but it does not constitute a compliance assessment of these standards³.

2. The banking sector in Maldives is highly concentrated, dominated by state-owned banks. The size of the banking sector's assets corresponds to 59 percent of the GDP in 2022. The sector consists of 8 banks, and the domestic state-owned bank plays a dominant role, accounting for 51 percent of total assets. The total share of state-owned banks rises to 75 percent when including the two foreign controlled state-owned banks operating in Maldives. Five out of eight banks are branches or subsidiaries of foreign banks, corresponding to 40 percent of total banking system assets. The MMA has the power to require a bank to maintain higher capital ratios if the bank is a systemically important bank as determined by the MMA. Currently, no bank is subject to a higher capital requirement due to its systemic importance.

3. Banks' deposit-based funding structure and high dollarization have important implications for the safety net framework. The banking system has a simple, traditional balance sheet structure and banks do not have complex financial instruments or exposures. Banks are principally deposit funded, with total deposits corresponding to 87 percent of total liabilities. As a result, the share of unsecured creditors, senior or subordinated, to bear losses before depositors, is low. There is a high level of dollarization in the banking system, with 53 percent of total deposits and 44 percent of loans denominated in foreign exchange (FX). The dollarization of loans to nonfinancial corporates is particularly high at 75 percent⁴. Two banks breach the upper limit to the NOP which is relatively loose in international comparison, and the significant maturity mismatch between longer

² This Technical Note was prepared by Hanife Yesim Aydin (MCM). The author would like to thank the Maldivian authorities for their excellent engagement and constructive dialogue throughout the FSAP process.

³ Maldives FSAP Detailed Assessment Report includes assessments on the framework for crisis management, recovery and resolution and public safety net.

⁴ Although in practice banks do not extend foreign currency credit to firms without foreign exchange earnings, current banking regulations do not provide any guidance on foreign exchange loans.

term loans and a high share of callable deposits that also exhibit tourism-related seasonality poses FX liquidity risk⁵.

4. The legal framework on bank resolution and crisis management is primarily contained in two laws. Established in 1981, the Maldives Monetary Authority (MMA) derives its scope, regulatory powers, and mandate from the MMA Act (1981)⁶. The Maldives Banking Act (MBA)⁷ covers the provisions on the legal powers of the MMA to license banks, conduct ongoing supervision, undertake corrective actions and address the bank resolution under the conservatorship regime. The MMA is authorized to issue regulations for the implementation and enforcement of the MBA. In addition to these two laws, the Deposit Insurance Scheme Regulation (DIR)⁸ includes provisions on insured deposits, management of the Deposit Insurance Fund (DIF), investment of the Fund's money, deposit coverage and payouts.

5. This is the first full FSAP for Maldives, as the previous exercise in 2016 was a solo World Bank Development Module. The previous assessment took place in a radically different environment, with much lower public debt and a favorable external environment. The Module highlighted risks related to shortcomings in regulatory and legal provisions as well as limited supervisory capacity and stunted financial development; and does not cover financial safety net and crisis management arrangements. Recent Article IV missions (2021 and 2022) recommend introducing a comprehensive crisis management framework by operationalizing a bank resolution framework and aligning it with the MMA lender of last resort function. There has not been progress in financial safety net and crisis management arrangements owing to the dual shocks of COVID-19 and the ramifications of Russia's war in Ukraine.

INSTITUTIONAL FRAMEWORK AND INTER-AGENCY ARRANGEMENTS

A. Institutional Arrangements

6. The Maldivian financial safety net (FSN) comprises the MMA, Ministry of Finance (MoF) and Capital Markets Development Authority (CMDA), with the MMA playing the key role. The MBA defines as objectives maintaining financial stability and public confidence in the banking system, protecting the rights of depositors and creditors of banks and managing systemic risks. The MMA Act authorizes the MMA to regulate and supervise the financial market excluding the securities

⁵ According to MMA's Prudential Regulation on Foreign Currency Exposure Limits, the foreign currency open position exposure for all currencies shall not exceed 40 percent of a bank's capital base, and the single currency open position exposure shall not exceed 25 percent of a bank's capital base for a long position, and 15 percent for a short position.

⁶ Law No: 6/81.

⁷ Law No: 24/2010, amended in 2015.

⁸ This Regulation is issued pursuant to Section 62 and 66 of the Maldives Banking Act.

market which is regulated by the Capital Market Development Authority (CMDA)⁹. The CMDA is responsible for the supervision of the Pension Fund and companies that have their shares listed on the capital market, including two banks and one insurance company. MMA's area of jurisdiction covers banks, insurance companies, non-bank financial institutions and payments institutions. Additionally, MMA regulates the payment system and houses the credit information bureau. There is no separate deposit insurance agency, and the deposit insurance fund (DIF) is managed by the MMA.

7. MMA is responsible for microprudential supervision, including the use of enforcement tools. The MBA confers on MMA powers to address banks problems through enforcement measures and sanctions, insofar as the bank has violated the provisions of the MBA or has engaged or is engaging in unsafe or unsound banking operations. The powers are broad, including relatively mild actions¹⁰, cease and desist orders and specific requirements to address the problems, measures to remove or replace individual board members and managers or the full board of directors. More drastic measures involve placing the bank into conservatorship or revoking a bank's license and placing the bank into receivership during a liquidation process. As the resolution authority, the MMA may need to coordinate with other authorities (CMDA in case that the failed bank has its shares listed, the Ministry of Finance in case of a recapitalization measure, and foreign authorities in case that a subsidiary or branch of a foreign bank is placed under conservatorship).

8. MMA is the lender of last resort as well as the authority to trigger and execute resolution actions. As a resolution authority, the MMA is empowered by the MBA to intervene a failing bank and implement resolution actions under the conservatorship regime. There is no emergency liquidity assistance (ELA) framework in the Maldives, but the MMA Act empowers the MMA to lend to financial institutions for a maximum 90-day period, which can be extended three times. State owned banks as well as the branches and subsidiaries of foreign banks are subject to the same early intervention and bank resolution regime. Additionally, all banks, including the state owned and foreign owned banks, are members of the deposit insurance scheme (DIS), subject to the same coverage level and deposit insurance levies.

9. The role of the Ministry of Finance (MOF) in the financial safety net is currently restricted to recapitalization using public funds. The MBA includes the provisions for the potential recapitalization of the bank by the MoF, in cases where financial stability is at risk. A bank may be recapitalized using public funds if the MOF decides, upon the recommendation of the MMA, that the recapitalization is required for maintaining financial stability. The recommendation of the MMA to recapitalize a bank using public funds should be accompanied by a recapitalization plan prepared by the MMA in consultation with the conservator including the intended measures to remediate the weaknesses of the bank.

10. The MMA does not have a separate unit for bank resolution. The Banks and Other Financial Institutions Division (BOFD) is responsible for bank resolution. BOFD is also responsible for (i) licensing banks and other financial institutions; (ii) monitoring their activities to ensure compliance

⁹ Law no: 2/2006 (Maldives Securities Act).

¹⁰ These include actions like warnings and entering into voluntary agreements with the MMA.

to the laws, regulations, and other requirements of the MMA; and (iii) assessing the financial soundness and performance of these institutions. There is no dedicated personnel for bank resolution within the BOFD. The mission recommends establishing a separate Resolution Unit under the BOFD to undertake the work needed on bank resolution. The Resolution Unit should be operationally separate from the BOFD, with distinct responsibilities and separate reporting lines to different Deputy Governors. If that is not practicable given the resource constraints, the MMA should ensure the existence of an ad hoc team that would be converted to a separate unit in due course, with appropriate safeguards to ensure its autonomy and minimize conflicts of interest.

