INTERNATIONAL MONETARY FUND

IMF Country Report No. 23/404

MALDIVES

FINANCIAL SYSTEM STABILITY ASSESSMENT; AND PRESS RELEASE

December 2023

In the context of the Maldives—Financial System Stability Assessment, the following documents have been released and are included in this package:

- A **Press Release**
- The **Financial System Stability Assessment** (FSSA) for Maldives, prepared by a staff team of the IMF for the Executive Board's consideration on a lapse-of-time basis This report is based on the work of an IMF Financial Sector Assessment Program (FSAP) mission to Maldives during February and May 2023. The FSSA report was completed on November 6, 2023.

The documents listed below will be separately released.

Technical Notes

- Macroprudential Policy,
- Bank Stress Testing and Climate Risk Analysis, and
- Financial Safety Net and Crisis Management Arrangements.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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PRESS RELEASE

PR23/451

Press Release – IMF Executive Board Concludes 2023 Financial System Stability Assessment with Maldives

FOR IMMEDIATE RELEASE

Washington, DC – December 14, 2023: The Executive Board of the International Monetary Fund (IMF) concluded the Financial Sector Assessment Program (FSAP) [1] with Maldives on November 27, 2023 without convening formal discussion. [2] The Financial Sector Stability Assessment (FSSA) report was completed on November 6, 2023. The report is based on the work of joint IMF/World Bank FSAP missions to Maldives during February-March and May 2023.

Maldives is a tourism dependent economy with a small financial sector dominated by state-owned banks. Systemic risks stem largely from a growing sovereign-bank nexus, high dollarization, and a shortage of foreign exchange. The FSAP risk analysis found that banks are generally resilient to adverse economic shocks but highly exposed to sovereign debt and large borrowers, which makes them vulnerable to adverse developments on these fronts. While banks generally maintain adequate liquidity, they are relatively exposed to foreign currency risks. A climate risk analysis suggests no material mid-century coastal flood impact on the banking system.

The FSAP concluded that further strengthening of financial sector policies is needed to improve the resilience of the financial system. The authorities should adopt regulation to address frictions in the foreign exchange market, resume liquidity management operations and develop systemic risk indicators. Priority should also be given to establishing a macroprudential framework along with instruments, publishing a financial stability report, and ensuring full reporting of non-bank payment obligations. To improve financial sector oversight, the Maldives Monetary Authority should issue regulatory standards to clarify the enforcement regime and review its off-site monitoring procedures and staffing.

Similarly, the financial safety net and crisis management arrangements should be enhanced by improving early intervention mechanisms, introducing recovery and resolution planning, and enhancing the deposit insurance system. In addition, an effective liquidity assistance framework should be established. To address challenges from climate change, the granularity and coverage of climate data should be improved and climate risk analysis initiated.

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[1] The Financial Sector Assessment Program (FSAP), established in 1999, is a comprehensive and in-depth assessment of a country's financial sector. FSAPs provide input for Article IV consultations and thus enhance Fund surveillance. FSAPs are mandatory for the 47 jurisdictions with systemically important financial sectors and otherwise conducted upon request from member countries. The key findings of an FSAP are summarized in a Financial System Stability Assessment (FSSA).

[2] The Executive Board takes decisions under its lapse-of-time procedure when the Board agrees that a proposal can be considered without convening formal discussions.

INTERNATIONAL MONETARY FUND

MALDIVES

FINANCIAL SYSTEM STABILITY ASSESSMENT

November 7, 2023

KEY ISSUES

Context: Maldives is a tourist dependent economy with a small financial sector dominated by state-owned banks. Protracted fiscal and external deficits have raised concerns about debt sustainability and the level of international reserves. Large government funding needs have resulted in a strong sovereign-bank nexus, and rationing of foreign exchange by the Maldives Monetary Authority (MMA) has fueled a parallel foreign exchange market.

Findings: Banks are generally resilient to adverse economic shocks thanks to ample interest margins, but they are vulnerable to an unraveling of the sovereign-bank nexus simulated by a domestic debt exchange imposing value losses. Under such severe conditions, capital adequacy ratios fall significantly, and several banks would breach regulatory single exposure limits. Liquidity risk is significant at individual institutions, and they are vulnerable to withdrawals of large deposits. Interest rate risk is manageable for most banks, while individual institutions are relatively exposed to foreign currency risks in their balance sheets. Imposing a standard risk weight on domestic sovereign securities in foreign currency would lower bank capitalization considerably. A climate risk analysis suggests no material mid-century coastal flood impact on the banking system.

Policies: In light of elevated systemic risks, the authorities should adopt regulation for money changing businesses, and foreign exchange regulation, differentiate reserve requirements by currency, resume liquidity management operations, and develop systemic risk indicators. Moreover, a macroprudential framework, including key borrowed-based instruments, should be developed, a financial stability report published, and reporting to the credit registry of recurring non-bank payment obligations from consumer good leases initiated. The MMA should also apply the standard risk weight on domestic sovereign securities in foreign currency, issue regulatory standards to clarify the enforcement regime, and review its off-site monitoring procedures and staffing. Moreover, shortcomings in early intervention, bank resolution and the deposit insurance framework should be addressed and an effective emergency liquidity assistance framework be adopted. Risk-based AML/CFT supervision should also be improved. Methodologies for solvency, liquidity, and market risk stress tests should be developed, granularity and coverage of climate data improved, and climate risk analysis initiated.

Approved By
May Khamis and Anne-Marie Gulde-Wolf

Prepared By
Monetary and Capital Markets Department

This report is based on the work of the Financial Sector Assessment Program (FSAP) mission that visited Maldives in February and May 2023. The FSAP findings were discussed with the authorities in January 2024.

- The FSAP team was led by Torsten Wezel (IMF) and Natalie Nicolaou (World Bank) and included Trevor Lessard (IMF deputy mission chief), Yesim Aydin, Ivan Guerra, Kiran Sastry, Javier Uruñuela Lopez, Étienne Vaccaro-Grange, and Yizhi Xu (all IMF staff), Fabiana Carvalho (IMF external expert), and Mazen Bouri (World Bank deputy mission chief), Sharmista Appaya, Gian Boeddu, Richard Mark Davis, Miquel Dijkman, Michaela Mei Dolk, Ismael Fontan, Bryan Gurhy, Ivor Istuk, Tatsiana Kliatskova, Antonia Preciosa Menezes, Rachel Chi Kiu Mok, Martijn Gert Jan Regelink, José Ángel Villalobos (all World Bank staff), and Guillermo J. Rodriguez Ruiz (World Bank consultant). Vanessa Guerrero provided administrative support.

- The mission met with H.E. Ali Hashim, Governor of the Maldives Monetary Authority, Mr. Ahmed Imad, Deputy Governor of the MMA, Ms. Mariyam Shifa, Assistant Governor of the MMA, Ms. Mariyam Abdul Nasier, Chief Debt Management Executive of the Ministry of Finance, Mr. Ahmed Suravash Adam, Chief Financial Budget Executive of the MoF, Mr. Ahmed Shaam, Chief Executive Officer of the Housing Development Corporation, and senior officials at the MMA, the MoF, other public sector institutions, banks, and financial sector organizations.

- The FSAP assesses the stability of the financial system as a whole and not that of individual institutions. It is intended to help countries identify key sources of systemic risk in the financial sector and implement policies to enhance its resilience to shocks and contagion. Certain categories of risk affecting financial institutions, such as operational or legal risk, or risk related to fraud, are not covered in the FSAP.

- This report was prepared by Torsten Wezel with contributions from the Maldives FSAP team.

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TABLES

APPENDICES

Glossary

AED	Emirati Dirham
AGO	Attorney General Office
AML/CFT	Anti-Money Laundering/Combating the Financing of Terrorism
BCP	Basel Core Principles for Effective Banking Supervision
BML	Bank of Maldives
bps	Basis points
CAR	Capital Adequacy Ratio
CIB	Credit Information Bureau
CNY	Chinese Yuan
DDE	Domestic Debt Exchange
DJA	Department of Judicial Administration
DM	Development Module
DSTI	Debt-Service-to-Income
ELA	Emergency Liquidity Assistance
EUR	Euro
FATF	Financial Action Task Force
FC	Foreign Currency
FCP	Financial Consumer Protection
FI	Financial Institution
FIU	Financial Intelligence Unit
FSA	Financial Sector Assessment
FSAP	Financial Sector Assessment Program
FSAP DM	Financial Sector Assessment Program Development Module
FSSA	Financial Sector Stability Assessment
FX	Foreign Exchange
GBP	British Pound Sterling
GDP	Gross Domestic Product
HDC	Housing Development Corporation
HDFC	Housing Development Finance Corporation
HQLA	High Quality Liquid Assets
IADI	International Association of Deposit Insurers
IMF	International Monetary Fund
IPS	Instant Payments System
IT	Information Technology
JACI	J.P. Morgan Asia Credit
JPY	Japanese Yen
JSC	Judicial Services Committee
KA	Key Attributes of Effective Resolution Regimes for Financial Institutions
KWD	Kuwaiti Dinar
LCR	Liquidity Coverage Ratio
lhs	Left hand side

LTV	Loan-to-Value
MBA	Maldives Banking Act
MBS	Maldives Bureau of Statistics
MCM	Monetary and Capital Markets Department, IMF
MoED	Ministry of Economic Development
MoF	Ministry of Finance
MoJ	Ministry of Justice
MIRA	Ministry of Inland Revenue
MMA	Maldives Monetary Authority
MPAO	Maldives Pension Administration Office
MRPS	Maldives Retirement Pension Scheme
MRR	Minimum Reserve Requirement
MSE	Maldives Stock Exchange
MSME	Micro, Small and Medium Enterprise
MT	Medium Term
MVR	Maldivian Rufiyaa
NBFI	Non-Bank Financial Institution
NFIS	National Financial Inclusion Strategy
NOP	Net Open Position
NPL	Non-Performing Loans
NRA	National Risk Assessment
PPI	Pre-provision Income
PSP	Payment Service Provider
OFC	Other Financial Corporations
rhs	Right hand side
RR	Required reserves
RTGS	Real Time Gross Settlement
RW	Risk Weight
SDFC	SME Development Finance Corporation
SME	Small and Medium Enterprise
SOE	State-Owned Enterprise
SSP	Shared Socioeconomic Pathway
ST	Short Term
UN	United Nations
UNDP	United Nations Development Program
US	United States
USD	United States Dollar
WP	Working Paper

EXECUTIVE SUMMARY

The Maldives' economy has rebounded strongly from the pandemic, yet fiscal and foreign exchange (FX) imbalances persist. Notwithstanding double-digit growth in 2022, the country, which maintains a stabilized exchange rate, continues to experience high public debt and a widening current account deficit. Support to state-owned enterprises (SOEs) has added to fiscal imbalances. Rising financing needs are met by domestic debt issuance and monetary financing. A shortage on the official FX market reflects import-intensive investment, pandemic-related public spending, and FX rationing by MMA and banks, fueling a parallel market.

Systemic vulnerabilities include a growing sovereign-bank nexus, high dollarization coupled with tight FX, and shadow banking. Banks increasingly finance central government and SOE debt, with prudential policies further incentivizing such holdings (e.g., zero risk weight on domestic sovereign paper in FX, which comprises around one-third of banks' holdings of domestic debt). Also, the current trajectory of public debt service combined with possibly falling FX inflows could deplete official reserves and exacerbate exchange rate management. Unregulated financing of consumer durables by leasing companies leave recurring household payment obligations underreported. Reform is needed in managing systemic liquidity and reserve requirements as is regulation addressing issues in the parallel FX market.

Stress tests corroborate several vulnerabilities, notably from the sovereign-bank nexus and concentration. Banks are found to be resilient to economic shocks thanks to ample interest margins. However, an unraveling of the sovereign-bank nexus (e.g., value losses on sovereign paper) reduces capital ratios considerably, and credit concentration risk is high. Most banks maintain adequate liquidity despite missing liquidity regulation, yet some could not meet funding outflows or the exit of the largest depositors. While maturity mismatch risk appears contained, FX risk on banks' balance sheets (wide net open positions) is high. The MMA should enhance its stress testing capacity to keep track of these vulnerabilities.

Maldives is exceptionally vulnerable to climate change. A climate risk analysis finds a mild effect on banks for mid-century conditions. Better coverage and granularity of climate data and enhanced climate risk analysis would help exemplify the climate implications for the economy and financial sector. Supervisors and financial institutions currently lack the analytic skills needed for such complex analysis and also the specialized knowledge for the management of climate-related financial risks. The MMA should develop an institutional climate risk and opportunity strategy to prioritize actions on climate risk supervision and coordinate their implementation.

Priority should be given to establishing macroprudential institutional and analytical frameworks. Needed reforms include: (i) a financial stability committee to discuss and coordinate macroprudential policy action; (ii) indicators for monitoring of systemic risks; (iii) an upgrade of resources for financial stability analysis; and (iv) publication of a financial stability report. After closing data gaps (e.g., in properly measuring debt service from lease and hire purchases), the MMA should adopt borrower-based instruments (e.g., loan-to-value and debt-service-to-income limits) and those safeguarding bank liquidity and capital buffers.

The regulatory and supervisory framework needs improvement. Key recommendations include: (i) strengthening MMA independence; (ii) redefining off-site monitoring; (iii) enhancing enforcement; (iv) introducing liquidity requirements; (v) increasing the risk weight on domestic FX sovereign exposures; and (vi) increasing resources as MMA staffing remains insufficient.

Improvements are required in financial safety net and crisis management arrangements. These include: (i) making early intervention and resolution triggers forward-looking; (ii) introducing recovery and resolution planning; (iii) overhauling the use of public funds in resolution; and (iv) enhancing the deposit insurance system. An effective emergency liquidity assistance framework is needed to address challenges from the high dollarization and FX shortages. Interagency arrangements and crisis preparedness should also be strengthened.

Several opportunities for fostering financial sector development exist. A concerted effort under the National Financial Inclusion Strategy is needed to address gaps, notwithstanding scant data. Credit enhancement mechanisms (e.g., a portfolio guarantee scheme) would encourage bank lending to MSMEs. Further efforts are needed to promote digital financial services, competition, and innovation. Also, ways to stimulate markets for green finance and resilience should be explored.

Table 1. Maldives: Key Recommendations

	Timing[1]	Agency
Systemic Risk Mitigation		
Adopt regulation for money changing businesses and foreign exchange regulation.	ST	MMA
Differentiate reserve requirements by currency to mitigate risks from high financial dollarization.	I	MMA
Resume liquidity management operations and take measures towards an active secondary market.	ST	MMA
Develop indicators for monitoring of systemic risks.	ST	MMA
Bank Stress Testing and Climate Risk Analysis		
Improve integrity and granularity of supervisory data, including data compiled by the Credit Information Bureau (CIB).	ST	MMA
Develop methodologies for solvency, liquidity, and market risk stress tests and engage banks in a dialogue about stress test procedures and results, including banks' own stress tests.	ST	MMA
Improve granularity and coverage of climate data, geographical exposures of the country and financial system, and climate-related damages and foster intra-agency collaboration to support access to existing data.	ST	MoED, MBS, MMA
Initiate climate risk analysis in collaboration with other agencies to assess the effect of actual and future climate conditions on the financial sector and the economy.	MT	MMA
Macroprudential Policy		
Augment reporting of data on recurrent household payment obligations from leasing contracts to the CIB.	I	MMA
Establish a macroprudential framework, including a committee for macroprudential coordination, and publish a financial stability report.	ST	MMA
Introduce key borrower-based and capital-related macroprudential policy instruments.	ST	MMA
Banking Regulation and Supervision		
Amend capital regulation to apply a 100 percent risk weight on bank holdings of Maldives government securities in foreign currency (perhaps phased in) and introduce liquidity requirements.	I	MMA
Issue regulatory standards to clarify the enforcement regime and to ensure that non-compliant actions by banks are immediately met with enforcement action.	I	MMA
Review MMA's off-site monitoring procedures and staffing count, including redefining the methodology and including mandatory meetings with bank senior management.	ST	MMA
Strengthen the independence of MMA's Board of Directors by changing the overall composition and voting rights of members.	ST	MMA, MoF

Table 2. Maldives: Key Recommendations (Concluded)		
Climate Regulation and Supervision		
Develop and publish an institutional strategy on climate risk and opportunities	ST	MMA
Issue supervisory expectations on the integration of climate risks into business strategies, governance and risk management as well as regulatory reporting.	MT	MMA
Financial Integrity		
Share the Maldives' national risk assessment (NRA) findings with financial sector.	ST	MMA, MoF
Adopt a risk-based approach to supervision of the financial sector.	MT	MMA
Address identified technical compliance deficiencies related to financial sector laws and regulations.	ST	MoJ, MMA
Crisis Management and Resolution		
Make amendments to the Banking Act and deposit insurance regulation to address shortcomings in early intervention, bank resolution and deposit insurance framework and to the MMA Act to include provisions for ELA; and strengthen policies and procedures in these areas.	I	MoF, MMA
Establish an ELA framework.	I	MMA
Require systemically important banks to prepare recovery plans, prepare resolution plans and undertake resolvability assessments for them.	ST	MMA
Financial Sector Development		
Develop the National Financial Inclusion Strategy (NFIS) with a specific MSME access to finance pillar.	ST	MMA, MoF MoED
Enhance credit infrastructure, including: (i) passing the Secured Transaction Act and Insolvency Law, (ii) reviewing the Civil Procedure Code for fast-track or simplified procedures for smaller claims, and (iii) expanding the collection of credit information.	ST	MMA, DJA
Introduce a national green taxonomy and develop a framework for tracking green finance provided by public and private sources.	MT	MoF, MMA
[1] I: Immediately; ST: short term = 1-2 years; MT: medium term = 3–5 years.		