11. The DIF is managed by the same division in the MMA. The DIF is segregated from other funds within the MMA and subject to external audit on a yearly basis, but there are no governance rules specified for the Fund. There is no dedicated personnel responsible for the management of the DIF.¹¹

12. The MBA does not include resolution objectives. The MBA includes as objectives maintaining financial stability and public confidence in the banking system, protecting the rights of depositors and creditors of banks and managing systemic risks. Resolution objectives should be explicitly stated in the MBA. In addition, the objectives should include (i) ensuring continuity of systemically important financial services and avoiding unnecessary destruction of value, and (ii) seeking to minimize the overall costs of resolution and losses to creditors (KA 2.3).

13. The legal framework provides a sufficient level of legal protection to MMA staff¹². The MBA provides legal immunity to the MMA Board of Directors and staff, including the conservator and receiver appointed by the MMA, unless the decisions have been made in bad faith or constitute a criminal offense. Under these circumstances, any expenses incurred by the board members and staff will be borne by the MMA.

14. The independence of the MMA needs to be strengthened. The highest governing body of the MMA, as an independent institution, is the Board of Directors, responsible for determining the primary policies of the MMA. The Board of Directors includes representatives from the Government and from the private sector. This presence, particularly considering the prominent role of the state in the financial sector, as the controlling shareholder of the largest bank in Maldives and as main or major shareholder in other financial institutions, exposes MMA to potential political interference, that may pose threats to MMA independence. MMA's operational independence to effectively implement resolution measures (KA 2.5) may eventually be compromised by external interference or lack of resources.

¹¹ See the section on Deposit Insurance and Resolution Funding for recommendations.

¹² Section 9 of the MMA Act and section 54 of the MBA provide legal immunity to the MMA's employees provided that legal action is conducted against them based on the actions they have taken carrying out their responsibilities and that the action or inaction was without bad faith and reasonable diligence (Section 9 of the MMA Act) or without bad faith or has committed a criminal offence (Section 54 of the MBA).

B. Inter-Agency Arrangements

15. MMA is the authority in charge of financial stability in the Maldives. The MMA Act defines the MMA as an independent authority with three primary objectives: (i) to maintain price stability conducive to the sustainable growth of the economy, (ii) without prejudice to the previous objective, to maintain financial stability and (iii) without prejudice of the two previous objectives, to support the Government in achieving macroeconomic stability and economic growth.

16. Interagency arrangements are insufficient and crisis preparedness is low. Currently, there are no regular, periodic meetings among MMA, CMDA and MoF as FSN participants and cooperation across these agencies is done on an “as needed” basis. The MMA signed an MoU with the CMDA in 2014 to provide for mutual assistance and cooperation, including exchange of information. There is no tripartite Memorandum of Understanding (MoU) among these agencies, nor an MoU between the MOF and the MMA. Cooperation across FSN participants including the exchange of information should be enhanced.

17. The framework for financial stability has not been operationalized in the Maldives. MMA has been preparing a draft for selected macroprudential tools, but until now, it has not been significantly active in macroprudential policy making. MMA does not prepare a financial stability report. There is an insufficient level of coordination on financial stability between the financial safety net participants. There is no high-level committee that would bring together the MMA, CMDA and MoF for discussing system-wide risks and engaging in contingency planning, and that would serve as a platform for information exchange¹³.

18. A new Financial Stability Committee (FSC) recommended for macroprudential policy should also be tasked with crisis preparedness and management.¹⁴ This committee, comprising of the MMA, MoF and CMDA, should function as a forum where the authorities work together on crisis preparedness and management, with each safeguarding its own responsibility and autonomy for the exercise of its relevant powers within its mandate. The committee’s role in relation to bank resolution should be formalized as a coordination role, with the MMA participating in its capacity as supervisor, lender of last resort and resolution authority. The coordination role of the FSC should not preempt the powers and initiative of the MMA as resolution authority. Each member agency should have clear roles and responsibilities to perform under stress and in crisis situations. The FSC should also be charged with preparing a communication strategy.

¹³ There is a multi-agency Macroeconomic Policy Coordinating Committee (MPCC) which leads the process of establishing the macroeconomic forecasts. The MPCC comprises the MoF, MMA, Ministry of Tourism, Ministry of Planning, Bureau of Statistics and Maldives Inland Revenue Authority. The MPCC is a high-level policy coordination body and is supported by a technical group. The purpose is to prepare forecasts in September/October during the preparation of the budget. These are revised at the technical level in February of the next year, if needed. The MPCC does not have direct role in crisis preparedness from a financial stability standpoint and does not have any responsibility related to financial sector issues.

¹⁴ Maldives Technical Note on Macroprudential Policy.

19. MMA has signed MOUs with three foreign authorities and is in the process of signing MOUs with two others. MMA has entered into MoUs with the Bank of Mauritius (2011), the Reserve Bank of India (RBI) (2015) and the Central Bank of Sri Lanka (CBSL) (2020). Moreover, the MMA is negotiating MoUs with the Hong Kong Monetary Authority and the State Bank of Pakistan.

20. The MOUs signed with foreign authorities do not explicitly cover resolution matters. Only the MoUs with the RBI and the CBSL contain specific provisions on crisis management. Among other aspects, they regulate that both parties to the MoU should: (i) share the contingency arrangements they may have prepared for crisis management purposes, including systemic impact, liquidity, solvency and contingency funding plans, or contingency liquidation arrangements in the event of bankruptcy; (ii) provide the party with information pertaining to the deposit protection arrangements; (iii) provide support from the home to the host in requiring the head office of the branch to provide initiatives and solutions for liquidity assistance and other measures. The MBA should empower the MMA to establish working relationships with resolution authorities in foreign jurisdictions, including the signing of MOUs with those authorities allowing for the exchange of information on recovery and resolution matters on a reciprocal basis, reserving the right of discretionary national action if necessary to achieve domestic stability in the absence of effective international cooperation and information sharing. This information exchange should be subject to appropriate confidentiality requirements.

21. In the case of foreign-owned D-SIBs, the mission recommends that the MMA work closely with the home resolution authorities to deepen the MMA's understanding of the home authorities' resolution plans. It would be useful for the MMA to identify the matters for which legal recognition in Maldives might be needed in order to facilitate the implementation of the home resolution authority's resolution plan for a D-SIB with a subsidiary or branch in the Maldives. In the assessment of the legal recognition in Maldives, the MMA should consider the appropriateness of the plan contingent on meeting the resolution objectives in Maldives, including maintaining continuity of critical functions and services, as well as protecting depositors and other creditors of the subsidiary or branch. The MBA needs to be amended in line with the FSB KAs¹⁵ in relation to establishment of legal framework conditions for cross border cooperation.

22. While the MMA should seek to achieve cooperative solutions with foreign resolution authorities, it should be able to take discretionary national actions if action or inaction by home jurisdictions jeopardizes financial stability in the Maldives. This would include the cases where the license of the parent bank in the home country is cancelled or the parent bank is subject to a resolution action in its country such as compulsory winding-up, which could be considered as an indication of nonviability or likely to become nonviable.

¹⁵ KA7-Legal framework conditions for cross border cooperation.