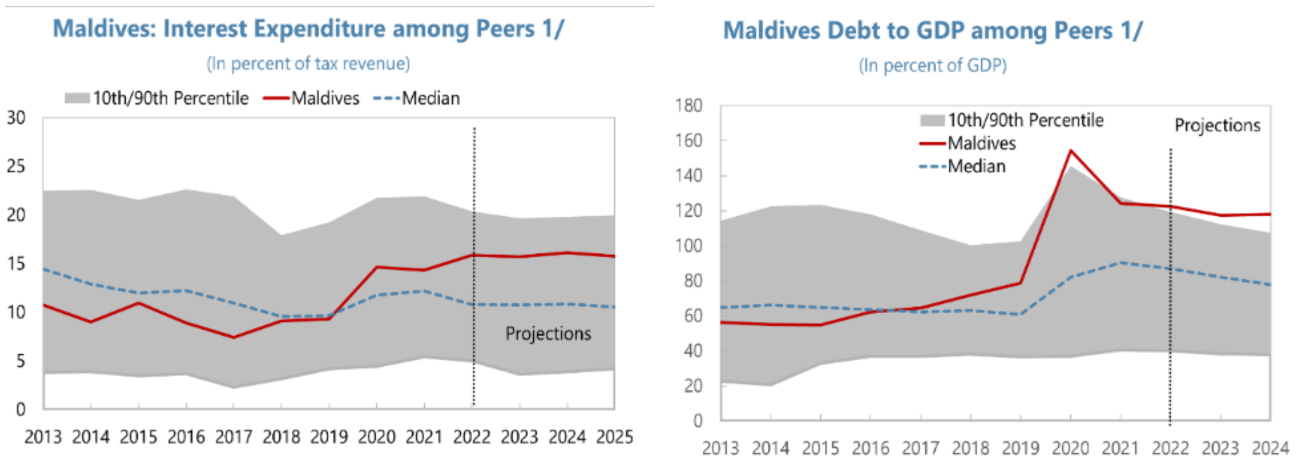
BACKGROUND

1. The Maldivian economy has rebounded from the pandemic-induced contraction. The recovery is due to a strong rebound in tourist arrivals, exceeding pre-pandemic levels. This coincided with a recovery in bank performance (NPL ratio declining to 5.9 percent, and return on assets rising to 5.0 percent at end-2022). Not least due to the higher investment in sovereign paper, growth of bank credit slowed to 4½ percent, with the tourism sector being the main recipient (40 percent of private sector credit).

2. Despite the recent recovery, fiscal vulnerabilities remain elevated. Fiscal space is limited by high public debt and debt service which have reached 115 and 11 percent of GDP at end-2022, respectively (Figure 1), including in foreign currency (debt in FX represents 52 percent of public sector debt). Debt-financed capital expenditure on infrastructure programs has increased. These, together with various subsidies, have led to a debt overhang with a front-loaded maturity profile (Figure 2). The 2022 IMF Debt Sustainability Analysis assessed that sovereign debt is not sustainable in the baseline and that Maldives remains at high risk of both external and overall debt distress.[1]

3. Continued support to SOEs has added to fiscal vulnerabilities. Debt service on external variable rate FX loans, particularly Housing Development Corporation's (HDC) social housing projects, is rising.[2] At the same time, most SOEs earn revenue only in MVR. Without further external financing and improved corporate governance, the revenue gap and currency mismatch will worsen SOEs' finances. Furthermore, the central government must prioritize debt repayment of certain SOEs to avoid default on external debt (e.g., HDC whose external debt contracts include cross-default clauses with certain external government bonds).

Figure 1. Maldives: Interest Expense and Public Debt Level Compared to Peers

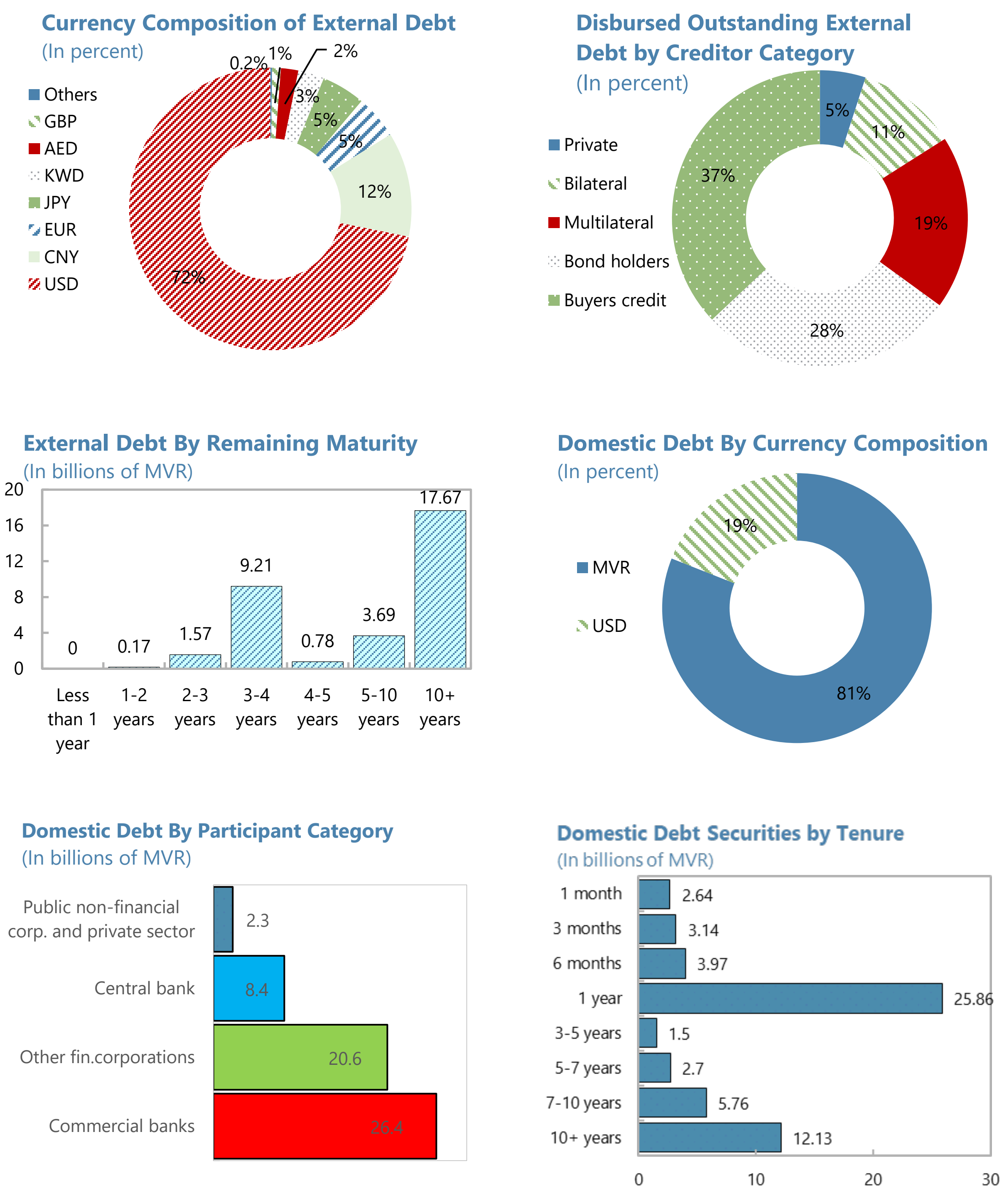


Sources: World Economic Outlook; and IMF staff calculations.
1/ Peer countries include Cabo Verde, Barbados, Antigua and Barbuda, Jamaica, Sri Lanka, Dominica, Seychelles, St. Vincent and the Grenadines, Mauritius,St. Lucia, Fiji, Grenada, St. Kitts and Nevis, Dominican Republic, the Bahamas, Samoa, Haiti, Vanuatu, Tonga, and Timor-Leste.

[1] Maldives' sovereign spread (implied by JPMorgan's JACI index) was 1400 bps in mid-2023.

[2] HDC develops islands and offers rent-to-own programs (19 percent of debt financed by government and 80 percent guaranteed since the pandemic).

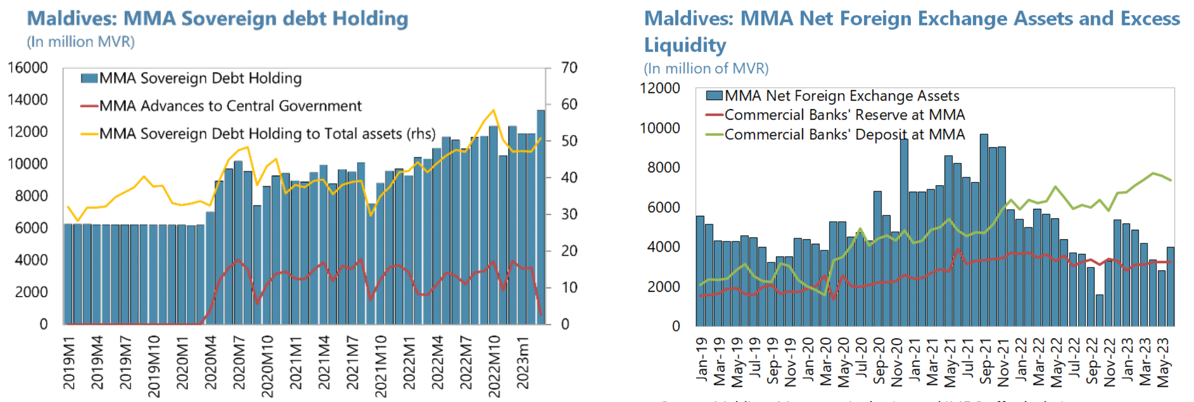
Figure 2. Maldives: Outstanding Debt of the Central Government, end-2022



Sources: Ministry of Finance and IMF Staff calculations.

4. As a result, rising budget needs are being met by domestic debt issuance and monetary financing. Domestic debt amounts to 66 percent of GDP[3] and accounts for 70 percent of the increase since end-2019. Banks now hold nearly half of the stock (equaling 27 percent of bank assets) which is mostly short-term (78 percent share of T-bills) and in local currency (55 percent share). Some banks hold government bonds well in excess of their capital (4 to 5 times).[4] MMA advances to government have increased and are the main source of excess bank liquidity (Figure 3).

Figure 3. Maldives: MMA Central Government Debt Holdings, Net FX Assets, and Bank Liquidity



Sources: Maldives Monetary Authority; and IMF Staff calculations.

Source: Maldives Monetary Authority; and IMF Staff calculations.

5. An acute FX shortage has emerged in the official market, where a stabilized exchange rate is maintained, fueling a parallel market. The shortage began with the import-related public investment surge and continued with pandemic-related spending and rising global commodity prices. Also, not all FX inflows to resorts enter the official market. As fiscal and SOE finances deteriorated further and net international reserves fell to less than two months of imports, MMA had to prioritize FX supply to public entities at the expense of banks that must ration FX sales to clients. Banks can only meet 10-20 percent of importers' FX needs. The remainder is sourced from a well-established parallel market (with stable premiums of 10-15 percent suggesting elastic FX supply from resort owners with money changer license) for which pending regulation should be adopted.

FINANCIAL SYSTEM STRUCTURE

6. Banks dominate the financial sector (Table 2). They hold more than three-fourths of financial system assets (two private domestic banks, five foreign-controlled banks and one domestic state-owned bank, with two of the foreign banks also state-owned). Hence, three-fourths of banking system assets are under government control. The sector is very concentrated (Herfindahl-Hirschman Index near 3,000, well above peers, Figure 4), with the largest bank holding 51 percent of system assets.

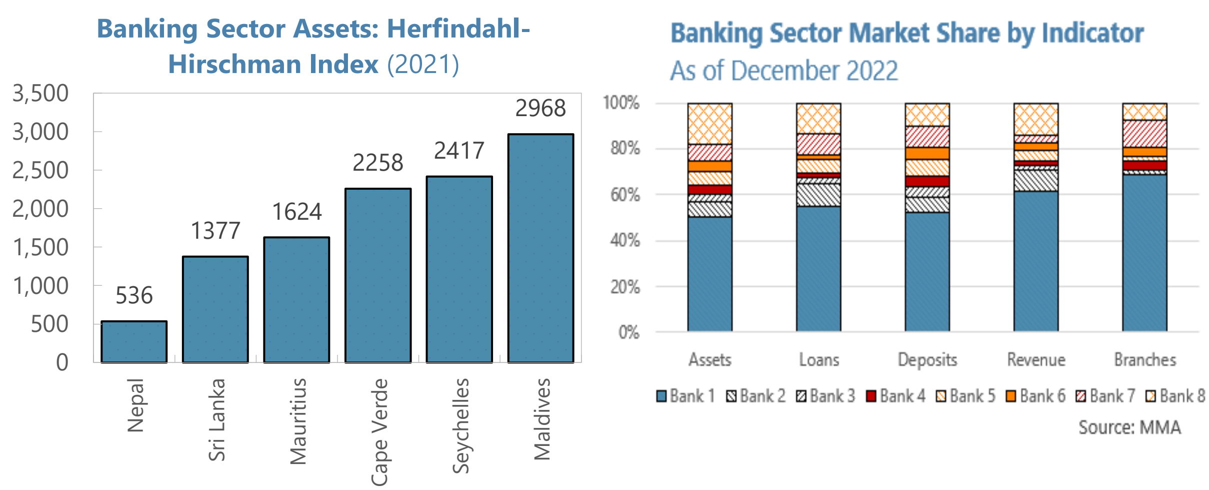
[3] The government also provides loan guarantees to SOEs (21 percent of GDP additionally).

[4] During 2020-22, banks' sovereign debt holdings and loans roughly doubled to MVR 26.4 billion and 3.4 billion, respectively.

Table 3. Maldives: Structure of the Financial System, end-2022				
Financial Institution	**Number of Institutions**	**Assets (millions of MVR)**	**Share of total assets**	**Share of GDP**
Banks	8	88,552	77%	93%
Other Financial Corporations (OFC)	9	26,808	23%	28%
of which:				
Finance Companies, regulated	3	4,192	4%	4%
Insurance Companies	5	2,852	2%	3%
Pension Fund (MRPS)	1	19,764	17%	21%
Total	17	115,360	100%	121%

Sources: MMA Monthly Statistics, Maldives Pension Administration Office (MPAO); IMF Staff calculations.
Note: Financial service providers outside the regulatory perimeter are not included.

Figure 4. Maldives: Banking Sector



Source: Data for Maldives from the Maldives Financial Review, data for the rest of the countries from their respective central bank or Fitch Connect. Note: Data for Seychelles and Nepal as of 2020, and for Mauritius as of 2022 Q2.

7. **Financial soundness indicators (Appendix III) suggest that banks are sound overall, but vulnerabilities exist**. At around 50 percent, the banking system's capital adequacy ratio (CAR) is well above the regulatory minimum of 12 percent, and its profitability is high. There has been no contagion from the recent international banking turmoil. However, after expiry of pandemic-related relief[5] and with a growing sovereign-bank nexus, severe shocks could erode bank capital rapidly because, as elsewhere, domestic sovereign exposures, including in FX, are zero risk-weighted.

[5] The minimum reserve requirement was reversed to pre-pandemic level (from 5 to 10 percent). Also, the moratorium of six months on loan repayments and flexibility in provisioning on rescheduled loans were rolled back in 2021.

8. **The NBFI sector is small.** There are only three non-bank credit institutions, which include state-owned SME Development Finance Corporation (SDFC) financing MSMEs and experiencing high NPLs, and majority government-owned Housing Development Finance Corporation (HDFC) providing housing finance. In addition, there are five insurance companies, with a state-owned institution dominating the sector, and the public pension scheme (MRPS)[6] whose large government securities holdings augment the sovereign nexus. In addition, four finance and leasing companies offer lease and hire options for consumer goods, particularly vehicles (Appendix VII). The sector's size is unknown given absent regulation and reporting requirements.

9. **Balance sheet data suggest strong linkages between the financial sector and government as well as risks from potential FX liquidity shocks.** The Balance Sheet Approach (BSA) matrix shows that both banks and NBFIs are heavily exposed to domestic sovereign debt (28 percent and 19 percent of GDP, respectively, with one-third of banks' exposure in FX). Banks' funding is also significantly dollarized and could see strain if large depositors experienced distress, notably balance-of-payment shocks.

VULNERABILITIES AND RISKS

10. **The main macrofinancial vulnerability stems from high central government and SOE debt.** Several factors could stress government finances further (e.g., tighter financial conditions, SOE distress). Eroding fiscal space could jeopardize key SOEs' viability. As external debt service must be prioritized, payment delays to suppliers and, ultimately, banks could occur. Furthermore, in an extreme situation sovereign domestic debt may need to be restructured.

11. **Banks' exposure to sovereign risk through SOE lending is rising.** SOE exposures represent only about 10 percent of corporate loans (over 25 percent at some banks) but have risen by 150 percent since the start of the pandemic. HDC accounts for one-sixth of outstanding bank loans to SOEs. The main risk for banks stems from macro-fiscal linkages, as many SOEs depend on government support. Consequently, a macro shock impairing external debt service capacity could spill over to banks that even under baseline conditions will need to lend more to SOEs, replacing the stretched central government.

12. **Regulatory policies have contributed to banks' sovereign debt holdings.** Zero risk weights on government paper in local and foreign currency and exemptions from provisioning favor sovereign paper rather than risky private sector loans. Also, liquidity supervision treats government securities across all maturities as High-Quality Liquid Assets (HQLA) when in fact a 30-day cutoff would align with the Basel III Liquidity Coverage Ratio (LCR), even if liquidity risk is mitigated by short maturities of T-bills.[7] Lastly, sovereign debt holdings and government-guaranteed loans are exempt from single exposures limits.

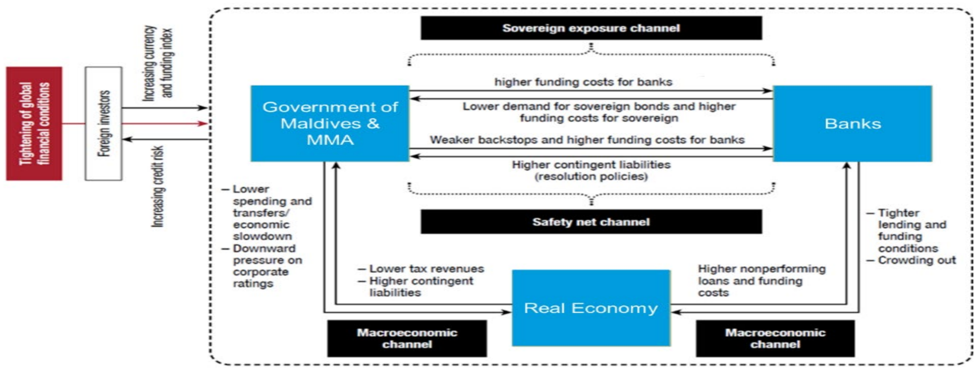
[6] Established in 2009, the MRPS is very liquid and a cash-flow positive, young pension scheme (in 2021, contributions were more than tenfold pension payments).

[7] Similarly, market risk in government securities (incl. in FX) is contained as they are held to maturity at historical cost.

13. Rising public sector borrowing and FX needs have also impacted the MMA. Its advances to government have repeatedly been converted into non-tradeable long-term securities at preferential rates.[8] To protect its balance sheet and thwart further inflationary pressure, the MMA plans to further gradually decrease the overdraft limit.[9] In addition, the MMA's international reserves are increasingly earmarked for imports and public sector debt service, reducing FX supply to the official market.

14. There are different channels through which a problematic sovereign-bank nexus could unravel. Previous IMF analysis has highlighted three main transmission channels (Figure 5). In case of sovereign distress, domestic debt could be restructured by payment rescheduling, principal reduction, or debt exchange lowering the net present value. Such action could erode banks' capital rapidly, as due to zero risk weighting banks hold no capital against their massive government debt portfolios.

Figure 5. Maldives: Key Channels of the Sovereign-Bank Adverse Feedback Loop



Source: IMF Global Financial Stability Report, Chapter 2, April 2022, with modifications by the FSAP team.

15. There are risks from sectoral loan concentration and large exposures (Figure 6). Banks' loan portfolios are highly concentrated in tourism and construction (half of credit, mostly in FX). Also, many banks are highly exposed to a few large corporates and close to the single exposure limit of 15 percent of regulatory capital (higher in certain circumstances), another reason for banks' high CAR. Under sufficient stress, banks may breach the single exposure limit even if remaining above the minimum CAR.

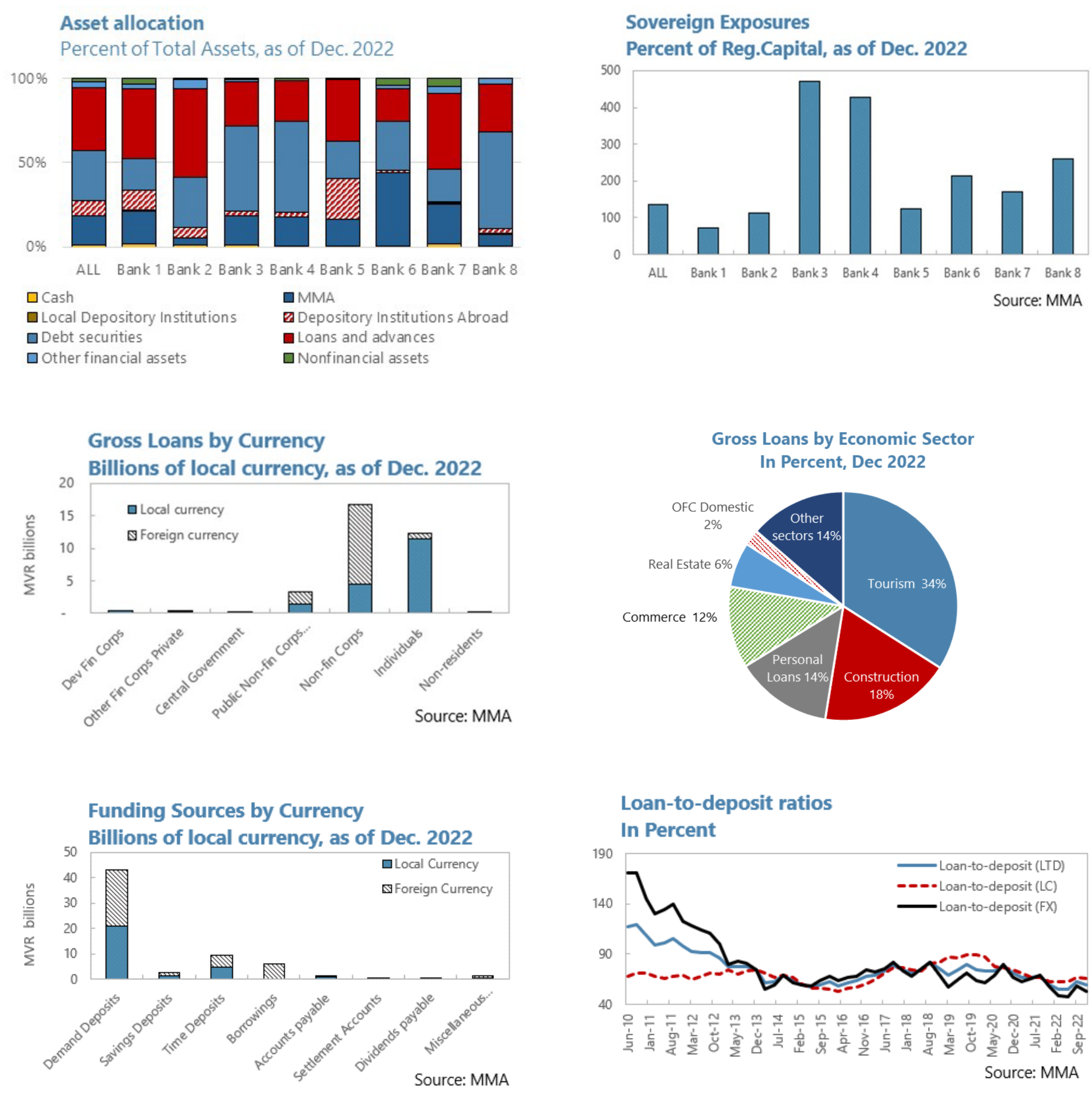
16. High loan dollarization combined with persistent FX shortages also represents a stability risk. Deposit and loan dollarization are high at 53 and 44 percent, respectively. However, dollarization of loans to private nonfinancial corporates is particularly high at 75 percent. While most banks have positive net open FX positions (NOPs), the significant maturity mismatch between longer-term loans and ample daily callable FX deposits that also exhibit seasonality nonetheless

[8] The most recent debt exchange in early 2023 was a MVR 4.4 billion securitization (at 2.9 percent for 40 years).

[9] Although MMA advances have not breached the previous cap, repeated securitizations have created space for new advances and so expanded exposure to central government.

poses FX liquidity risk. Although banks generally lend in FX only to corporates with a natural hedge (debt service in FX covered by FX income), those can still experience a temporary FX squeeze, as happened during the pandemic-related tourism stop in 2020Q2. A devaluation would affect SOEs with sizable FX mismatches and corporates with temporarily imperfect hedges.

Figure 6. Maldives: Banking Sector Asset Allocation, FX Position and Sovereign Exposure



Source: MMA and IMF staff calculations.

17. Another vulnerability centers around "shadow banking" by non-banks. Finance companies providing lease and hire purchase options not always perform rigorous creditworthiness checks, causing a delinquency ratio of 30 percent at one institution. Total recurrent household payment obligations remain unclear since most companies are not registered with the credit information bureau (CIB). As such schemes flourish unobserved by regulators, households could become overstretched and delinquencies rise (Appendix VII).

18. Market mechanisms for redistributing liquidity across banks are limited in Maldives. The minimum reserve requirement (MRR) is the main monetary instrument, absent active open market operations or standing facilities to manage systemic liquidity. Excess liquidity causes a small premium on MVR deposits over FX deposits and depositors' preference for the latter. The MMA should therefore differentiate reserve requirements by currency (higher rate on FX deposits) and within FX reserves by maturity (lower RR on longer-term deposits). The MMA should resume liquidity management operations, and secondary market activity could be bolstered, including active primary dealers and an electronic platform for government debt securities auctions and trading.[10] The MMA has a FX swap line only with the Reserve Bank of India, and a FX swap facility with commercial banks remains unused by banks.

19. There are also external risks to financial stability. These include recurring commodity price volatility due to supply disruptions and demand fluctuations, higher bank funding costs possibly due to further tightening of monetary policy by major central banks or the materialization of systemic turmoil in financial markets, and security incidents halting tourist arrivals.

20. Maldives is exceptionally vulnerable to climate change, notably sea level rise and coastal flooding. As low-lying islands, an increase in the frequency and severity of climate events would materially affect the Maldivian economy, with negative spillover effects to the financial system. COVID-19 disruptions to travel highlighted the economy's vulnerability to large swings in tourism. However, in contrast to the pandemic, when Maldives benefitted from global fiscal and monetary loosening, future climate emergencies will likely occur in an environment of reduced buffers, reduced economic prospects, and much higher debt levels. Although adaptation projects are on the government's agenda. resort operators must also contribute to achieve broader geographical coverage.

Maldives Vulnerability to Climate Change

Key elements highlighting Maldives vulnerability to climate change	80 percent of Maldives' islands are less than one meter above sea level
	90 percent of the islands report flooding annually
	97 percent of the islands report shoreline erosion
	64 percent of the islands report severe erosion
	50 percent of the housing structure are within 100 meters of the coastline

[10] In establishing a primary dealer system, MMA should, however, guard against a monopolistic setting elevating the cost of government financing.

SYSTEMIC RISKS AND FINANCIAL SECTOR RESILIENCE

A. Banking Sector Stress Tests

21. The stress tests applied the usual FSAP range of analysis for non-complex banking sectors (Appendix V), with a few exceptions. The FSAP conducted: (i) solvency stress tests (top-down and bottom-up by banks) and a credit concentration test; (ii) a sovereign risk sensitivity analysis based on a hypothetical scenario of domestic debt exchange; (iii) a suite of liquidity stress tests[11] and a test for deposit concentration risk; and (iv) market risk stress tests. An interconnectedness test was not performed as there is no functioning interbank market, nor a duration-based test for mark-to-market losses in the banking book due to the very short tenor of sovereign paper. Lastly, the NBFI sector was excluded due to its small size and important unregulated institutions not reporting data.

22. The quality of supervisory data for stress testing is mixed. Loan exposures broken down by major economic sector exist only from 2015, and designation by specific types of recipients is unavailable. The FSAP team decided to use longer quarterly series (since 2010) for credit risk modeling,[12] segmented by loans in local currency (mostly to households and MSMEs) and, separately, in FX (mostly to larger corporates). However, data on funding and other assets are sufficiently granular and complete for liquidity stress testing.

23. The solvency stress test is predicated on three scenarios (Table 3). The baseline and moderate stress scenarios reflect the IMF's latest projections (baseline/adverse, forecast cutoff date end-2022). The third is a bespoke crisis scenario assuming a deep, if short-lived, recession from external distress that, combined with mounting domestic imbalances, causes a devaluation (by 20 percent) and a domestic debt exchange of T-bills for bonds (25 percent face value reduction). The credit risk modeling found only inflation and import growth (proxy for economic activity)[13] to be robust drivers. Still, projections for all variables were shared with banks in the bottom-up stress test.

24. The results (Table 4) corroborate that banks are less vulnerable to economic shocks than to an unraveling of the sovereign-bank nexus. The system's CAR remains largely unchanged in the moderate stress scenario relative to the baseline because higher provisions are easily absorbed by ample pre-provision income and offset by the growth of risk-weighted assets. However, the impact of the assumed domestic debt exchange in the severe scenario[14] causes the CAR to drop by 14.8 percentage points, with 3 banks (12 percent of assets) becoming undercapitalized. In addition, several banks jointly comprising 30 percent of assets would breach the applicable single exposure limit due to falling capital. This finding dovetails with strongly falling CAR

[11] The Net Stable Funding Ratio was not computed due to lack of information on stable vs. non-stable funding.

[12] Dynamic fixed effects panel models with logit-transformed NPL ratios using quarterly data.

[13] Exports could not be used because they do not include tourism, and real GDP growth is available only annually.

[14] The test simulates a domestic debt exchange of T-bills into longer-dated and lower-yielding bonds. Consistent with Fund guidance (IMF WP/19/266) and standard practice in FSAPs with sovereign nexus analyses (e.g., Bahamas (2019), South Africa (2022), WAEMU (2022)), all T-bills were stressed, irrespective of regulatory treatment.

in the credit concentration test assuming a default of the largest five borrowers, which suggests the need for more frequent syndication of large commercial loans. Lastly, imposing a 100 percent risk weight on domestic FX securities (as the BCP assessment recommends), the CAR would drop by 9 percentage points when added to the severe scenario, with one bank exhausting most of its excess capital.