C. Summary of Recommendations

- Establish a separate Resolution Unit in the MMA; if not practicable, establish an ad hoc team to be converted to a separate unit in due course, with appropriate safeguards to ensure its autonomy and minimize conflicts of interest (¶10).
- Amend the MMA Act to explicitly include the resolution objectives, including ensuring continuity of systemically important financial services and avoiding unnecessary destruction of value and seeking to minimize the overall costs of resolution and losses to creditors (KA 2.2).
- Consider strengthening the independence of MMA's board of directors by removing Government and private sector representatives from it.
- Enhance the domestic cooperation and coordination across financial safety net participants.
- Task a new Financial Stability Committee (FSC) recommended for macroprudential policy with the coordination of activities pertaining to crisis preparedness and management. Ensure that the coordination role of the FSC does not preempt the powers and initiative of the MMA as resolution authority.
- Amend the MBA in line with the FSB KAs in relation to establishment of legal framework conditions for cross border cooperation.
- Empower the MMA to establish working relationships with resolution authorities in foreign jurisdictions, including the signing of MOUs with those authorities allowing for exchange of information on recovery and resolution matters on a reciprocal basis reserving the right of discretionary national action and subject to appropriate confidentiality requirements.
- Identify the matters for which legal recognition in Maldives might be needed in order to facilitate the implementation of the home resolution authority's resolution plan for a D-SIB with a subsidiary or branch in the Maldives.
- Ensure that the MMA is able to take discretionary national actions if action or inaction by home jurisdictions jeopardizes financial stability in the Maldives.

EARLY INTERVENTION, AND RECOVERY AND RESOLUTION PLANNING

A. Early Intervention

23. MMA's supervisory approach entails the combination of off-site examination and on-site monitoring. The supervisor uses the CAMELS methodology; ratings are updated after an on-site inspection and during the quarterly monitoring. MMA does not adjust its supervisory intensiveness, or its allocation of supervisory resources based on the banks' risk profile or systemic relevance. The

MMA does not currently use a system of early warning indicators (EWI). The stress testing framework consists of a sensitivity analysis exercise, and the results are not used regularly as input for early detection of risks and assessment of potential vulnerability of banks to economic and financial shocks. The MMA has not developed internal contingency plans for how it would respond to bank stress and weakness.

24. Section 55 of the MBA provides for enforcement powers and corrective actions to apply to a bank that has breached any laws, regulations, conditions for licensing, instructions or orders imposed by the MMA and in case of unsafe and unsound practices. The MBA creates a broad set of measures for dealing with banking problems. These include relatively mild measures (written warnings or voluntary agreements), cease and desist orders and specific requirements to address the problems and compelling banks to take measures to address governance problems (such as removing board members, appointment of an advisor, etc.), or imposing administrative sanctions on banks and administrators. All of these actions are unilaterally decided by MBA. More drastic measures involve placing the bank into conservatorship or revoking a bank's license (Box 1).

25. The legal framework lacks clearly defined qualitative and quantitative early intervention triggers. Despite the reference to the unsafe and unsound practices of banks, there is no regulation or guidance including the definitions of those practices. In addition, the powers conferred onto the MMA do not follow an escalated structure by reference to the severity of the situation.

26. The MMA needs to establish a more forward-looking set of early intervention triggers. The lack of the definition of unsafe and unsound practices in the MBA or in any other regulation or guidance may preclude MMA from taking action against an institution or its administrators. Notwithstanding the fact that the legal framework for handling troubled banks includes a broad range of enforcement measures, the MBA should be strengthened to allow for an escalated structure of early intervention in response to specified triggers.

27. Given the MMA's lack of experience in the implementation of early intervention measures, it is crucial for the MMA to issue relevant regulations or guidelines for operationalizing the early intervention regime comprising preventative and corrective actions. It would be useful for the MMA to be guided by any internal framework setting out the parameters and governance under which early intervention decisions are made. The guidance would also cover the definition of unsafe and unsound practices, linked to both qualitative and quantitative triggers for early intervention, without being unduly prescriptive. It would be useful to develop a formalized early warning system (EWS) comprising a range of EWIs that can be used to inform about incipient stress in individual banks and in the banking system as a whole. The stress testing framework should be enhanced and used as an effective tool for early detection of risks and assessment of potential bank vulnerability to economic and financial shocks. Additionally, the MMA needs to develop contingency plans for how it would respond to emerging stress and weakness in a bank and noncompliance with regulatory requirements, and undertake regular testing of its capacity to apply early intervention.

Box 1. Overview of MMA Supervisory Tools to Address Risks and Weaknesses

Set forth below are the enforcement and early intervention tools the MMA relies upon to address open bank supervisory issues. These are supported by section 55 of the MBA. The same section identifies two conditions that will lead to the use of these tools in section 55(a) of the MBA as: (1) breaching any laws, regulations, conditions for licensing, instructions or orders imposed by the MMA and (2) engaging in unsafe and unsound practices. This should not be considered an exhaustive list; selected, relevant measures are set forth below.

- giving banks cease and desist orders from particular actions, or requiring banks to take affirmative action to correct the violations leading up to enforcement and early intervention actions;
- requiring the bank to submit a detailed description of remedial measures to eliminate these violations;
- requiring the board of directors to inject additional capital within a time period acceptable to the MMA, or to submit a plan acceptable to the MMA for increasing capital to a level specified by the MMA;
- prohibition of declaration or payment of any cash dividends or profit distribution;
- imposing restrictions on loan extensions or allowing for extensions under certain conditions;
- appointment of one or more representatives of the MMA to bank's board of directors to review and examine the violations and to take the necessary measures for their elimination;
- requiring the bank to hire, for a period of time and under conditions to be specified by the MMA, an advisor who shall have authority to make decisions or disapprove actions proposed to be taken by the bank regarding the sale, disposition or transfer of the bank's assets, the loan or investment of the bank's funds, the undertaking of any debt, obligation or liability, and the payment of dividends;
- removing the chairman, board member or the managing director, any other executive officer or the manager of foreign branches;
- imposing administrative penalties
- revoking the bank's license.

B. Recovery and Resolution Planning

28. There is no recovery and resolution planning (RRP) framework in the Maldives. The legal framework does not authorize the MMA to require banks to prepare recovery plans or require the MMA to prepare resolution plans and undertake resolvability assessments. Given the lack of any crisis experience, the absence of effective recovery and resolution planning may cause the authorities to rely on administrative take-overs and public recapitalization in systemic cases (Box 2).

29. The MMA should be authorized to require banks to prepare a recovery plan that complies with requirements to be specified by the MMA. The specific requirements of the recovery plans should be consistent with, and proportional to, the size and complexity of each bank. Recovery planning should start with a pilot program focusing on the largest bank. Once the pilot program has been completed, recovery planning should be extended proportionally to the other banks. MMA should issue a regulation on recovery planning and provide necessary guidance to banks for the preparation of recovery plans.

30. The MMA should prepare resolution plans for systemically important banks and perform accompanying resolvability assessments. Under the resolution plan, the MMA should

determine the resolution strategies for the bank based on the assessment of how to protect financial stability while protecting its critical functions. MMA should also perform the resolvability assessment of the bank. The assessment would evaluate the feasibility of preferred resolution strategies and their credibility considering the likely impact of the bank's failure on the financial system and the economy at large. The MMA should be empowered to require banks to remove impediments to resolution which may include changes to banks' legal, operational and financial structure or their business activities.