Table 3. Maldives: FSAP Macro Variables for the Baseline, Moderate and Severe Scenarios

(in percent)	Est.		Proj.	
	2022	2023	2024	2025
Real GDP growth				
Baseline	12.3	7.2	5.7	6.5
Moderate	12.3	-14.3	13.4	10.4
Severe	12.3	-24.4	8.8	10.5
Inflation rate (eop)				
Baseline	3.3	5.1	2.5	2.1
Moderate	3.3	5.8	4.2	2.4
Severe	3.3	9.5	5	2.6
Bank lending rate				
Baseline	10.9	10.9	10.9	10.9
Moderate	10.9	12.5	11.2	10.9
Severe	10.9	16.3	13.2	10.9
Exchange rate (MVR per USD)				
Baseline	15.4	15.4	15.4	15.4
Moderate	15.4	15.4	15.4	15.4
Severe	15.4	18.5	18.5	18.5
Credit growth				
Baseline	11.7	9.8	8.7	8.9
Moderate	11.7	6.6	13.9	10.7
Severe	11.7	2.2	10.4	9.5
Fiscal balance (percent of GDP)				
Baseline	-11.1	-9.1	-8.5	-5.7
Moderate	-11.1	-18.2	-13.9	-9.6
Severe	-11.1	-22.1	-19.5	-15.1
Total Arrival (thousand)				
Baseline	1675.26	1765.199	1899.109	2140.794
Moderate	1675.26	753.752	1214.506	1602.94
Severe	1675.26	676.116	893.058	1221.722
Exports Growth (percent)				
Baseline	35.952	4.122	6.295	6.945
Moderate	35.952	1.86	6.095	6.708
Severe	35.952	-0.403	5.909	6.486

Source: IMF staff estimates.

Table 4. Maldives: Summary of IMF FSAP Stress Test Results

	Dec. 22	Dec. 23	Dec. 24	Dec. 25
CREDIT RISK				
NPL projection foreign currency model	**in percent of total loans**			
NPL ratio stress baseline scenario	9.0	10.5	11.8	12.0
Highest NPL ratio of any bank	34.4	41.6	46.1	46.8
NPL ratio stress moderate scenario	9.0	11.0	12.6	13.0
Highest NPL ratio of any bank	34.4	43.2	48.5	49.5
NPL ratio stress severe scenario	9.0	12.3	14.8	14.7
Highest NPL ratio of any bank	34.4	47.0	54.4	54.0
NPL projection local currency model				
NPL ratio stress baseline scenario	3.4	4.5	5.1	5.4
Highest NPL ratio of any bank	27.5	36.1	40.4	42.1
NPL ratio stress moderate scenario	3.4	4.7	5.5	5.7
Highest NPL ratio of any bank	27.5	37.4	42.4	43.6
NPL ratio stress severe scenario	3.4	5.4	6.3	6.2
Highest NPL ratio of any bank	27.5	41.0	46.2	46.2
	in percent of RWA			
CAR baseline scenario	50.9	52.3	53.9	55.0
CAR moderate scenario	50.9	53.1	50.6	50.2
CAR severe scenario	50.9	39.3	44.0	45.1
Number of banks failing		1		
Pct. of banking system <12% CAR		3.3		
Capital shortfall in % of GDP		0.1		
CAR baseline scenario adjusted for 100% RW on domestic securities in FX	41.1			
SOVEREIGN RISK	**in percent of RWA**			
Drop in CAR (ppt.) due to impact of domestic debt exchange		14.8		
CREDIT CONCENTRATION RISK	**in percent of RWA**			
CAR baseline scenario in 2023	50,9	52,3	53.9	55.0
CAR two-notch downgrade of 5 largest borrowers	50.9	46.7	48.0	49.0
CAR downgrade to loss of 5 largest borrowers	50.9	20.6	21.1	21.6
Number of banks failing		5		
Pct of banking system <12% CAR		27.1		
Capital shortfall in % of GDP		0.7		

Table 4. Maldives: Summary of IMF FSAP Stress Test Results (Concluded)

	Dec. 22	Dec. 23	Dec. 24	Dec. 25
INTEREST RATE REPRICING RISK	**in percent of RWA**			
Increase of interest rates by 2.0 percent		51.1		
LIQUIDITY RISK				
Number of banks failing cashflow-based test in either currency		2		
Banks failing the cashflow test in either currency in % of system assets		25.3		
Banks failing the cashflow test in either currency in % of GDP		23.3		
Basel III Liquidity Coverage Ratio, MVR		253.8		
Basel III Liquidity Coverage Ratio, USD		235.1		
DEPOSIT CONCENTRATION RISK				
Number of banks failing test in either currency		7		
Assets of banks failing the test in % of banking system assets		49.9		
Assets of banks failing the test in % of GDP		46.0		
FOREIGN CURRENCY RISK				
Number of banks breaching NOP limits after 20% devaluation 1/		2		
Assets of banks the test in % of banking system assets		23.3		
Assets of banks failing the test in % of GDP		20.1		

Sources: Authorities' data and staff calculations.
1/ 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.

25. **The liquidity stress tests indicate significant risk at individual institutions and a high susceptibility to withdrawals of large deposits**. While all but one bank would meet the LCR requirements in both MVR and FX, one bank each (together comprising 25 percent of system assets) would fail a cashflow-based maturity mismatch test in local and foreign currency. Even more concerning is that about half of the banking system (measured by assets) could not withstand the withdrawal of the five largest deposits, indicating inordinate deposit concentration.

26. **Interest rate risk is found to be manageable for most banks, while some are relatively exposed to FX risks in their balance sheets.** An interest rate risk test assuming a symmetric increase of 200 basis points on interest-bearing assets and liabilities with residual maturities of up to one year caused capitalization to drop by only 1.3 percentage point thanks to the relatively short maturities of loans and securities, with two-thirds maturing within one year (8 percent for

liabilities).[15] Changes in NOPs reflecting FX risk in balance sheets are moderate upon an assumed devaluation by 20 percent, although two banks breach the relatively loose upper NOP limit and a large bank's NOP becomes even more negative and approaches the single currency limit.

27. **Bottom-up tests by banks based on the FSAP's macroeconomic scenarios see a moderate impact, largely consistent with the top down stress tests.** All reporting banks (six out of eight) would remain adequately capitalized under stress, although several expect a pronounced drop in CAR in the severe scenario. Projections for the NPL ratio align broadly with the FSAP team's estimates, notably in the severe scenario. Similarly, banks expect continued high profitability under the baseline and a deteriorating bottom line under stress. However, despite clear instructions provided, there were cross-bank inconsistencies (some banks did not provide the requested metrics or reported starting-point capital different from official data).

28. **MMA should improve its stress testing capacity and initiate a dialogue with banks on periodic stress tests.** MMA already conducts stress tests and requires banks to submit results for preset scenarios involving sensitivity analysis on a quarterly basis. These are, however, rather simplistic and not based on consistent macrofinancial scenarios. Therefore, MMA should build stress testing capacity and develop a suite of stress test methodologies not only for solvency risk but also liquidity and market risks. MMA should also provide banks with more detailed scenarios and engage them in discussions on results for early detection of systemic risks.

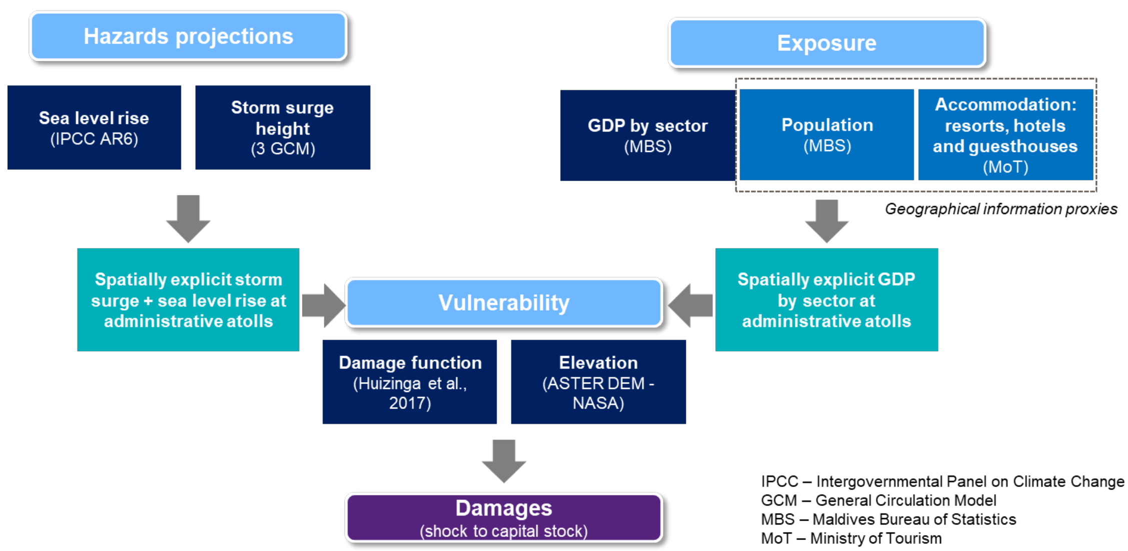
B. Climate Risk Analysis

29. **The climate risk analysis estimated a shock to physical capital under different climate scenarios, leveraging authorities' and global data, and imposes it onto the financial system (Figure 7).** For the hazard component, the assessment considered global climate data on sea level rise and storm surge height on actual conditions and future climate scenarios, SSP2-4.5, SSP3-7.0, and SSP5-8.5. This data is assigned to each administrative Atoll and Greater Male area. The exposure disaggregated the economic activity into these locations, using the authorities' geographical information as proxies, and Huizinga et al. (2017) damage functions link the hazard intensity to the percentage of damage by industry, adjusted for the elevation. Due to unavailability of banking sector standardized geographical exposure data, the analysis considered the impact of by-sector damage rates on the corresponding banks' loans related to immovable assets, although not geographically differentiated. In addition to the direct impact, banks could see an indirect impact through effects on households' and corporates' income affected by a climate event. While insurance companies can also be affected, the main effect will be higher reinsurance premiums or the inability to obtain reinsurance for climate-related events, specifically for coastal flooding.

[15] The average maturity of T-bills is about 290 days. Banks deliberately space their bond purchases such that equal parts come due each month. The short maturity would, however, lengthen a lot in case of a domestic debt exchange.

30. The physical risk analysis suggests no material mid-century coastal flood impact on the banking system.[16] Sea level rise would be the leading factor aggravating coastal floods, directly impacting the population and the country's economy, mainly through the geographical spread of tourism infrastructure. The direct damages to the capital stock for mid-century scenario may reach up to 3.4 percent, and 20 percent for the end-century scenario (Figure 8, lhs). For mid-century, when directly impacting the loans related to physical immovable assets from the banks by increasing loan loss provisions (Figure 8, rhs), the impact was found to be mild, with a 0.5 percentage point decline in the banking system's CAR, and up to 0.9 percentage points for the most affected bank. These results need to be interpreted with caution, given the high uncertainty surrounding the climate data, limited data to model the geographical exposures, as well as the possible indirect damages and spillover effects in Maldives' tourism-dependent economy. Thus, the authorities should operationalize an institutional strategy on climate and related supervisory expectations for the financial sector regarding business strategies, governance, risk management and reporting, in line with international standards.

Figure 7. Maldives: Physical Risk Analysis Framework



Source: IMF staff.

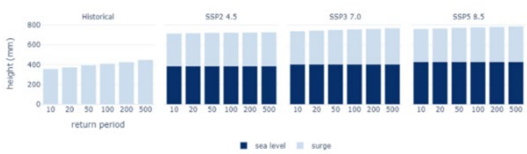
[16] There is higher uncertainty about climate conditions towards the end of the century due to the divergence between scenarios after mid-century, with higher accelerations and specific ice-sheet processes that could impact sea levels in higher emissions scenarios.

Figure 8. Maldives: Results of Climate Risk Analysis

The main risk factor for coastal floods is sea level rise…

Average Storm Surge + Sea Level Rise of all Atolls

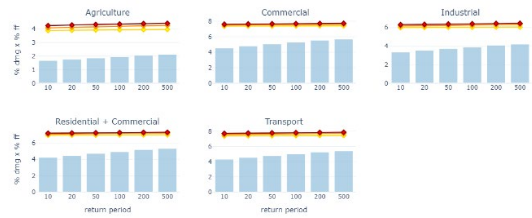
(mm) Height of storm surge by return period + 95th percentile sea level rise, 2050



…which will lead to different damages by industry

Average Damage Rate of all Atolls

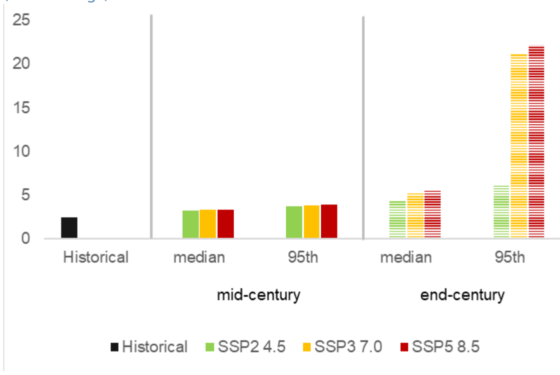
(%) Damage rate by sector, 95th percentile sea level rise mid-century



While for end-century, the damage could reach a concerning level…

Decline in Capital Stock

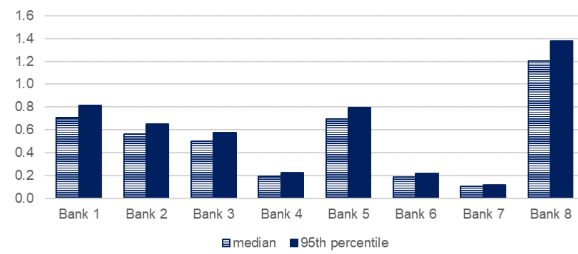
(% Percentage)



…the impact on the banking system for the mid-century will be mild.

Immovable Assets Portfolio Damage Rate

(% Percentage)



Source: IMF Staff calculations.

FINANCIAL SECTOR OVERSIGHT

A. Macroprudential Policy

31. Preconditions for macroprudential policymaking are not favorable. The MMA's capacity constraints and its sentiment that the financial system is non-complex and low risk has resulted in a minimalist approach to macroprudential oversight. There is no macroprudential or financial stability committee, nor a macroprudential mandate with clear objectives. The bulk of the work on macroprudential policy would need to be done by the MMA’s financial stability unit, which, however, lacks clear objectives, resources, and direct access to the Board. In addition, coordination with the Capital Market Development Authority (CMDA) and main stakeholders of the financial system is limited. Communication to the public is also sparse, with no publication of a financial stability report. The MMA suffers from a significant lack of data infrastructure, particularly limited data scope and cumbersome access to the CIB. Lastly, except for a leverage ratio, there are no macroprudential policy instruments, although the MMA has drafted blueprints for loan-to-value (LTV) and debt-service-to-income (DSTI) ratios, and the Basel III Liquidity Coverage Ratio.

32. The MMA should establish an institutional macroprudential framework. A financial stability committee that is chaired by the MMA with the participation of key stakeholders (CMDA, MoF, and other institutions as needed) should be established.[17] To strike a balance between preserving the MMA's autonomy and benefits from involving other stakeholders, the MMA should have the same number of votes as other stakeholders combined (with a tiebreaking vote in case of a draw). The committee that may also assume certain responsibilities in crisis management (see below) should be given a clear macroprudential mandate with decision-making powers and would rely on the MMA's financial stability unit to act as secretariat. That unit would also monitor systemic risks, perform stability analyses, and prepare a financial stability report, thus requiring more resources.

33. Moreover, the MMA should build a system of early warning indicators to monitor systemic risks. A dashboard of both broad-based and sectoral indicators would strengthen risk assessment. Indicators of credit (e.g., Basel credit-to-GDP gap), real estate developments, corporate performance, household indebtedness, and housing affordability should inform about potential risks beyond the banking sector. Creation of such a dashboard would, however, require a significant data collection effort and ready access to the CIB. Moreover, the FSAP recommends creating a property price index, leveraging information at HDC and HDFC and possibly banks possessing such data to assess emerging risks (e.g., surging house prices, weakening housing affordability). While the MMA could lead this data collection effort, calculation, and publication of a property price index should be in the remit of the Maldives Bureau of Statistics.

34. Key borrower-based macroprudential instruments should be introduced. The MMA should proceed to establish regulation for LTV and DSTI limits. Despite the low share of residential mortgage loans (5.2 percent), the HDC's expanding rent-to-own schemes have spurred housing demand, construction, and prices. Imposing regulatory LTV limits, complemented by DSTI limits, should help rein in risks. Most banks have internal LTV and DSTI limits, and actual ratios of retail clients (70-80 percent and 40-50 percent, respectively) are near the regulatory limit the MMA contemplates for lower-income earners (50 percent). However, data gaps should first be closed by compiling payment obligations for consumer good lease and hire purchases widely used instead of ordinary consumer loans (Appendix VII). Including such recurring payment obligations in the definition of debt service and the DSTI ratio would paint a truthful picture of household leverage. Two unregulated leasing companies indicated they would welcome reporting to the CIB if in return receiving borrower information useful for lease origination decisions.

35. In addition, the MMA should develop macroprudential instruments for safeguarding bank liquidity and sustainable funding as well as additional capital buffers. Specifically, the MMA should adopt a liquidity regulation (LCR, in both MVR and USD) and sustainable funding of lending (Net Stable Funding Ratio and loan-to-deposit ratio, again in both currencies). Beyond these crucial instruments, the MMA could also adopt other instruments addressing systemic risks (e.g.,

[17] Model 2 for the macroprudential mandate (¶81 of IMF Staff Guidance Note on Macroprudential Policy).

Basel III positive neutral countercyclical capital buffer, D-SIB buffer, and a systemic risk buffer to help address concentration risks).

B. Banking Regulation and Supervision

36. Further progress is needed to enhance compliance with the Basel Core Principles for Effective Banking Supervision (BCP). The FSAP conducted the first full assessment of the MMA's implementation of BCP of 2012, focusing on banking supervision and regulation. Key recommendations include: (i) redefining off-site monitoring; (ii) operationalizing crisis management; (iii) enhancing enforcement; (iv) increasing supervisory resources; (v) strengthening MMA's independence; (vi) introducing liquidity requirements; (vii) amending capital adequacy rules to increase from 0 to 100 percent the RW on domestic sovereign exposures in FX; and (viii) redefining requirements on banks' stress testing.

37. Although Maldives has developed a relatively strong regulatory framework, material gaps persist. The Banking Act contains a comprehensive framework for bank regulation and supervision. The MMA has developed legal instruments to implement the provisions of the Act. However, key gaps include the lack of a comprehensive regulation for liquidity risk and crisis management and the application of a zero RW on domestic sovereign exposures in FX.[18]

38. Moreover, the MMA's institutional structure, including the composition of the Board, needs to be strengthened further. The MMA's highest governing body, the Board of Directors, includes representatives from the private sector and, crucially, from the government. Considering the prominent role of the state in the financial sector, the presence of strong lobbies and the inadequate definition of conflicts of interest in the MMA Act, this arrangement exposes the MMA to potential political interference and may compromise its independence, therefore necessitating institutional changes.[19]

39. During the last decade, the MMA has managed to reduce banking sector risks. The MMA has concentrated its limited supervisory resources on intrusive on-site inspections that performed thorough credit file reviews focused on provisioning and adherence to limits. During the last years, The MMA has shifted its focus to operational risk and AML/CFT rules and, more recently, corporate governance and risk management. The latter should be further pursued but demands a different supervisory approach, consistent with the introduction of new, principle-based regulations.

40. The approach to off-site monitoring has not been able to influence banks' conduct and needs improvement. Supervisors prepare quarterly monitoring reports where ratings are updated. In preparing the reports, there are no regular meetings with senior officials or the statutory

[18] The recommendation to increase the RW to 100 percent is not only in line with the Basel I framework in Maldives but also the Basel III framework requiring that RW for Maldives' B- rating (Fitch).The RW could be raised gradually (e.g., by 20 percent each year over five years) to lessen the immediate impact on individual banks.

[19] At many central banks, a government representative is allowed to participate in board meetings but without voting rights; and, according to corporate governance sound practices, the appointment of non-executive, external members tasked with specific functions could enhance central bank accountability.

auditor. Qualitative aspects such as governance or risk management are not assessed during off-site monitoring. Supervisors do not perform forward-looking assessment, due to lack of focus and tools. The results of the off-site monitoring are rarely shared nor discussed with banks.

41. **There is also a low "enforcement attitude".** The MMA has traditionally preferred to exert moral suasion, opting for recommendations and warnings over sanctions and other enforcement actions. There are no requirements for recovery planning in place. The MMA should issue regulatory standards or guidelines to clarify the enforcement regime, including the conservatorship.

42. **Significant questions remain over staffing and resources.** Despite allocating more resources to banking supervision, the MMA's staffing is still insufficient to implement its supervisory model. For instance, the MMA has not managed to shorten the on-site minimum legal cycle (currently every two years) or perform more than one examination simultaneously. Moreover, the new regulatory instruments and upgrade of the supervisory procedures warrant additional resources.

C. Financial Integrity

43. **Maldives' AML/CFT system was last assessed in 2011 as nascent, and a new assessment is imminent (2024-2025).** The upcoming assessment will require Maldives to demonstrate compliance with the revised Financial Action Task Force (FATF) standards as well as its effective implementation. In 2011, the financial sector was identified as susceptible to considerable risks related to illegal proceeds generated from drug-trafficking, corruption, and indications of fund-raising for terrorist activities abroad. Subsequently, Maldives enacted the Prevention of Money Laundering and Financing of Terrorism Act (PMLFT Act) and issued regulations for key financial sectors. A recent NRA found additional risks posed by organized crime and new technologies. Emerging risks also include risks related to non-resident inflows, including in the parallel exchange market.

44. **To benefit the financial sector, the authorities should address remaining legal gaps swiftly and enhance implementation of the AML/CFT framework**. The authorities' current and planned steps include mitigating risks identified in the NRA, addressing gaps in the legal framework, issuing regulations for remaining sectors (e.g., payment service providers/virtual asset service providers, and financing businesses). The authorities should share the NRA's findings with the financial sector, enabling it to factor these in their own institutional risk assessment and mitigation plans, including enhancing suspicious transactions reporting. Regulation of the financial sector and service providers should be improved, and supervision should be conducted on a risk-based approach, also to address risks related to non-resident inflows. Such reforms would assist the authorities to demonstrate their commitment to AML/CFT, which would ultimately be beneficial to the financial sector and also to their cross-border business.

FINANCIAL SAFETY NET AND CRISIS MANAGEMENT ARRANGEMENTS

45. The Maldives Banking Act (MBA) provides for corrective actions and enforcement powers that the MMA may apply to a bank having breached any laws, regulations, instructions, or conditions imposed by the MMA, and in case of unsafe and unsound practices. The MMA should take additional steps to enhance the framework and align with international standards.

- *The MMA needs to establish a clearer and forward-looking set of early intervention triggers.* In addition, the lack of definition of unsafe and unsound practices in the MBA or other regulation or guidance may preclude the MMA from taking action against any bank or its administrators. The MMA should issue relevant regulations or guidelines for operationalizing the early intervention regime.

- *The MMA should be authorized to require banks to have a recovery plan compliant with MMA requirements.* This would start with a pilot program focusing on the largest bank. Upon completion, recovery planning should be extended to other banks, proportional to their size and complexity.

- *The MMA should prepare resolution plans for systemically important banks and perform accompanying resolvability assessments.* The MMA should determine the resolution strategies and evaluate the feasibility and credibility of preferred resolution strategies in the resolvability assesment.

46. The MBA should be amended to strengthen the bank resolution framework and enhance its effectiveness in line with the FSB's Key Attributes of Effective Resolution Regimes for Financial Institutions (KA) and regulations for operationalizing the framework be issued.

- *The triggers for initiating resolution should be strengthened*. The MBA should be amended to include forward-looking resolution objectives, and the governance trigger should be strengthened. 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.

- *The MBA should be amended to empower the MMA to trigger resolution and for resolution powers to be applied immediately in case of a quick failure of a bank deemed non-viable or likely non-viable.* 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 MMA should not own and capitalize a bridge bank.* This is to address conflicts of interest in the case of Maldives and to protect MMA's balance sheet when the bridge bank tool is implemented without public recapitalization of the failing bank..

- *Safeguards against recapitalization by public funds need to be strengthened.* This should be an exceptional last-resort mechanism only when there is a significant risk of destabilization of the financial system and no other option available. Public funds should be used after all estimated losses have been allocated to shareholders and, to the extent possible, to unsecured creditors. There should be pre-defined mechanisms for loss recovery such as ex-post levies from the banking sector.

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

a. Establishing a separate unit for the management of the DIF, ensuring operational independence and governance arrangements,

b. Enhancing MMA's information technology capacity to access to online depositor accounts and adopt a plan to reduce the reimbursement period for insured deposits to 7 days (IADI CP 15),

c. Determining the target fund size on the basis of clear, consistent and transparent criteria and a reasonable timeframe to reach the target size (CP 9),

d. Expanding the DIF mandate to a paybox plus mandate (CP 9),

e. Providing for emergency funding arrangements for the deposit insurance system (CP 9),

f. Ensuring that the legislation does not allow for any borrowings and contributions from the MMA in case of a shortfall in funding from the DIF.

48. The MMA should develop an effective emergency liquidity assistance (ELA) framework. This requires amendments to the MMA Act to include ELA provisions and safeguards, and to clarify that ELA can be provided by the MMA on a discretionary basis to solvent and viable banks with temporary liquidity shortages. ELA should be provided against adequate collateral and at a sufficiently high interest rate. Stress testing could be used for viability assessment purposes. Given the limited market mechanism and liquidity management tools, the liquidity management framework should be enhanced, including open market operations and standing facilities.

49. High dollarization and FX shortages create challenges for ELA provision in FX. The required level of international reserves should be assessed considering potential needs for ELA in FX. The MMA should prioritize the provision of ELA in MVR and should use the RR in FX to provide a liquidity backstop for banks, while providing ELA in FX only if absolutely necessary and provided it has sufficient FX to meet other policy objectives. The following should be considered in this context:

- *The MMA should be empowered to provide ELA in FX but its ability to do will depend on the level of FX reserves freely available*. Typically, official FX reserves are highly constrained and sufficient only to provide FX liquidity in an idiosyncratic case rather than in a systemic event. MMA may need to bolster its reserves, e.g., by arranging swap arrangements with other central banks or tightening prudential requirements (e.g., tightening NOPs or increasing reserve requirements in FX).
- *ELA in FX should be provided to subsidiaries or branches of foreign banks only as part of a comprehensive set of measures and under very specific circumstances and conditions*. Liquidity problems at the local entity may indicate wider problems in the group that may entail the risk of FX liquidity being "upstreamed."
- *The first-best solution is for the local entity to obtain sufficient liquidity from its parent, if necessary supported by the home authorities*. The MMA should only provide ELA in FX in case the entity is deemed systemic and if this is likely to deliver a viable going concern entity, and only after the establishment of enhanced supervisory monitoring and pre-approval of any flows from the local entity to its parent. The MMA should ensure that ELA in FX is not a substitute for liquidity support from the parent bank or other parts of the group.

50. The Financial Stability Committee recommended for macroprudential policymaking should also be tasked with crisis preparedness and management. The FSC should function as a forum with a coordination role where authorities collaborate for crisis preparedness and management, with each institution safeguarding its own responsibility and autonomy for the exercise of its relevant powers within its mandate.

FINANCIAL SECTOR DEVELOPMENT

52. Access to finance for smaller enterprises remains a significant challenge as the banking sector is serving the needs of government and larger enterprises. A concerted effort under the National Financial Inclusion Strategy is needed to address the gaps notwithstanding scant data in this sector. The authorities need to restructure SDFC away from subsidized lending towards second-tier intermediation. In addition, credit enhancement mechanisms (e.g., a portfolio guarantee scheme) would encourage banks to expand lending to MSMEs. In tandem, the authorities need to reform the credit-enabling infrastructure (e.g., movable collateral registry under the pending Secured Transaction Act, a modern insolvency framework).

53. The authorities have made advances in financial inclusion, but there are gaps in the usage of financial products and challenges due to the geographic dispersion of the country. There is limited adoption of credit and insurance, along with restricted access in remote areas and low financial literacy. The MMA now has financial consumer protection powers through the amended MMA Act, but an enabling regulatory and supervisory framework still needs to be adopted. Further reforms to foster inclusion should focus on digital financial services, competition, and innovation (e.g., interoperability, access to clearing infrastructure, and cross-border connectivity). Efforts to address inclusion in remote islands should be directed towards digital channels.

54. The authorities should explore ways to stimulate markets for green finance and resilience. It is estimated that Maldives climate investment needs amount to 15 percent of GDP annually, which cannot be met solely by the domestic market; drawing on available public international sources of funding is therefore crucial. The authorities could support green finance by developing a national climate strategy, introducing a green taxonomy, and leveraging the existing state-owned financial institutions. They should explore options to strengthen disaster risk finance and develop insurance to improve financial resilience to climate-related disasters.

AUTHORITIES' VIEWS

55. The Maldives' authorities expressed their appreciation for the report and its analysis of the macrofinancial vulnerabilities in the financial system. The MMA emphasized the importance of publishing the report as part of the FSAP process, as this would give an impetus to think about the next steps, including introducing new regulations. The MMA also agreed to consider forming a financial stability committee with various stakeholders.

56. The authorities also showed a strong interest in further examining the sovereign-bank nexus which is a major vulnerability for the Maldives. MMA requested that further recommendations be provided on feasible measures to address this issue, such as reducing the exposure of banks to government securities, enhancing the oversight of banks, and strengthening the fiscal framework and debt management. The Ministry of Finance requested additional information on the possible policy measures to address the sovereign-bank nexus, including the experience of peer countries in this area.

Appendix I. FSAP Development Module 2016: Status of Implementation of Main Recommendations

Main Recommendations	***Priority***	***Horizon***	***September 2022 Update from the MMA***	***Status***
Strategic Planning and Institutional Reforms				
Prepare a holistic financial sector strategy through an inclusive and consultative process with all stakeholders following good international practice (MMA, GoM).	High	Short Term	Not yet achieved	Work in Progress
Unify the supervisory structure under a single independent supervisory authority by integrating CMDA into the MMA. (GoM, the Parliament).	High	Medium Term	CMDA is an independent institution established under the Maldives Securities Act 2/2006 for developing and regulating the capital market in the Maldives. Both institutions operate independently.	Not Implemented
Establish a regulatory and supervisory unit for financial consumer protection covering all financial services under the MMA, with reporting to an MMA board member who is not responsible for prudential supervision.	High	Medium Term	Financial Consumer Protection section is placed under the Financial Sector Development Area of MMA (Area 5) since 2018. FCPS presently reports to the head of Area 3 FCPS has not yet established framework to conduct regulatory and supervisory (market conduct) functions. FCP presently mediates between consumers and financial institutions complaints filed.	Not Implemented
Consider a more streamlined arrangement for MMA's board of directors that would increase the political independence of MMA (GoM, Parliament).	Medium	Medium Term	**Reforms Achieved**. Through the amendment brought to MMA Act in 2020, that included following changes to the criteria of MMA board members under section 6 (7); (g) shall not be a person elected to any post pursuant to any election specified by law; (h) shall not be a member of the Cabinet; (i) shall not be a member of or active in, a political party	Partially Implemented
Financial Efficiency				
Promptly enact pending and	High	Medium	National Payment System Act was	Work in

Main Recommendations	Prior ity	Horizon	September 2022 Update from the MMA	Status
missing financial sector laws (the Parliament, MMA, GoM).		Term	enacted in 2021 for the purposes of development, regulation and oversight of the Maldives' national payment system. Amendment to MMA Act was enacted in 2020, section 24-1, (a) to enable MMA to regulate, licence, register and supervise credit information systems operated by other parties. (b) Further, the amendment enables MMA to mandate parties who provide goods and service on credit to participate such system operated by MMA. Pending in the Parliament: Insurance Act – in the committee stage Pending at the Attorney General's Office (AGO): Credit Information Bill –draft sent to AGO in 2021.	Progress
Review the entire structure of interest rates and establish a consistent policy rate (MMA). Renew open market operations and issue additional treasury bonds to absorb excess liquidity and to develop a yield curve (MMA/MoFT).	High	Medium Term	MMA plans to review the interest rate corridor and the indicative policy rate and bring changes along with reforms to foreign exchange regulation. The MMA is ready to resume open market operations if exchange rate and inflationary pressure intensifies.	Not Implemented
Address the forex shortage in the financial markets by exploring several possible options (MMA/MoFT/MED).	High	Medium Term	MMA is reviewing the reforms to foreign exchange regulation and is currently engaged in on-going discussions with relevant stakeholders.	Not Implemented
Develop requirements for more parametric business plans submitting for ed for licensing and enforce them with adequate margins for maneuver during supervision (MMA).	Medi um	Long Term	Business plans are obtained in as much detail as MMA wants.	Not Implemented
Enhance capacity building to effectively enforce legal and regulatory provisions and provide a level playing field in market development (MMA/CMDA).	Medi um	Medium Term		