Box 2. Recovery and Resolution Planning

RRPs are critical elements of resolution frameworks in all jurisdictions. The Key attributes require RRP for all banks that are systemic in failure and resolvability assessments for global systemically important banks but leave the possibility of the wider application of these tools. The essential elements of RRP are set out in Annex I-4 of KAs. RRP enhance the crisis preparedness of all parties.

As part of the risk management framework, the recovery plan is an instrument of the bank to identify options to restore financial strength or viability under stress or after a shock to capital or liquidity. Such plans will lay out how a bank will recover from distress as a going concern bank and outside of the resolution regime. The additional benefit of recovery plans is that they contain updated information on the structure of the bank and the asset and liability structure and include concrete plans for addressing distress in the market. Banks prepare the recovery plans, and banks' boards have oversight responsibility for the development and maintenance of recovery plans. Recovery plans include credible options to cope with a range of scenarios including idiosyncratic and market-wide stress; scenarios that address capital shortfalls and liquidity pressures, and processes to ensure timely implementation of recovery options in a range of stress situations. Recovery plans should be prepared under the guidance provided by the supervisory authority and assessed by the supervisors. The specific requirements of the recovery plans should be consistent with, and proportional to, the size and complexity of each bank.

The purpose of resolution plans is to facilitate the effective use of resolution powers to protect systemically important functions without severe systemic disruption and exposing taxpayers to loss. Resolution authorities prepare the resolution plans based on the information provided by the banks, but the KAs also allow for the preparation of resolution plans by banks, to be reviewed by the resolution authorities. Authorities should identify potential resolution strategies and assess the necessary preconditions and operational requirements for their implementation, including with regard to arrangements for cross-border coordination. Bank resolution plans include information on a bank's organizational structure and business lines, its ownership structure, its critical functions, its assets, liabilities and contractual obligations, loans, the range of sources available for resolution funding, the bank's critical interdependencies, and processes for cross-border implementation. Similar to recovery plans, the complexity of resolution plans will vary based on the bank's complexity and systemic importance.

In the event of a failure, the decision on how to resolve should be made quickly, and resolvability assessments will be critical for systemically important and even medium sized banks. Resolvability assessments should contain, among others, an analysis of the following: (a) the extent to which critical financial services and functions can be maintained in a failure, (b) the nature and extent of intragroup exposures, (c) the capacity of the firm to deliver adequate and timely information, and (d) the robustness of cross-border cooperation and information sharing arrangements.

C. Summary of Recommendations

- Include clearly defined and forward-looking early intervention triggers in the MBA.
- Issue relevant regulations or guidelines for operationalizing the early intervention regime comprising preventative and corrective actions, including the guidance for setting out the parameters and governance under which early intervention decisions are made.
- Develop a formalized EWS.
- Develop contingency plans for how the MMA would respond to emerging stress and weakness in a bank and noncompliance with regulatory requirements and undertake regular testing of MMA capacity to apply early intervention.
- Authorize the MMA to require banks to prepare recovery plans and require the MMA to prepare resolution plans and undertake resolvability assessments.

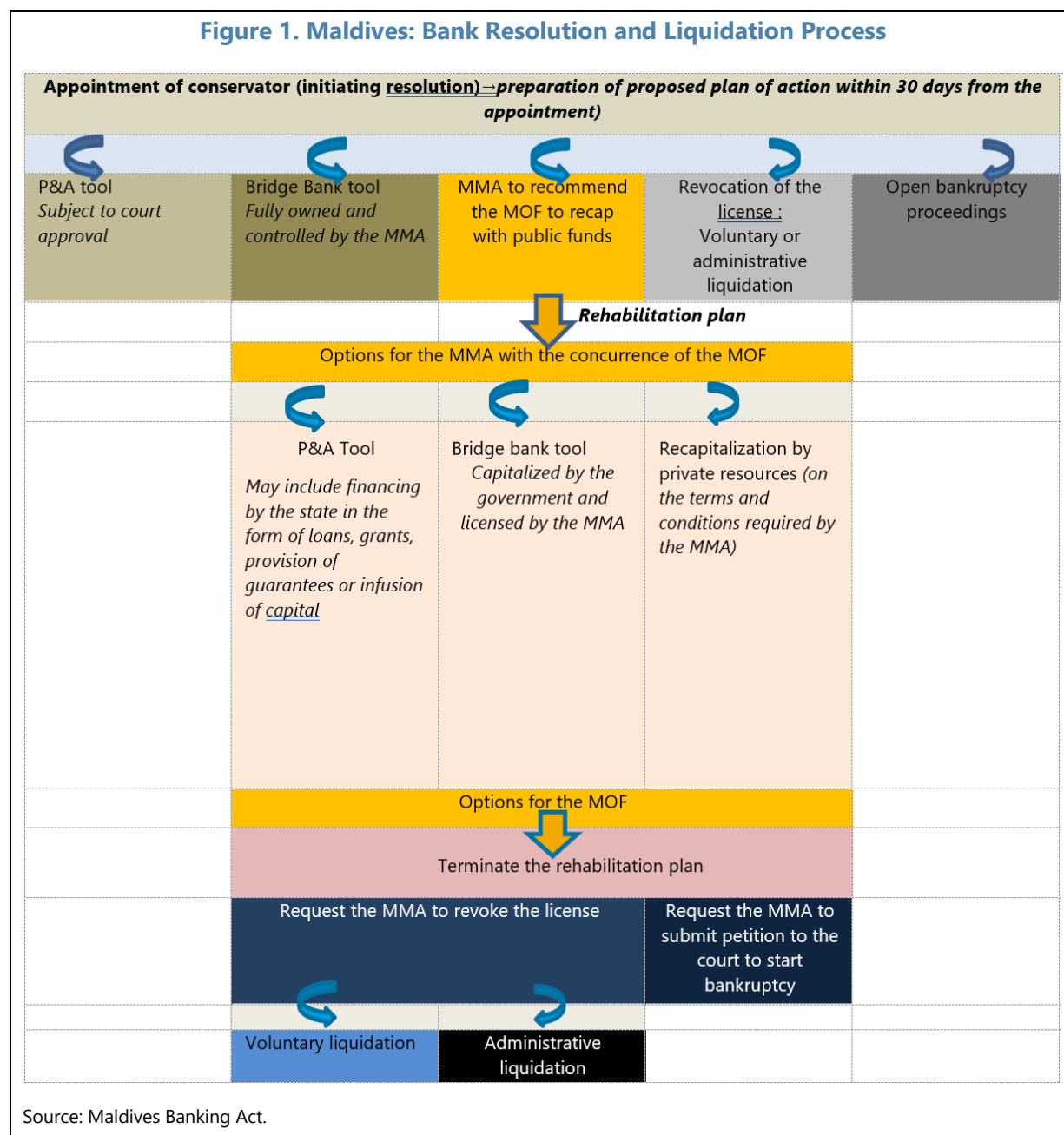
BANK RESOLUTION AND LIQUIDATION

A. Key Issues

31. The MBA includes provisions for orderly resolution of banks, recapitalization by public funds, and voluntary or administrative liquidation. The process can be summarized as follows (see also Figure 1):

- Resolution triggering and the appointment of the conservator.** The MBA specifies the triggers under which the MMA *should*, or the MMA *may* appoint a conservator. The appointment of a conservator is a mandatory step for resolution initiation.
- Intervention.** Simultaneously with the appointment of the conservator by the MMA, shareholder powers are suspended. A moratorium may be imposed on all of the bank's liabilities, with the exception of the withdrawal of 50 percent of their total deposits by natural persons upon the approval of the MMA.
- Resolution proposal.** The conservator prepares a report to the MMA, including the proposed action plan, within 30 days following the appointment. The conservator may propose (i) purchase and assumption (P&A) or bridge bank options for resolution; (ii) recapitalization by public funds, to be submitted to the approval of the MOF by the MMA; (iii) liquidation.
- Resolution approval.** The resolution is triggered, and the conservator is appointed at the sole discretion of the MMA. Transactions involving the recapitalization of the bank with private investors, sale, and merger and acquisition (M&A) of the bank could be undertaken on the circumstances and on the terms and conditions approved by the Court at the recommendation of the MMA. Recapitalization by public funds depends on the decision of the MOF.