Main Recommendations	***Prior ity***	***Horizon***	***September 2022 Update from the MMA***	***Status***
Corporate Governance				
Adopt and enforce comprehensive corporate governance regulation. Regulation should cover governance for bank branches. Issue and enforce a risk management regulation that assigns board responsibility for monitoring the full contingent of risks in the bank's operating environment (MMA).	High	Short Term	Corporate Governance regulation for Banks, Insurance Companies and Finance Companies was issued in July 2020. The Regulation is applicable to foreign branches as well. "Risk Management Guidelines for Banks, Insurance Companies and Finance Companies" has been issued in March 2022	Fully Implemented
Strengthen legislation by introducing and defining the notion of independent directors and expanding the definition of related party to include subsidiaries of a bank. Strengthen supervisory monitoring of financial disclosure by banks (MMA)	Medi um	Medium Term	**Introducing and defining Independent Directors:** Corporate Governance regulation for Banks, Insurance Companies and Finance Companies issued in July 2020 requires of ¼ of the Board members to be independent directors. **Expanding the definition related party to include subsidiaries of a bank**: The definition of related person in the Regulation on Limits on Loans to Related Persons and Regulation on Transactions with Related Persons **captures subsidiaries of a bank. This was clearly explained to the FSAP mission then as well. The relevant part of the definition is given below:** "Two or more persons will be considered to be related if one person has the ability, directly or indirectly, to <u>control the other person/s or to exercise significant influence over the financial and operating decisions of the other person/</u>s, or <u>if both persons are subject to common control or common significant influence</u>." **Strengthen supervisory monitoring of financial disclosure by banks:** The disclosure requirement of banks has been enhanced in the Corporate	Fully Implemented

Main Recommendations	Priority	Horizon	September 2022 Update from the MMA	Status
			Governance regulation for Banks, Insurance Companies and Finance Companies issued in July 2020. Section 19 of the Regulation requires the financial institutions to include a corporate governance report with its annual report.	
The BML board should play a larger role in the oversight of the enterprise risk management development project and hold management and the contracted firm accountable for effective delivery (MoFT, BML).	High	Short Term	Completed.	Fully Implemented
Introduce 1-2 expatriates with strong international experience in banking, risk management, and business strategy to the BML board. The government should be represented on the board only by one individual, preferably a civil servant from the Ministry of Economic Development—responsible for SME development—vetted by MMA against common fit and proper criteria (MoFT, BML, MMA).	High	Medium Term	MMA's role is limited to vetting the fitness and propriety, which is done even now.	Fully Implemented
The BML Board should elevate its focus on the development mandate, balanced with its commercial incentive structure, including by fulfilling the bank's role in data sharing with CIB, cancelling exclusivity contracts with cash agents, and opening up the ATM/POS network to other banks for a cost recovery fee (MoFT, BML).	High	Medium Term	Data sharing with CIB issues has been solved since 2017. Cash Agents agreement of BML has no exclusivity clause. AMEX cards are however exclusive to BML Bml'S ATM/POS terminals network are open for other banks.	Partially Implemented
Islamic Finance				
Issue a regulation to phase out dual memberships on Shariah boards of both the regulators	High	Short Term	MMA's Shari'ah Governance Framework restricts members of Institutional Shari'ah Committees	Partially Implemented

Main Recommendations	***Priority***	***Horizon***	***September 2022 Update from the MMA***	***Status***
and the market players (MMA and CMDA boards).			from holding membership in more than one institution of same category. It categorizes institutions into banks, takaful and other financial institutions. Although there is no regulation prohibiting dual memberships on Shari'ah boards of both regulators, when appointing members to the Shari'ah Council of MMA this is taken into account and we do not appoint anybody who holds membership of the Shari'ah board of CMDA.	
Develop a legal and regulatory framework for Islamic Banking, Takaful, Sukuk and short-term certificates. Revise the accounting, auditing, and reporting standards for Islamic financial institutions (MMA). Review the legal framework of the Sukuk market and establish Special Purpose Vehicles (SPVs) in the Sukuk market space (CMDA).	High	Medium Term	The review and revision of the existing legal and regulatory framework is a key activity included in MMA's Strategic Plan. This activity is currently planned for early 2023. It would also include the accounting and reporting standards for Islamic financial institutions. A guideline on Shari'ah Audit is included in the Shari'ah Governance Framework.	Work in Progress
Strengthen oversight of the transparency and disclosure requirements of Sukuk issuances. Streamline the Shariah stock screening process for listed companies in the stock exchange (CMDA, Stock Exchange).	Medium	Medium Term	CMDA has issued regulations on both sukuk issuances as well Shari'ah stock screening. Awaiting a response from CMDA whether the regulations/processes have been revised or streamlined since the recommendations of the FSAP.	Partially Implemented
Islamic finance development units should be adequately staffed with the appropriate skills and empowered to enforce market discipline (MMA, CMDA).	High	Medium Term	The Islamic Finance Unit of MMA was reorganized and placed within the Financial Sector Development and Financial Inclusion area of the MMA and given a more development focused mandate. Additional staff has been recruited to the Islamic Finance Section.	Partially Implemented
Establish a Shariah-compliant risk guarantee scheme to unlock opportunities for Shariah- compliant financing	Medium	Medium Term	The Islamic Finance Unit of MMA was reorganized and placed within the Financial Sector Development and Financial Inclusion area of the MMA	Not Implemented

Main Recommendations	***Prior ity***	***Horizon***	***September 2022 Update from the MMA***	***Status***
to MSMEs (MMA, MoFT, MED).			and given a more development focused mandate. Additional staff has been recruited to the Islamic Finance Section.	
Capital Markets				
Establish a Policy Steering Committee and a Project Group, comprising both the public and private sector, to coordinate (i) the repair of specific elements of the infrastructure, and (ii) the introduction of banks as market makers in T-bonds (MoFT, MMA, CMDA).	High	Medium Term	As an agent to the government for issuance and settlement of government securities, MMA initiated Government Securities Market Development (GSMD) Project in 2017 under which a Central Securities Depository (CSD) system implementation process was started. The scope of the project also included the introduction of Primary Dealership regime, where all institutions licensed by the Authority under the Banking Act [2010] are eligible to be appointed as Market Dealers who will perform the role of market makers to stimulate the Secondary Market process. The functions of market makers were tested through the CSD system and they work accordingly. However, effective from 12 August 2021, MoF decided to terminate agency agreement between MoF & MMA. Therefore, the GSMD Project and the CSD System implementation process was transferred to MoF.	Partially Implemented
Replace the depositary with a more robust system, including a Delivery versus Payment (DvP) settlement process linked to the Real Time Gross Settlement (RTGS) system (MMA). Replace MSE's trading system with a well-established international system that is fit for purpose (MSE).	High	Medium Term	During the Inception Phase of the Central Securities Depository (CSD) implementation project it was decided to integrate the Maldives Real Time Gross Settlement System (MRTGS) system with the CSD system in order to facilitates simultaneousness of securities trade operations and settlement with the Delivery versus Payment (DvP)	Partially Implemented

Main Recommendations	*Priority*	*Horizon*	*September 2022 Update from the MMA*	*Status*
			process.	
Coordinate, through the Project Group, a market makers pilot including short-dated T- bonds and the STO corporate bond (MoFT, MMA, CMDA)	High	Medium Term	Any issuance related to Government Securities will be conducted by the Ministry of Finance as Government Securities Issuance function has been transferred to the Ministry In 2021	Not Implemented
Once the government bond market has begun to function seek to support the MSE in obtaining appropriate well-established trading systems (MoFT).	Medium	Long Term	Government securities being issued by MoF	Not Implemented
		Insurance		
Engage an international supervisor or consultant to prepare manuals for effective onsite review and offsite analysis of insurance companies and arrange staff training (MMA).	High	Short Term	Manuals have been prepared with the help of Consultant and SARTTAC technical assistance is on-going for staff training.	Work in Progress
Review existing regulations and guidelines that are the de facto insurance legal framework, enact law(s) on insurance contracts, insurance supervision and insolvency, and address gaps in the regulations and guidelines (GoM).	High	Medium Term	Draft Insurance Act has been submitted to AG office by MMA in March 2018. Now the Act is going through the final stages in the Parliament.	Work in Progress
Increase competition in the insurance market by privatizing Allied Insurance and allowing all insurers to compete for every business line, including mandatory insurance (GoM).	Medium	Medium Term	More players have entered the insurance industry since the study. Allied Insurance not yet privatized.	Partially Implemented
Investigate an initiative to enter into arrangements with other countries for the purchase of catastrophe insurance (GoM).	Medium	Medium Term	Catastrophe insurance gap analysis is being conducted (base line study with UNDP).	Work in Progress
		Pensions		
Resolve the issue of double pensions to some members by limiting the unfunded benefits of these members to	High	Short Term	Under the 'New Retirement Benefit Guideline' produced by the National Pay Commission, all institutions following the pay structure are to	Partially Implemented

Main Recommendations	***Prior ity***	***Horizon***	***September 2022 Update from the MMA***	***Status***
the period between retirement and the age of 65 (GoM).			follow a harmonized pension benefit system.	
Permit MRPS to purchase conservative international instruments and supply the international currency to do so (MMA).	Medi um	Medium Term	No further developments regarding the matter. Ongoing discussions with MoF & CMDA	Not Implemented
Explore the securitization of home loans and authorize MRPS to purchase securities issued by the securitization program (GoM).	Medi um	Medium Term	Currently, MRPS invests in debt instruments issued by HDFC. Direct exposure to real estate market is restricted under the Pension Act.	Not Implemented
Financial Inclusion				
Enhance data collection and reporting on financial inclusion for policymaking by conducting surveys on MSME and household finance leveraging household and enterprise surveys, gather indicators from financial institutions (MMA, MED, MIRA).	High	Short Term	MMA presently collects financial inclusion data for Financial Access Survey. MMA has completed first demand side survey to formulate NFI strategy. FI disaggregated data collection project is ongoing by FCPS section.	Work in Progress
Leverage postal offices and airports to establish a network of financial service agents; prohibit exclusivity of cash agents, enforce opening of BMLs financial infrastructure for a cost recovery fee to BML (MMA).	High	Medium Term	MMA pursuing National Payment System project. The objective will be achieved through this, hence not pursing with agent network banking.	Work in Progress
The GoM should establish a special purpose vehicle (an apex SPV) to consolidate all credit lines run by the GoM's ministries. The apex SPV should house the planned partial credit guarantee scheme. The SPV must be professionally managed financial entity under the MMA supervision (MED, MMA).	High	Medium Term	Credit Guarantee Scheme and Affordable Housing Scheme (both partial guarantee schemes) was operated by MMA until 2021. The schemes are no longer in operation, and no other schemes are run by MMA. No SPV has been established to run credit lines or similar guarantee schemes.	Not Implemented
Adopt a comprehensive legal and regulatory framework for	Medi um	Medium Term	The Consumer Protection Regulation (under the amended MMA Act) in	Work in Progress

Main Recommendations	*Prior ity*	*Horizon*	*September 2022 Update from the MMA*	*Status*
financial consumer protection to cover all financial services, and establish an alternative dispute resolution mechanism, such as a Financial Ombudsman (MMA, CMDA).			ongoing. The establishment of alternative dispute resolution mechanism is yet to be established, however subject to enactment of the regulation.	
Financial Market Infrastructure: Payment and Settlement Systems				
Complete the legal and regulatory framework by enacting a comprehensive Payment Systems Act and related regulation in the area of E-money and other relevant systems and services (MMA, MoFT, Parliament).	High	Short Term	The National Payment System Act was published on 18 May 2021. The Regulation on Payment Services which governs payment services (including e-money services and other payment services) was published on 13 March 2022. Additionally, the following regulations are planned to be issued this year: Regulation on Access to Payment Accounts (to facilitate Open Banking in the Maldives) Regulation on Electronic Customer Due Diligence (to enable E-KYC in the Maldives).	Work in Progress
Adopt policies, including charging schemes, to progressively discontinue the issuance of high value cheques and to reduce their overall usage in the country. Collaborate to increase the usage of electronic payments among the population (MMA, Industry).	High	Medium Term	An Action Plan was formulated in consultation with the banks to discontinue the usage of cheques by June 2024. This plan was formally launched during April 2022 and became effective from July 2022. The key action items under the plan includes: imposition of value ceiling of MVR 50,000 and USD 3,000 on cheque transactions effective, 1st April 2023, Migrate all Direct Credit transfers processed through ACH to IPS by June 2023. Reduce the frequency of cheque clearing to twice a week (by 1st April 2023), and once a week (by 1st	Partially implemented

Main Recommendations	***Prior ity***	***Horizon***	***September 2022 Update from the MMA***	***Status***
			January 2024). Introduction of fees on cheque transactions effective, October 2023.	
Increase the efficiency and broaden the secure use of payment infrastructure, in particular the RTGS and ACH, finalize the implementation of STP mechanisms and introduce new services for the customers (MMA, Commercial Banks).	High	Short Term	MMA is currently in the process of implementing an Instant Payment System (IPS) under the Maldives Payment System Development project as part of its efforts to modernize the payment landscape of Maldives. Currently, the project is planned to be implemented over 2 phases. In the Phase 1 – which is scheduled to go-live during the last quarter of 2022 – MMA plans to implement IPS, which will facilitate account-based domestic retail payments. Banks and non-bank Payment PSPs are expected to be connected to the IPS via open APIs, enabling digital and integrated payment solutions to be introduced to the market. The system will also enable customers to make payments using easy-to-remember 'aliases' such as e-mails, National ID numbers, phone numbers for payments. The Payment Platform, inclusive of the white-labelled mobile application, that is being developed under Phase 2 is currently planned to go-live during the second quarter of 2023. The main objective of this platform is to provide the new entrants as well as the incumbent PSPs with a readily available solution to extend the services of the IPS to the end-users. MMA is also planning to upgrade the existing RTGS System within the next two years and phase out the usage of ACH completely.	Work in Progress
Finalize the creation of a	Medi	Medium	Payment Systems and Oversight	Work in

Main Recommendations	*Prior ity*	*Horizon*	*September 2022 Update from the MMA*	*Status*
Payment Systems Oversight unit to guarantee safety and efficiency of the financial sector and increase financial access and protection of consumer rights (MMA).	um	Term	Division was established in 2019 with the primary objective of implementing the oversight function for payment systems within MMA and developing the national payment system. MMA is currently in the process of developing the oversight framework, manuals and other necessary documentation for the oversight of payment systems and payment service providers	Progress
Financial Market Infrastructure: Credit Reporting Systems				
Form a MCIB users' group chaired by MMA and communicate the outcome of the DQA. Adopt adequate measures to avoid unfair access to the MCIB (MMA).	High	Short Term	Currently Data Quality Analysis of the existing data is shared with the relevant data provider and guidance is provided on how to correct the issues identified. As per Credit Information System Regulation, Credit Information System can only be accessed to authorized staff of data provider and Credit Information Bureau staff. No access is provided to any other party.	Partially Implemented
Review the existing draft law. Develop an oversight framework (MMA).	High	Medium Term	The drafted Credit Information System Act is now in Attorney General's Office.	Work in Progress
Continue ongoing efforts to broaden the scope of data and take all potential creditors into consideration (MMA and other relevant authorities).	Medi um	Medium Term	The new Credit Information System Regulation allows alternative data providers (financial/non-financial) to participate in Credit Information System.	Work in Progress
Consider the development of a consumer protection framework for CRS, including adequate protocols to correct errors included in the MCIB (MMA).	Low	Long Term	The new Credit Information System Regulation came into effect on July 2022. Under section 10, credit data should only be accessed for a permissible purpose. The Dispute Module in the current credit information system enables data correction of errors on credit facilities reported by consumers and data providers.	Partially Implemented
Financial Market Infrastructure: Insolvency and Creditor Rights				
Pass a Secured Transactions	High	Medium	**Pending**: draft Secure Transaction	Work in