- e. **Liquidation.** The administrative liquidation is conducted by the receiver under the supervision of the MMA.



32. The bank resolution process in Maldives is initiated by the appointment of a conservator. The MBA determines the triggers upon which a conservator should be appointed, and resolution initiated: (i) the bank fails to pay its financial obligations; (ii) capital of the bank is reduced to less than 50 percent of the minimum requirements; (iii) a petition has been submitted for the bankruptcy of the bank; (iv) the board of directors is unable or unwilling to manage the affairs of the bank. There are circumstances where it is in the discretion of the MMA to appoint a conservator and

initiate the resolution: (i) the bank fails to carry out an order of the MMA; (ii) the bank's capital is too low to support safe and sound banking operations; (iii) there is evidence or reasonable cause to believe that the bank or any of its administrators have engaged or are engaging in criminal activities; (iv) there is reasonable cause to believe that the board of directors is unable or unwilling to manage the affairs of the bank.

33. The MBA defines triggers for the initiation of the resolution process, based on liquidity, solvency and governance, but the triggers for initiating resolution are all backward-looking, thereby jeopardizing the resolution initiation at a sufficiently early stage. In addition, the governance trigger is solely based on the board of directors being unable or unwilling to manage the affairs of the bank, and links to the capability of the bank to maintain adequate systems and controls and to effectively manage its risks are missing. The MBA should be amended to include forward-looking resolution objectives, and the governance trigger should be strengthened. In addition, the early intervention and bank resolution framework should include internal arrangements on the escalation process from the exercise of the MMA's power to take enforcement actions under section 55 through the initiation of resolution under section 70.

34. The MMA appoints the conservator for a term of 12 months renewable twice for 12 months periods. The MBA requires the conservator to be fit and proper to be eligible for the appointment, but eligibility criteria are not specified in the MBA or in a regulation or guideline. The conservator will be appointed for a term of 12 months, potentially renewed twice for 12-month periods and should be fit and proper for the role.

35. The MBA requires the conservator to take control of the bank's assets and liabilities and prepare a financial report within 30 days of the appointment. The report should include an estimate of the value of the bank's assets to be realized in a liquidation process (receivership) and a proposed action plan. There is no guideline for the valuation of the bank's assets during the liquidation process. Once the report has been delivered by the conservator, the MMA should decide between different options including the (i) request the public recapitalization of the bank, with the approval of the MOF; (ii) transfer all or part of the assets and liabilities of the bank, or its shares, to a bridge bank or to a third party (P&A transaction); (iii) withdraw the license of the bank and request the court to open the liquidation (receivership) process). The power under conservatorship also involves the possibility to apply a moratorium regime to the creditors of the bank for a maximum period of three months. All resolution measures are equally applicable to state-owned banks. Given the deposit-based funding structure, the P&A and bridge bank tools would likely be used in Maldives, and a bail-in tool is not included in the resolution toolkit.

36. The requirement for the delivery of a conservator's report should not be a prior requirement to implementing resolution powers, as this may jeopardize the timely implementation of effective resolution actions. The MBA should be amended to empower the MMA to trigger resolution and for resolution powers to be applied immediately in a quick failure for a bank deemed non-viable or likely non-viable, based upon the information that it is available at that time.

37. The authorities should amend the MBA to expedite court approval for P&A transactions. After the appointment, the conservator will assume all the powers of the bank's board of directors and the shareholders' meeting, with certain exceptions. Recapitalization of the bank by new investors, or a sale, merger or amalgamation with any other bank, closure or liquidation of the bank can only be undertaken in circumstances and on the terms and conditions approved by the court on MMA's recommendation. The P&A tool can also be implemented (i) during the rehabilitation phase of the recapitalization of the bank by public funds and requires the authorization of the conservator for this purpose by the MMA and (ii) under the receivership process in liquidation. Unlike the use of the P&A tool under the public recapitalization process, the Law does not specify the timeframe for the Court approval. The authorities reiterated that they the court involvement would not be avoided for the sake of protecting constitutional rights. The authorities should set a timeframe for court decisions to prevent any probable delays in the implementation of these tools, that may increase costs and/or jeopardize financial stability.

38. The MBA includes two distinct procedures in the implementation of the bridge bank tool. In the implementation of the bridge bank tool without the public recapitalization of the failing bank by MoF, the MBA authorizes the MMA, in its sole discretion, to organize and license a bridge bank to receive assets and liabilities of a bank under conservatorship or receivership. This bridge bank entails the full ownership and control by the MMA. Since the bridge bank will be operating under the supervision of the MMA, the government, not the MMA, should own and capitalize the bridge bank. That is critical to best address the conflicts of interest in the Maldives case and to protect MMA's balance sheet. The second procedure includes the implementation of the bridge bank option after the bank is recapitalized by public funds (see below).

39. Chapter 15 of the MBA describes the recapitalization with public funds. The MBA specifies that the recapitalization by public funds should be justified by preserving the stability of the Maldives banking system, as recommended by the MMA and decided by the MOF, but it lacks sufficient safeguards for the use of public funds (see the section on Resolution Funding). The MBA requires the MMA to prepare a recapitalization plan in consultation with the conservator. The plan should identify the existing weaknesses in the bank, determine the corrective measures required to remedy these weaknesses and provide a timetable and financing plan for the proposed rehabilitation. At any time during the execution of the plan, the MOF, following a consultation with the MMA, may (i) terminate the rehabilitation plan; (ii) request the MMA to revoke the license of the bank; or (iii) request the MMA to submit a petition to the Court for bankruptcy proceedings. The MBA explicitly prohibits the recapitalization of a bankrupt bank by public funds.

40. As part of the rehabilitation plan, the MMA is authorized to direct the conservator of a bank under rehabilitation to transfer all or part of the assets and liabilities of the bank to a bridge bank. The bridge bank should be established and capitalized by the government and licensed by the MMA. The MMA has full control over the bridge bank to receive any assets and liabilities of one or more banks. The MBA does not specify a maximum period for the operations of the bridge bank.

41. Another option is to use the P&A tool. Upon the request of the conservator made in accordance with the rehabilitation plan, and with the approval of the MOF, the MMA may authorize the conservator to transfer the shares, assets and liabilities of the bank to a healthy acquiring institution. This transaction may include financing by the government in the form of deposits, loans, grants, the provision of guarantees or infusion of capital. There are no safeguards for the financing by the government (please see Resolution Funding). Another option for the conservator (again with authorization by the MMA based on the approval of the MOF), is to order an increase in the authorized capital of the bank on the terms and conditions determined by the MMA.