Main Recommendations	***Prior ity***	***Horizon***	***September 2022 Update from the MMA***	***Status***
Law and establish a Collateral Registry that provides for clear priorities of creditors' rights (AGO, CR, MMA); implement a contractual, out-of- court enforcement mechanism over real property or alternatively establish an independent arbitration panel that can handle financial disputes in an expeditious manner; ensure full digitalization of the land registry (MMA); permit second charge mortgages over equity in real property (MMA); and strengthen judicial training and case management systems (JSC).		Term	Bill at the Attorney General's Office- draft sent to AGO in 2018 for review. - This draft covers only for security interests in movable property; Pending: draft Mortgage Bill at Attorney general's Office – MMA reviewed the draft bill and forwarded comments on the draft in 2016. - This draft bill covers for the creation, registration and enforcement in relation to security interest in immoveable property.	Progress
Develop out-of-court guidelines, promoted by MMA, to facilitate informal restructurings for multi-bank or syndicated loans (MMA); conduct training on the importance of the workout framework (MMA); and undertake legislative review of practices preventing effective reorganizations in the Maldives (MMA and AGO).	Medi um	Short Term	The drafted Secure Transaction Bill shall cover out of court settlement components.	Work in Progress
Pass an Insolvency Law that addresses the reorganization, liquidation and cross-border insolvency of corporates, as well as a formal bankruptcy regime for partnership, sole proprietorships and individuals (AGO, CR); strengthen training, supervision and qualification requirements for insolvency practitioners (AGO, MMA); and limit or abolish the	High	Medium Term	**Pending** in the Parliament, Bankruptcy Bill was sent to the relevant parliament committee in late 2020. - This bill covers insolvency matters related to natural persons and sole proprietorships only.	Work in Progress

Main Recommendations	***Prior ity***	***Horizon***	***September 2022 Update from the MMA***	***Status***
super-priority given to government claims, particularly MIRA (AGO, MIRA).				
Financial Integrity (AML/CFT)				
Address existing gaps in the legal framework for the implementation of the United Nations Security Council Resolutions 1267 and 1373 (MMA, Parliament).	High	Medium Term	Regulation on Management of Confiscated Funds and Properties related to Money Laundering and Financing of Terrorism was issued by the MMA Legal in the year 2020.	Partially Implemented
Enhance the supervisory capacity to effectively regulate offshore banks and ensure that the risks associated with the offshore sector are considered (MMA).	High	Medium Term	The Regulation for Offshore Banks Operating in the Special Economic Zone was issued by MMA in the year 2015. The authorities indicated that no offshore financial institutions have been licensed in the Maldives.	Not Implemented
Focus on effectively implementing the AML/CFT measures introduced in the new law and regulations (MMA).	Medi-um	Long Term	Supervisory activities have been conducted in relation to certain reporting entities. Efforts are being made to improve the AML/CFT regulatory framework, including in relation to DNFBPs.	Work in Progress

Appendix II. Selected Economic Indicators, 2019–2028

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
			Prel.	Proj.						
Output and prices			(Annual percentage change)							
Real GDP	6.9	-33.4	41.7	12.3	7.2	5.7	6.5	5.9	5.5	5.1
Inflation (end-of-period) 1/	1.7	-2.0	0.2	3.3	5.1	2.5	2.1	2.0	2.0	2.0
Inflation (period average) 1/	1.3	-1.6	0.2	2.6	5.2	2.8	2.2	2.0	2.0	2.0
GDP deflator	-1.1	0.2	1.7	2.6	5.2	2.8	2.2	2.0	2.0	2.0
Central government finances			(In percent of GDP)							
Revenue and grants	26.4	26.4	25.7	30.6	29.6	29.1	28.6	28.5	28.4	28.4
Expenditure and net lending	33.0	49.9	39.5	41.7	38.7	37.6	34.2	33.3	32.9	32.0
Overall balance	-6.6	-23.5	-13.8	-11.1	-9.1	-8.5	-5.7	-4.8	-4.4	-3.6
Overall balance excl. grants	-7.9	-25.2	-15.0	-12.2	-10.5	-9.2	-6.3	-5.4	-5.0	-4.2
Financing	6.6	23.5	13.8	11.1	9.1	8.5	5.7	4.8	4.4	3.6
Foreign	1.1	4.4	6.2	2.7	2.1	1.8	0.5	1.5	-0.2	0.2
Domestic 2/	5.5	19.2	7.6	8.3	7.0	6.7	5.2	3.3	4.6	3.5
of which: Unsecured financing 3/	…	…	…	…	1.0	…	…	…	…	…
Primary balance	-4.8	-20.7	-11.3	-7.5	-5.6	-5.0	-2.4	-1.6	-1.3	-0.7
Public and publicly guaranteed debt	78.8	154.4	120.1	114.9	108.9	108.0	103.5	99.1	95.4	91.6
Monetary accounts			(Annual percentage change)							
Broad money	9.5	14.2	26.2	15.1	10.8	8.7	8.9	8.0	7.6	7.2
Domestic credit	3.4	34.4	8.8	20.7	10.7	12.3	11.9	11.0	10.7	10.1
Balance of payments			percent of GDP, unless otherwise indicate							
Current account	-26.6	-35.5	-7.9	-18.1	-16.0	-14.2	-12.8	-9.7	-9.1	-8.5
Of which:										
Exports	6.4	6.9	5.3	6.3	5.8	5.6	5.5	5.5	5.5	5.4
Imports	-49.2	-45.7	-44.4	-52.1	-48.3	-47.3	-45.2	-43.5	-43.4	-42.9
Tourism receipts (in nonfactor services, net)	56.4	37.4	64.5	64.5	61.3	61.3	61.3	61.3	61.3	61.3
Income (net)	-10.0	-8.2	-9.1	-9.2	-8.9	-8.3	-8.0	-7.6	-7.4	-7.1
Current transfers	-10.4	-9.6	-7.9	-8.1	-9.4	-8.9	-8.7	-8.6	-7.9	-7.5
Capital and financial account (including e&o)	27.4	41.7	4.6	18.5	12.3	14.5	13.2	9.1	11.0	9.8
Of which:										
General government, net	1.9	4.0	3.8	3.9	0.5	1.9	-0.4	0.7	-0.9	-0.5
Banks and other sectors, net	3.5	15.6	-4.9	-0.1	1.0	0.3	0.3	0.3	0.3	0.3
Overall balance	0.7	6.2	-3.3	0.4	-3.7	0.3	0.3	-0.7	1.9	1.4
Gross international reserves (in millions of US$; e.o.p.)	754	985	806	828	566	591	615	549	724	859
In months of GNFS imports	3.7	3.4	2.1	2.0	1.3	1.2	1.2	1.0	1.3	1.4
Exchange Rate (rufyiaa/US$, e.o.p.)	15.4	15.4	15.4	15.4	15.4	15.4	15.4	15.4	15.4	15.4
Memorandum items:										
GDP (in millions of rufiyaa)	86,259	57,569	83,000	95,655	107,936	117,319	127,720	137,924	148,361	159,065
GDP (in millions of U.S. dollars)	5,598	3,736	5,386	6,207	7,004	7,613	8,288	8,950	9,628	10,322
Tourism bednights (000')	10,689	3,985	10,073	11,727	12,356	13,294	14,557	15,772	16,897	17,925
Tourist arrivals (000')	1,703	556	1,322	1,675	1,765	1,899	2,141	2,319	2,485	2,636
Tourism bednights (% change)	12.8	-62.7	152.8	16.4	5.4	7.6	9.5	8.3	7.1	6.1
Tourist arrivals (% change)	14.7	-67.4	137.8	26.7	5.4	7.6	12.7	8.3	7.1	6.1
Dollarization ratio (FC deposits in percent of broad money)	52.9	45.8	…	…	…	…	…	…	…	…

Sources: Maldivian authorities and IMF staff projections.
1/ CPI-Male definition.
2/ Domestic financing includes MMA advances, SDF contribution and India's USD 250 million bond from the State Bank of India branch in Male.
3/ Unsecured financing includes possible new sources of domestic financing or negotiated official bilateral financing as higher external financing costs are limiting options to tap international capital markets.

Appendix III. Financial Soundness Indicators, 2019–2022

	2019Q3	2019Q4	2020Q1	2020Q2	2020Q3	2020Q4	2021Q1	2021Q2	2021Q3	2021Q4	2022Q1	2022Q2
Core FSIs												
Regulatory capital to risk-weighted assets	47.26	46.40	46.51	47.93	48.19	46.27	45.76	47.17	48.75	47.26	48.83	48.28
Tier 1 capital to risk-weighted assets	40.84	38.96	43.57	44.07	42.94	40.97	42.05	41.47	39.86	36.21	44.69	42.22
Nonperforming loans net of provisions to capital	4.17	2.32	1.68	2.22	1.39	0.08	-0.32	0.13	-0.03	0.43	0.13	-0.71
Common Equity Tier 1 capital to risk-weighted assets	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Capital to assets (leverage ratio)	22.69	20.81	22.65	22.66	21.46	19.03	19.07	18.51	17.73	15.66	18.73	17.88
Nonperforming loans to total gross loans	9.58	9.35	9.19	9.63	8.92	8.16	7.84	7.85	7.46	6.69	6.38	6.05
Loan concentration by economic activity	87.80	87.07	86.84	86.84	86.79	87.79	88.60	89.23	89.52	88.90	88.07	87.71
Provisions to nonperforming loans	78.21	87.60	90.93	88.31	92.25	99.51	101.97	99.16	100.21	96.60	98.87	106.46
Return on assets	5.06	4.59	4.42	3.09	3.44	2.50	4.72	4.93	6.12	6.05	5.90	5.38
Return on equity	14.72	13.35	13.00	8.86	9.75	7.50	15.86	16.33	20.18	20.91	20.39	18.63
Interest margin to gross income	64.12	65.03	66.56	71.15	72.57	71.65	62.14	61.22	55.69	57.14	57.40	59.30
Noninterest expenses to gross income	29.81	31.84	30.33	29.56	28.70	31.76	28.55	27.92	24.91	27.14	31.53	29.24
Liquid assets to total assets	40.63	42.58	43.20	44.59	39.07	42.56	43.43	42.54	42.35	46.30	48.16	48.88
Liquid assets to short-term liabilities	66.67	68.20	66.96	69.94	67.02	69.73	69.40	68.66	67.37	71.80	73.85	74.60
Net open position in foreign exchange to capital 1/	8.44	6.42	9.59	9.13	5.21	-9.25	-8.65	-10.08	5.58	6.20	-5.23	-5.69
Additional FSIs												
Large exposures to capital	60.89	60.71	45.59	53.94	58.45	70.17	60.59	70.68	72.67	68.60	44.36	47.18
Gross asset position in financial derivatives to capital	0.00	0.00	0.00	0.00	0.00	2.35	1.33	1.27	1.20	1.15	1.12	0.98
Gross liability position in financial derivatives to capital	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Trading income to total income	4.28	4.08	3.95	3.67	3.76	3.59	3.55	3.20	2.92	3.10	3.88	3.74
Personnel expenses to noninterest expenses	34.59	34.93	37.45	39.19	40.03	37.22	32.55	34.71	34.48	34.51	30.58	31.29
Customer deposits to total (noninterbank) loans	122.20	131.12	134.28	134.21	124.62	137.24	145.37	145.88	143.72	164.69	177.80	180.92
FX loans to total loans	50.06	48.13	47.74	48.45	48.28	47.61	47.63	47.56	47.91	47.19	45.46	44.60
FX liabilities to total liabilities	55.07	56.26	55.33	50.59	52.45	54.98	55.18	52.63	51.96	54.16	55.26	55.03
Credit growth to private sector	7.44	7.48	7.34	6.46	7.46	8.86	8.62	9.57	8.19	4.94	2.23	1.60
Residential real estate loans to total gross loans	5.37	5.39	5.24	5.31	5.30	5.37	5.43	5.33	5.21	5.12	5.24	5.24
Commercial real estate loans to total gross loans	0.5	0.6	0.6	0.6	0.5	0.5	0.3	0.2	0.2	0.3	0.3	0.4

Source: IMF Financial Soundness Indicators.

1/ The net open position in foreign currency measures the foreign currency mismatch for the deposit taking institutions to identify exposure to exchange rate risk, which takes into account both on- and off- balance-sheet positions.

Appendix IV. Risk Assessment Matrix

Risks	Likelihood (High, Medium, Low)	Impact of Risk (High, Medium, Low)	Policy Response
Systemic regional instability causes financial market dislocations and adverse cross-border spillovers bring about a widening of the parallel market exchange rate spread and an increase sovereign debt stress. Potential 'twin-crisis' risks rise from the banking sector's large sovereign-bank nexus, risks to the exchange rate peg as, and financial sector exposure to regional sovereigns.	**Medium**	**High.** Banks' capital could erode rapidly in the event of sovereign stress considering that RWs on banks' sovereign debt exposure are zero and that sovereign debt represents roughly 30 percent of banks' total assets. Maldives is also highly dollarized economy and financial system and abandoning the peg, or re-pegging at a depreciated rate, would exert significant pressure on banks and the economy.	Reduce domestic financing needs and adjust the RW on banking sector sovereign debt exposure Reduce excess liquidity in the system and implement measures to reduce the level of dollarization in the economy.
Intensification of military conflicts, commodity price shock, and supply chain disruptions. Emergence or escalation of regional conflict(s) and resulting economic sanctions exacerbate disruptions in trade remittances, tourism, FDI and financial flows, thereby decreasing domestic growth, tightening financial conditions and affecting confidence.	**Medium**	**High.** Slower growth and damage to business confidence would adversely impact investment and consumption. Global financial tightening threatens FX stability and external debt sustainability. As risk of sovereign distress increases, banks are facing spillover risks through the sovereign-bank nexus.	Extend support measures: (i) asset purchase program to support liquidity in bond markets and compress risk premia and (ii) provide liquidity support to banks. To mitigate risks emanating from the sovereign-bank nexus, the authorities should implement fiscal consolidation to reduce financial needs and adjust banks' RWs on sovereign debt exposures.
Abrupt global slowdown or domestic economic shock. A global downturn, or a domestic security incident	**Medium**	**High**: a global slowdown or domestic shock would disrupt tourist arrivals from key source countries, putting pressure on FX	Provide targeted and temporary fiscal support to the most vulnerable and hardest-hit workers and businesses, and if

Risks	Likelihood (High, Medium, Low)	Impact of Risk (High, Medium, Low)	Policy Response
leading to a shock to tourism, would reverberate through trade and financial channels.		reserves and the budget deficit.	necessary, keep financial conditions accommodative to support banks.
Extreme climate events. Extreme climate events cause more severe than expected damage to infrastructure (especially in smaller vulnerable economies) and loss of human lives and livelihoods, amplifying supply chain disruptions and inflationary pressures, causing water and food shortages, and reducing medium-term growth.	**Medium**	**High:** Disruption in tourism and other economic activity, damage to properties from coastal flooding, higher food and energy inflation weakening debtor capacity to repay obligations.	Establish contingent financing plans with development partners. With clear criteria of exceptional circumstances, provide targeted and temporary assistance to affected groups and sectors. Prioritize public investment in disaster-resistant infrastructure and sustainable growth. Identify financial sector exposures to physical risks from climate change.

Appendix V. Stress Testing Matrix (STeM)

Banking Sector: Solvency Risk		
1. Institutional Perimeter	Institutions included	• All 8 domestic banks
	Market share	• 100 percent of banking system assets
	Data and baseline date	• Supervisory data as of December 2022
2. Channels of Risk Propagation	Methodology	• IMF stress testing framework
	Satellite models for macro-financial linkages	• Model-based forecast of main macroeconomic and financial variables. • Satellite panel data models for bank-level NPL ratios • Bottom-up stress test: Banks were asked to use their own models or to apply expert judgment and estimate impact of FSAP stress test scenarios on NPL ratio, income and CAR.
	Stress test horizon	• 3 years (end-2022 to end-2025).
3. Tail Shocks	Scenario analysis	• Macro scenarios include a baseline, a moderate and a severe stress scenario, with macro-financial variables (tourist arrivals, bed-nights, real GDP growth, exports, imports, lending rate, consumer inflation). • **Baseline scenario:** Latest baseline scenario of the APD country team. • **Moderate scenario**: Latest adverse scenario of the APD country team that is built on an economic downturn in advanced countries important to economic activity in Maldives. • **Severe scenario:** Bespoke adverse scenario involving a significant economic deterioration, depreciation of the MVR against the U.S. dollar (i.e., abandoning the peg), leading to a twin-coupled with a period of extreme sovereign stress and debt restructuring.