42. The overall design of the resolution tools is complex and requires streamlining. As explained in the previous paragraphs, the MBA includes different mechanisms for the same resolution tools. For example, recapitalization of the bank by new investors, or a sale, merger or amalgamation with another bank require court approval, while these tools can be utilized without court approval when public funds are used. Similarly, implementation of bridge bank tool is subject to two distinct procedures. The rationale behind these differentiations is unclear, and likely to cause complications when financial stability is at stake. The mission recommends amending the MBA to provide a resolution framework incorporating a unified mechanism under which different resolution tools can be implemented sequentially or in combination, and where feasible under the legal framework, without court involvement, subject to relevant safeguards to protect interests of shareholders and creditors.

43. Given the lack of resolution experience, the MMA should enhance its operational preparedness for bank resolution. This would include developing a resolution manual which should set out a comprehensive guidance on: (a) the assessment of a bank's viability; (b) the selection of a resolution option for a bank, considering its systemic importance and whether it is domestic or foreign owned; (c) procedures for facilitating entry into resolution; (d) step-by-step implementation of resolution options; (e) coordination between home and host resolution authorities for each stage of resolution; (f) domestic coordination for the resolution of a bank (including, especially, between the MMA and the MOF); (g) communications with stakeholders at each stage of a resolution; and (h) the exit from resolution, including exit by the government to the extent it has provided public support (e.g., equity or debt funding or guarantees) to a bank in resolution.

44. The legal framework lacks guidelines or manuals for the operationalization of the resolution tools. When issuing the license for the bridge bank, the MMA should make a decision on whether the bridge bank should meet all prudential requirements including the capital adequacy related ones, like any other bank in the system. It should be clarified in the legislation with a view to ensuring a level playing field with commercial banks that the bridge bank should be required to meet most prudential requirements, in particular the capital requirement, if it cannot be sold within a short period. Additionally, it should be clarified that the purpose is to take over and continue operating certain critical functions and viable operations of a failed bank and not to carry over any legacy issues. The MMA should be legally empowered to provide the basis for an effective control over the bridge bank through powers including i) the appointment and removal of the management;

(ii) the power to give instructions and recommendations to the management; and (iii) approval of certain operations. The resolution guideline or manual should also specify the operationalization of the P&A under conservatorship, receivership or under the rehabilitation process during recapitalization by public funds.

45. Separate guidelines for the valuation process should be issued. Before transferring assets and liabilities to a third party or a bridge bank, the MMA should obtain a valuation of the bank's balance sheet. This valuation should be carried out by independent experts—with the option to use a valuation by the MMA if resolution timelines are too short to allow for independent valuation—and used to guide the resolution decision and help optimize the resolution structure (including the assets and liabilities to be transferred and their price), and reduce legal uncertainty.

46. The bank liquidation/receivership process is court-based, although MMA has an important role. The court is responsible for accepting the request for the bankruptcy of the bank, to appoint and dismiss a receiver and to authorize specific actions requested by the receiver in accordance with the Banking Act. MMA also has a relevant role in the process; the MBA contemplates the forced liquidation of the bank after the bank's license has been revoked by the MMA. The liquidation will be undertaken by a receiver under the supervision of the MMA. Within 90 days from the appointment, the receiver should submit the MMA a liquidation plan for the bank, including a proforma balance sheet, quarterly income statements and a report on the sale of the bank or a part of its assets. There is no guidance or regulation on valuation in place.

47. The MMA is authorized to open bankruptcy proceedings against a bank on one or more of the following grounds: (i) the bank is not paying its financial obligations, including its deposit liabilities as they fall due, and no liquidity support acceptable to the MMA is available; (ii) the core capital is less than 2 percent and no recapitalization plan acceptable to the MMA is available; and (iii) the bank is no longer viable and the MMA determines that there is no realistic means to return the bank to a viable condition within a reasonable time. If the petition for opening bankruptcy proceedings is rejected by the Court, the MMA should revoke the bank's license and start the liquidation process. The MMA may authorize the receiver to transfer the shares or assets and liabilities of the bank to a third party (P&A) without consent of the bank or its governing bodies. This would require the ex-ante court approval. If the Court does not disapprove within 15 days, the receiver may implement the proposal without further delay.¹⁶

48. The Court is authorized to award monetary compensation to affected parties and appropriately cannot modify, stay, suspend or reverse the actions taken by the conservator, receiver or the MMA in good faith. That is in line with international best practices, but the compensation should be provided, if justified, under the "no creditor worse off than in liquidation" (NCWOL) principle, which is missing in the legislation.

¹⁶ This holds for the P&A transaction in the rehabilitation phase of the recapitalization by public funds. However, the MBA does not specify the case where the Court does not approve the P&A transaction according to section 72 of the MBA.

49. The creditor hierarchy set out in the MBA involves a preferential treatment for deposits up to Maldivian Rufiyaa (MVR) 100,000. Any other depositor claims and other unsecured creditors rank pari passu. The legislation should provide preference to insured deposits and uninsured deposits relative to unsecured creditors (Box 3). This could take the form of tiered or general depositor preference. In addition, the legislation should authorize the MMA, to deviate from the pari passu treatment of creditors of the same class, under exceptional circumstances, to contain the potential systemic impact of an institution's failure or to maximize value for the benefit of all creditors. The reasons for the deviation should be duly disclosed, and the legal framework should provide a right to monetary compensation in case creditors receive less as a result of resolution than they would have received in liquidation ('no creditor worse off' safeguard).

Without	Tiered	General
(1) All deposits (with DIC subrogation to insured deposits) rank equally with other senior unsecured claims.	(1) Insured deposits.	(1) All deposits (with DIC subrogation).
	(2) Eligible deposits, exceeding the deposit insurance limit.	
	(3) Other general unsecured claims (including non-eligible deposits).	(2) Other general unsecured claims.

B. Summary of Recommendations

- Amend the MMA to:
 - enhance resolution triggers by including forward looking triggers and enhancing governance triggers by including links to the capability of the bank to maintain adequate systems and controls and to effectively manage its risks; and
 - provide a resolution framework incorporating a unified mechanism under which different resolution tools can be implemented sequentially or in combination, and if feasible under the legal framework, without court involvement, subject to relevant safeguards to protect interests of shareholders and creditors, and if feasible under the legal framework, without court involvement, subject to relevant safeguards to protect interests of shareholders and creditors.
- Include internal arrangements on the escalation process in the early intervention and bank resolution framework, from the exercise of the MMA's power to take enforcement actions under section 55 through the initiation of resolution under section 70.

- Amend the MBA to empower the MMA to trigger resolution and for resolution powers to be applied immediately for a bank deemed non-viable or likely non-viable.
- Include necessary provisions in the MBA to expedite the Court approval for the P&A tool in section 72 of the MBA.
- Amend the MBA to ensure that the bridge bank is not owned and controlled by the MMA.
- Enhance the operational preparedness of the MMA for bank resolution.
- Prepare guidelines or manuals for the operationalization of the resolution tools.
- Prepare valuation guidelines.
- Include the NCWOL principle in the legislation.
- Provide teared or general depositor preference in the MBA.
- Empower the MMA to deviate from the pari passu treatment of creditors of the same class.

EMERGENCY LIQUIDITY ASSISTANCE AND LIQUIDITY IN RESOLUTION

A. Key Issues

50. There is no emergency liquidity assistance (ELA) framework in place to provide liquidity support either in local currency or foreign currency. The MMA Act authorizes the MMA to grant loans, advances and re-discounts to banks and other financial institutions in Maldives for a maximum period of 90 days, based on the terms and conditions prescribed by the MMA Board. The terms of these loans, advances and rediscounts may be extended by additional periods of 90 days for a maximum of three times. This provision in the MMA Act is not in line with international best practices in terms of the provision of emergency liquidity assistance and needs to be redrafted¹⁷. Contrary to best practices, there is no regulation or guideline providing safeguards as regards the solvency of the banks or prospect of restoration to a sound liquidity position and recovery of the funds provided by the MMA.

51. The MMA should be legally empowered to provide ELA within a well-designed framework. This would require an amendment in the MMA Act to include the ELA provisions and safeguards, and to clarify that the ELA can be provided by the MMA on a discretionary basis to banks with temporary liquidity shortages but are assessed to be solvent and viable. The MMA Act should provide the legal basis for the operational independence of the MMA in ELA decisions. In addition,

¹⁷ The analysis of Section 22/n of the MMA is limited to the provision of ELA. The provision is unclear in terms of its overall scope as well and seems to be misaligned with good practices.

given the large share of government in the banking sector and the existence of government representatives in the MMA Board, the MMA should have an internal management committee responsible for the assessment and approval of the ELA. The ELA should be provided against adequate collateral and at a sufficiently high rate. A stress testing exercise could be used for viability assessment purposes.¹⁸ The MMA should adopt an action plan to identify the time-bound actions and legal amendments to implement the ELA framework¹⁹.

52. The MMA should develop the legal and procedural documentation regarding the provision of ELA for solvent and viable banks with temporary liquidity shortages. This documentation would include the indicative terms and conditions for ELA, collateral eligibility, haircuts on collateral values, interest rate policy -at a premium over a benchmark rate-, ELA master agreement, funding templates, MMA's contingency planning, communications and exit strategies. The documentation should also include the minimum requirements for a bank making an ELA application, including forward-looking solvency assessment by the supervisor and cash flow and funding plan for the duration of ELA. The MMA should work on implementing an intensified supervisory surveillance to ensure recovery of ELA loan. In exceptional circumstances, where the provision of the ELA is deemed imperative to maintain financial stability, but there are concerns about the bank's insolvency, or the bank cannot provide adequate collateral, the MMA should be provided by government indemnity to protect its balance sheet.

53. High level of dollarization and FX shortages in the economy and the risk of official reserves being depleted by a potential drop in FX inflows pose significant risks that the MMA may not be able to fully mitigate. While the possibility of the MMA to provide ELA in FX could help alleviate immediate pressures, durable adjustments in fiscal and monetary policies are required to address the macro-imbalances that lead to protracted FX shortages. In practice, the MMA should prioritize the provision of ELA in domestic currency and using the reserve requirements in FX to provide a liquidity backstop for banks, rather than relying on potential ELA in FX. The MMA should only consider the provision of ELA in FX if absolutely necessary to preserve financial stability and sufficient FX resources remain available to meet other policy objectives. The following points should be considered in the provision of the ELA in FX.

- *MMA should be empowered to provide ELA in FX but its ability to do so in practice will be limited to the level of FX reserves freely available at the time.* Typically, the FX reserves of a country will be highly constrained and sufficient only to provide FX liquidity in an idiosyncratic case rather than in the context of a systemic event. The MMA may need to take steps to bolster its FX reserves given their low levels. The MMA could request a swap arrangement with another central bank

¹⁸ According to the draft Liquidity Coverage Ratio (LCR) regulation, the MMA could consider providing contractual liquidity shortages to a bank with inadequate HQLA to satisfy the LCR requirement. A bank with sufficient collateral will be eligible to use MMA facilities. If a solvent and viable bank has temporary liquidity shortages, it will have access to the ELA provided that the eligibility criteria are met. This issue should not be addressed in the LCR regulation.

¹⁹ Given the limited market mechanism in Maldives, it will also be crucial to enrich the liquidity management framework with additional instruments including the open market operations and standing facilities. This will help mitigate the risks arising from banks' selling government bonds at fire prices in case of a systemwide liquidity shock that could be exacerbated by lack of liquidity in the market and active trading in sovereign bond markets.

and could consider tightening prudential requirements (e.g., reduce FX net open positions or increase reserve requirements in FX to make more FX liquidity available).

- *MMA should strike a balance on the cost of ELA in FX.* The interest rate should be high enough to discourage overuse or arbitrage but should not be so high so as to weigh on the bank's solvency.
- *ELA in FX should be provided to subsidiaries or branches of foreign-owned entities only as part of a comprehensive set of measures and under very specific circumstances and conditions.* The extension of FX ELA to such institutions entails additional risks. Liquidity problems in the local entity may indicate wider problems in the group and as such may entail a risk of FX liquidity being "up-streamed."
 - *The first-best solution would be for the foreign-owned bank to obtain sufficient liquidity from its parent, if necessary, supported by the home authorities.* The solvency of the group may be drawn into question if the parent and central bank of the home country are unwilling or unable to support it. MMA should provide ELA in FX only in case of systemic importance of the foreign owned bank and if this is likely to stabilize and deliver a viable ongoing entity, and only after enhanced supervisory monitoring and pre-approval of any flows from the local entity to its parent are established. The MMA should ensure that the ELA in FX should not substitute for liquidity support from the parent bank and that all alternative funding sources, including intragroup funding, are exhausted. The MMA should also develop contingency plans in case it becomes necessary to take control and ring-fence the local entity.

54. The MMA should be able to provide liquidity support in resolution, subject to adequate safeguards. The effective implementation of resolution strategies to ensure continuation of critical functions may depend on the MMA's ability to provide ELA as a temporary backstop. The following components should be incorporated to the ELA framework, through a comprehensive set of internal policies, processes and procedures, to provide for sufficient safeguards. First, the MMA should make a forward-looking viability assessment of the bank, complemented by realistic and time bound resolution actions, for providing liquidity support in resolution. Second, in close collaboration with the MOF, the government should provide indemnity to the MMA in case of significant uncertainty about the bank's solvency or the adequacy of collateral. Finally, there should be feasible exit arrangements.

B. Summary of Recommendations

- Amend the MMA Act to legally empower the MMA to provide ELA within a well-designed framework aligned with international best practices.
- Develop the legal and procedural documentation regarding the provision of ELA for solvent and viable banks with temporary liquidity shortages.
- Empower the MMA to provide liquidity support in resolution, subject to adequate safeguards.

DEPOSIT INSURANCE AND RESOLUTION FUNDING

A. Depositor Protection and Payout

55. The deposit insurance fund (DIF) in Maldives was introduced in 2015 and is managed by the MMA. The deposit insurance regulation (DIR) was issued in 2015 and has not been changed since. The DIF guarantees current, time and savings deposits up to MVR 30.000 or its equivalent in foreign currency per depositor in each member bank. Deposit insurance coverage is appropriately not differentiated across currencies and shall be paid out in MVR equivalent. The DIR specifies certain exemptions to deposit insurance.²⁰ It is mandatory for deposit taking banks, including the branches and subsidiaries of foreign banks, to become members of the deposit insurance scheme. Deposit insurance should cover the large majority of deposits by number to ensure credibility and protect small retail depositors, while leaving large value deposits uncovered for affordability and market discipline reasons. MVR 30.000 covers about 90 percent of total insurable deposit accounts which is consistent with a common rule of thumb.

56. The DIF is managed by the BOFD in the MMA which is responsible for the licensing, regulation and onsite and offsite supervision of banks and financial institutions. The BOFD is also responsible for bank resolution, albeit without a separate unit. This organizational structure raises concerns about the operational independence of the DIF. The DIF is segregated from other funds within the MMA and subject to external audit on a yearly basis, but there are no other governance rules specified for the Fund. Given the extensive workload of the BOFD and concerns for operational independence, the MMA should have a separate, dedicated unit responsible for the management of the DIF. This unit should have a sufficient level of human resources, including independent management, and an operational budget to support its operational independence and fulfillment of its mandate. The DIF should be subject to sound governance practices including appropriate accountability, internal controls, transparency and disclosure regimes (IADI CP3).²¹

57. The DIF is funded by the collection of initial contributions, annual premiums and late payment fees from the member banks. The contributions, premiums and fees for foreign currency deposits are paid in MVRs. Every member is required to pay the Fund an initial contribution corresponding to 0.5 percent of total insurable deposits. The amount of annual premiums corresponds to 0.1 percent of total insurable deposits, which is raised to 0.125 percent for banks with a CAR below 15 percent. The fund currently covers 2.5 percent of total insurable deposits as of end-2022. Given that the DIF is a new fund that is yet to reach a sufficiently high level of reserves, it would be useful to have a flat premium structure for insured deposits to help build a large enough fund.

58. The DIF does not have a target fund size. The mission recommends the MMA work on a target fund size sufficient to meet the expected future obligations and cover the operational and

²⁰ Deposit liabilities to the Government of the Maldives inclusive of Ministries, Departments and Local Governments; to shareholders, directors, key management personnel and other related persons as defined by the MMA; and deposit liabilities held as collateral against any accommodation granted are exempted from the deposit insurance.

²¹ IADI Core Principles for Effective Deposit Insurance Systems, November 2014.

related costs. Target size should be determined on the basis of clear, consistent and transparent criteria and a reasonable timeframe to reach the target fund size (IADI CP 9). Given the absence of historical data on bank failures, it would be useful to conduct top down and bottom-up stress tests to determine target fund size. The authorities should consider the amount of insured deposits system-wide, the uneven distribution of these deposits across banks (86 percent of total number of insurable deposit accounts is concentrated in two banks, one of which is the systemically important domestic bank) and the availability of a public backstop (see below) in the interpretation of top down and bottom of stress tests.

59. The MMA is required to pay out the reimbursement to insured depositors within thirty days following the revocation of the bank’s license or the appointment of the receiver. The existing 30-day deadline far exceeds international standards and best practice (which is 7 days). Member banks are required to submit deposit data to the MMA by the end of each January. The MMA should increase the frequency with which deposit data is collected and ultimately secure real time access to depositor information to facilitate rapid deposit payouts. The MMA should enhance its IT capacity to have access to online depositor accounts, prepare an operational handbook to facilitate the insured deposit payouts and adopt a credible, time-bound plan to reduce the reimbursement period to international best practice (IADI CP 15). In addition, the MMA should consider making regular tests of technical preparedness, run by the DGS in cooperation with individual banks, ensuring the availability of data and overall sufficiency of processes.

60. Efforts to promote the public awareness of the DIS are required. The MMA has not conducted any surveys to reveal the level of public awareness of the DIS. To increase the effectiveness of the deposit insurance scheme and contribute to financial stability, staff recommends the MMA inform the general public, on an ongoing basis, about the benefits and limitations of the scheme. This should be done through a long-term strategy with specific objectives and appropriate monitoring tools on banks’ communication practices and efficient use of media for that purpose (IADI CP10).

B. Resolution Funding

61. The DIF has a paybox mandate, without any potential contribution of the Fund in case a bank is placed into resolution. Given the absence of an external source of funding, such as a separate resolution fund, it would be helpful for the DIF to have a paybox plus mandate, enabling it to provide contributions to bank resolution subject to sufficient safeguards with emergency backup funding from the MOF (see below). The DIF should be responsible for providing support for resolution only up to what it would pay out in liquidation i.e., on a least-cost basis. The legal system should allow for ex-post recovery funding from the banking system of temporary public financing used to facilitate the orderly resolution of a failed bank.

62. The DIF must have a clear back-up emergency funding from the government in cases where the resources are insufficient to cover its responsibilities. Currently, there is no emergency funding arrangements for the deposit insurance system. These funding arrangements should include pre-arranged and assured sources of liquidity funding, preferably a credit line from the government

(in law or regulation). There should be a funding backstop in the form of a pre-agreed contingency line from the government (IADI CP 9) which would require an agreement between the MOF and the MMA. The DIR counts borrowings and contributions from the MMA or the Government among the sources of the Fund, however, the legislation should not allow for any borrowings and contributions from the MMA in case of a shortfall of funding from the DIF.

63. Safeguards against recapitalization by public funds need to be strengthened to minimize the risk of moral hazard. Recapitalization by public funds should be an exceptional mechanism used as a last resort, only for cases where there is a significant risk of destabilization of the financial system and no other option available. Public funds should be used only after all estimated losses in the failed bank have been allocated, to shareholders and, to the extent possible, unsecured creditors. Any public solvency support should be combined with deep restructuring and management reforms, to enhance long term viability. There should also be pre-defined mechanisms for loss recovery such as ex-post levies from the banking sector.

64. The MOF should have a clear exit strategy in any public funding arrangements for resolution. The aim should be for the government to extricate itself from all funding support arrangements and shareholdings as soon as market conditions permit following completion of the resolution, with a view to maximizing the net present value of recoveries in a manner consistent with resolution objectives.

C. Summary of Recommendations

- Expand the DIF mandate in the DIR to a paybox plus mandate.
- Ensure that the DIF has a clear back-up emergency funding from the government in cases where the resources are insufficient to cover its responsibilities.
- Establish a separate, dedicated unit responsible for the management of the DIF, ensuring operational independence and sound governance arrangements.
- Determine a target fund size on the basis of clear, consistent and transparent criteria and a reasonable timeframe to reach the target fund size.
- Increase the frequency with which deposit data is collected, enhance MMA's IT capacity to access to online depositor accounts and adopt a plan to reduce the reimbursement period for insured deposits to seven working days.
- Adopt a long-term strategy to promote public awareness of the DIS.
- Ensure that the legislation (the MMA Act and the DIR) does not allow for any borrowings and contributions from the MMA in case of a shortfall of funding from the DIF.
- Strengthen the safeguards against recapitalization by public funds to minimize the risk of moral hazard and the risks to taxpayers.

CONTINGENCY PLANNING AND CRISIS MANAGEMENT

A. Key Issues

65. Crisis preparedness is currently low. Banks are not required to prepare recovery plans. MMA has not operationalized its functions as a resolution authority. MMA does not prepare resolution plans and resolvability assessment for banks. MMA has not issued regulations for operationalizing the crisis management framework or engaged in crisis simulation exercises. MMA's experience in implementing enforcement actions is low, and the last action taken dates back to more than a decade ago.

66. The participants in the financial safety net (FSN) do not have contingency plans to deal with weak banks. The MMA follows the steps stipulated in the MBA. None of the FSN participants have a contingency plan detailing how they will respond to contingencies in the financial sector, a business continuity plan detailing how its operations will continue if it is affected by a disaster. The FSN participants, jointly or individually, have not conducted any crisis simulation exercise. MMA's role in contingency planning and crisis preparedness should be enhanced by developing an overarching crisis-management plan and conducting regular domestic crisis exercises. FSN participants should have regularly updated contingency plans.

B. Summary of Recommendations

- Enhance MMA's role in contingency planning and crisis preparedness by developing an overarching crisis-management plan and conducting regular domestic crisis exercises.
- Ensure that FSN participants have regularly updated contingency plans.