	Sensitivity analysis	• **Credit Risk** *Derived from projection of NPL ratio based on satellite models that include as regressors inflation and import growth, and assumptions about credit growth.* *An increase in NPLs in the following areas:* Local currency loan portfolio (mostly household and SME loans) *Default of largest 5 borrowers* • **FX-induced Credit Risk** • ***Severe scenario*** (currency devaluation): The team proposes to calibrate the scenario to historical volatility and analyze effect of: a. Loans to unhedged borrowers in FX (data on indirect currency risk permitting) • **Sovereign Risk** • ***Severe scenario*** *(domestic debt exchange):* a large exogenous shock leads to a period of severe sovereign stress. Debt sustainability concerns limit external commercial and official sector support. The scenario assumes a restructuring of domestic debt where T-bills and any other outstanding domestic government bonds (excl. MMA) are converted into a new bond on financial terms comparable to that given to the MMA in the most recent securitization of MMA claims (20-year maturity at an interest rate of 2.5 percent, equating to a 24.9 percent value loss applied as a haircut to the face value).
4. Risks and Buffers	Risks/factors assessed	• Total credit losses, pre-provision profit, repricing gap, shocks to the credit quality of sectoral and large exposures, domestic debt exchange (DDE) losses, losses from maturity and currency mismatches
	Behavioral adjustments	• Assumptions for pre-provision income growth and credit growth in scenarios as well as for income taxes paid, dividend payouts, maturity mismatch related repricing gap, NOP upon devaluation
5. Regulatory and Market-based Standards and Parameters	Calibration of risk parameters	• Projections of bank-by-bank NPL ratios based on satellite panel data regressions will be used in combination with projections for credit growth,

		pre-provision income, income taxes, dividends, and regulatory information to project banks' solvency positions in each scenario.
	Regulatory/Accounting and Market-Based Standards	• Minimum CAR hurdle rate: 12 percent
BANKING SECTOR: LIQUIDITY RISK		
1. Institutional Perimeter	Institutions included	• All 8 domestic banks
	Market share	• 100 percent of total banking sector assets and liabilities
	Data and baseline date	• Supervisory data as of December 2022
2. Channels of Risk Propagation	Methodology	• Cash-flow-based using maturity buckets • Withdrawals of five largest deposits of each bank
3. Risks and Buffers	Risks	• Funding liquidity shock
	Buffers	• Counterbalancing capacity
4. Tail Shocks	Size of the shock	• Assumptions for run-off rates on funding sources and roll-off rates on assets to estimate the funding gap based on historical volatility
5. Regulatory and Market-based Standards and Parameters	Regulatory standards	• Hurdle metrics: funding gap used for pass/fail result
6. Reporting Format for Results	Output presentation	• Funding gap by bank, aggregated • Number of banks that are found to be illiquid and their aggregate share in system assets
BANKING SECTOR: MARKET RISK		
1. Tail Shocks	Sensitivity analysis	• **Interest Rate Risk** *Income Effect* - Parallel shifts in interest rates of interest-bearing assets and liabilities, using the maturity buckets supplied for the liquidity stress test • **Currency Risk** • ***Severe scenario*** (currency devaluation): The team proposes to calibrate the scenario to historical volatility and analyze effect of: - Net Open Position (direct currency risk effect)

Appendix VI. FX Shortage: Causes and Implications

1. **The persistent FX shortage in Maldives is mostly due to government's ambitious investment programs that are executed mainly by HDC.** The twin deficits and net FX outflows from investment programs need to be met by external borrowing. Reportedly, HDC's has an annual net FX annual outflow of about USD 160 million which is equivalent to 20 percent of international reserves at MMA. Consequently, MMA has to earmark the allocation of FX to government and certain SOEs for their external debt service. Only the remainder goes to banks that, in turn, also ration FX to their clients.

2. **Other factors have contributed to the FX shortage.** First, not all FX inflows to resorts enter the official market and some are instead either kept in offshore accounts or directed to importers. Most resorts have money exchange licenses which facilitates supplying their FX to the parallel FX market. Second, some foreign banks have increased their repatriation flows due to the Maldives' low and falling sovereign rating while others do not repatriate due to possible dividend payment loss in FX.

3. **The parallel market has operated at a premium of around 10 to 15 percent since the pandemic.** This premium has been remarkably stable presumably for two reasons. First, considering the seasonal fluctuations in demand, the FX supply seems to be elastic and thus able to meet peaks in demand. That flexibility is ensured by large supply-side players dominating the market, including the resorts and fishery companies. Second, FX suppliers stand ready to stabilize the parallel market rate in response to market participants' needs in order to provide certainty in their business planning.

4. **Anecdotal evidence gleaned from banks suggests that they can meet around 10-20 percent of importers' FX demand, and the rest is procured through the parallel market.** In addition, some private sector importers have abandoned the traditional parallel market and instead source FX through bilateral relationships with resorts. Some also create their own FX income by providing logistics support to resorts. The parallel market creates deadweight losses to both traders and government that sees lower tax revenue since importers can claim the FX sourcing costs in their tax returns.

5. **The persistent FX shortage has implications for financial stability.** Given low official reserves, the shortage in the official market could lead eventually lead to a higher parallel market premium, possibly precipitating an exchange rate devaluation. A devaluation or a sudden stop of FX inflows may further exacerbate the FX shortage in the system.

6. **While some foreign owned banks have FX liquidity contingency lines from head offices, domestic banks lack this backstop.** MMA's low reserves suffice only for FX provision in an idiosyncratic case, not in a systemic event. MMA should consider ELA in FX only if critical to preserving financial stability and sufficient FX remains for other policy objectives. Therefore, MMA should consider tightening prudential requirements (e.g., net open position, FX reserve requirements) and bolstering its international reserves through additional swap arrangements with central banks, which would be challenging during a crisis. MMA should also encourage banks to have own FX swap facilities rather than relying on MMA resources. If a stressed parent is deemed unable to provide liquidity support as should be safeguarded, MMA should provide ELA in FX only to viable banks meeting ELA eligibility criteria, while also ringfencing the local entity.

Appendix VII. Lease-and-Hire Purchase Programs and Household Indebtedness

1. **Leasing operations that imply the obligor's ownership of the good financed at the end of the contract ("rent-to-own", or "lease-and-hire" purchase for consumer durables) are widespread in Maldives.** This is due to affordability as much as to cultural preference for instruments aligning with Islamic financing principles. Products financed under such schemes include vehicles, vessels, and consumer durables like mobile phones. The lease and hire market has flourished over the years; the FSAP team estimates that outstanding leases provided by four main finance/leasing companies and the bank most active in this segment amount to about MVR 1 billion, based on anecdotal information. This number compares to bank loans to households excluding mortgage loans of MVR 4.5 billion at end-2022. However, given the relatively small amounts financed, it is fair to assume that the leasing companies serve a share of the population in consumer finance that is comparable to that of banks.

2. **Under most plans, the leasing company retains ownership of the product until full payment at the end of the lease, except for one company that transfers the ownership and has experienced a relative high delinquency rate.** The exposures are "debt-like" in the sense that obligors are typically held accountable for full payment even if they decide to abandon the lease. If the amount from selling the repossessed good is insufficient to cover the outstanding obligation, lessees are often sued in court, although firms weigh the merits of this step given lengthy and costly court proceedings with uncertain outcomes.

3. **Only one of the four finance/leasing companies with about a 30 percent share in the leasing market as per outstanding leases is licensed and regulated by MMA and reports to the CIB.** According to MMA, it was decided not to regulate the other three companies because they finance primarily products offered by the same group (e.g., vehicles imported by the parent or a related company). The leasing companies generally welcomed the FSAP team's proposal for reporting of such exposures to the CIB. Given the widespread use of lease-and-hire schemes, inclusion of these non-bank financial institutions in the reporting to CIB would allow for a comprehensive record of recurring payment obligations from leases beyond loan service. Consequently, both banks and non-banks would enjoy objective information about client leverage instead of having to rely mostly on voluntary disclosures, which should contribute to lowering delinquency rates.

4. **Once the existing information gap is closed,** the MMA should proceed to calibrate the envisaged limit to the DSTI ratio based on comprehensive systemwide payment obligations and not just on bank debt service which does not paint a truthful picture of total household leverage.

Appendix VIII. Report on the Observance of Standards and Codes (ROSC): Basel Core Principles

SUMMARY AND METHODOLOGY

A. Introduction

1. This assessment of the implementation of the BCPs by MMA is part of the FSAP undertaken by the IMF and the World Bank in 2023. It reflects the regulatory and supervisory framework in place as of the date of the completion of the assessment. It is not intended to represent an analysis of the state of the banking sector or crisis management framework, which are addressed in the broader FSAP exercise. The Basel Core Principles (BCP) assessment mission took place between February 12 and March 2, 2023. The current assessment is based on the 2012 version of BCPs issued by the BCBS.[1] It is the first time Maldives has participated in a detailed assessment of the BCPs. This Report on the Observance of Standards and Codes (ROSC) summarizes the findings and recommendations of the assessment.

B. Information and Methodology Used for Assessment

2. Maldives has opted to be assessed and graded only against the essential criteria. To assess compliance, the BCP Methodology uses a set of essential and additional assessment criteria for each principle. The essential criteria (EC) set out the minimum baseline requirements for sound supervisory practices and are universally applicable to all countries. The additional criteria (AC) are recommended best practices against which the authorities of some more complex financial systems may agree to be assessed and rated. The assessment of compliance with each Core Principle (CP) is made on a qualitative basis, using a five-part rating system explained below. The assessment of compliance with each CP requires a judgment on whether the criteria are fulfilled in practice. Evidence of effective application of relevant laws and regulations is essential to confirm that the criteria are met.

3. An assessment of the effectiveness of banking supervision requires a review of the legal framework, and a detailed examination of the policies and practices of the institution(s) responsible for banking regulation and supervision. In line with the BCP methodology, the assessment focused on banking supervision and regulation in Maldives and did not cover the specificities of regulation and supervision of other financial institutions. The assessors reviewed the framework of laws, regulations, procedures, guidelines and other materials mainly provided by MMA and held extensive meetings with MMA officials. The assessors also held additional meetings with select banks and external audit firms.

4. The team appreciated the very high quality of cooperation received from MMA. The authorities provided a BCP self-assessment, responses to additional questionnaires, and access to supervisory documents, files and staff. In this respect, the assessors appreciate the excellent cooperation

[1] Basel Committee on Banking Supervision: Basel Core Principles for Effective Banking Supervision, September 2012: http://www.bis.org/publ/bcbs230.pdf, http://www.bis.org/publ/bcbs230.pdf.

received from the authorities and extend their gratitude to their staff who participated and facilitated this exercise.

5. The standards were evaluated in the context of the Maldivian banking system's structure and complexity. The BCP must be capable of application to a wide range of jurisdictions whose banking sectors will inevitably include a broad spectrum of banks. To accommodate this breadth of application, according to the methodology, a proportionate approach is adopted, both in terms of the expectations on supervisors for the discharge of their own functions and in terms of the standards that supervisors impose on banks. An assessment of a country against the BCP must, therefore, recognize that its supervisory practices should be commensurate with the complexity, interconnectedness, size, risk profile, and cross-border operations of the banks being supervised. The assessment considers the context in which the supervisory practices are applied. The concept of proportionality underpins all assessment criteria. For these reasons, an assessment of one jurisdiction will not be directly comparable to that of another.

6. An assessment of compliance with the BCP is not, and is not intended to be, an exact science. The assessment criteria should not be seen as a checklist approach to compliance but as a qualitative exercise involving judgement by the assessment team. While compliance with the BCP can be met in different ways, compliance with some criteria may be more critical for the effectiveness of supervision, depending on the situation and circumstances in a given jurisdiction. Hence, the number of criteria complied with is not always an indication of the overall compliance grade for any given principle. Nevertheless, by adhering to a common, agreed methodology, the assessment should provide the Maldives authorities with an internationally consistent measure of the quality of their banking supervision framework in relation to the BCP, which are internationally acknowledged as minimum standards. Emphasis should be placed on the commentary that accompany the grade of each principle, rather than on the grade itself.

C. Preconditions for Effective Banking Supervision

7. An effective system of banking supervision needs to be able to effectively develop, implement, monitor, and enforce supervisory policies under normal and stressed conditions. The preconditions include:

- **Sound and Sustainable Macroeconomic Policies:** See Section on Macrofinancial Developments in this report.

- **A well-established framework for financial stability policy formulation:** see section on Financial Oversight in this report.

- **A well-developed public infrastructure:** The payment and settlement infrastructure are managed by MMA and includes wholesale and retail payment systems but deficiencies remain (no switch for payment cards, limited interoperability, no central securities depository for government securities). Access to finance is a major constraint to micro, small and medium sized enterprises, The insolvency and creditors' rights framework in Maldives warrants further improvement. Despite high account ownership, there are gaps in financial inclusion in the context of the widely dispersed population. MMA operates a credit registry that is used for banks' lending decisions but not for supervisory purposes.

- **A clear framework for crisis Management, recovery and resolution:** see section of Financial Safety Net and Crisis Management Arrangements in this report.

- **Effective Market Discipline:** Transparent information is provided by banks and MMA to the public. However, this information is disclosed with different degrees of comprehensiveness and in different formats what might hinder effective market discipline. Capital markets are not developed, characterized by limited issuance and participation, reflective of an unsophisticated financial sector. The government securities market, which tends to provide the foundation stone of the broader capital market, is not developed, with issuance focused on Treasury bills.

MAIN FINDINGS

A. Responsibilities, Objectives, Powers, Independence (CP1–2)

8. The MMA is the responsible authority for banking supervision in Maldives. MMA is also in charge of regulating and supervising other financing institutions. The Maldives Banking Act (MBA) lays out the rules applicable to the banking activities in Maldives and contains a broad delegation to MMA to develop regulations, instructions and other legal acts for the implementation of the Act. MMA has issued an ample set of regulations covering, among others, capital adequacy, asset classification and coverage, limits to large exposures and related parties, audit and disclosures and, more recently, corporate governance. MMA has also issued Guidelines on Risk Management and binding instructions and circulars.

9. The Maldives Monetary Act regulates the governance and operations of MMA. MMA is governed by a Board of Directors of 7 members: the Governor and the Deputy Governor, one employee of MMA, two government representatives, and two representatives of the private sector. The Board of Directors is responsible for approving regulations, the annual budget, the accounts and the report. The Governor is responsible for the approval of actions related to supervised institutions, although he can delegate these tasks to MMA's senior managers.

10. The independence of MMA should be strengthened. First, the presence of representatives of Government and of the private sector[2] in the Board of Directors exposes MMA to significant risks to its independence, which the key role of the state in the financial sector intensifies. The current rules on defining and managing conflicts of interest in MMA's Board of Directors limit conflicts of interest to personal interests, therefore excluding the professional interests that may affect some of the current board members. Moreover, although the appointment and removal of the Governor and Deputy Governor is done by the President with consultation with the Parliament, the reasons for their dismissal are not strictly

[2] In many central banks, a government representative is allowed to participate in board meetings, but without voting rights; and, according to corporate governance sound practices, the appointment of non-executive, external members with relevant expertise to supervisory bodies within the Board tasked with specific functions could enhance central bank accountability.

limited by law to the lack of fitness and propriety nor there is a mandate to require the disclosure of the reasons of the dismissal.

11. The resources devoted to banking supervision should be increased. There is evidence that resource constrains have affected the capacity of MMA to perform its supervisory activities. MMA has not been able to perform on-site inspections beyond the minimum 2-year frequency imposed by the MBA. Nor has MMA been able to conduct on-site examinations simultaneously. MMA faces also significant challenges when performing banking supervision, as it gradually moves towards a regulatory and supervisory system that involves a more intensive usage of supervisory judgement, for example, by taking a more forward-looking approach, and potentially revamps its off-site monitoring system. Even when the supervisory division has increased its resources during the last year, the current headcount may not be enough to effectively perform MMA's banking supervision activities.

B. Licensing, Change in Control, and Acquisitions (CP 4–7)

12. The MBA lays out a strong framework for licensing. The MBA reserved the exercise of banking, including deposit-taking, and the use of the word "bank" to institutions licensed as banks by MMA. The list of banks, including branches and subsidiaries of foreign entities, is available in MMA's website. The activities subject to licensing also include the establishment by a bank in Maldives a foreign branch or representative office in a different country. The Law lists the activities that banks can provide, whereas also enumerating the activities that are prohibited to banks. Relevant laws also lay out two more licensing regimes, one for Islamic banking activities, that may be granted to either Islamic banks or to banks intending to provide Islamic banking services from a different department and a license for providing offshore banking services in the Special Economic Zone, that has not been used hitherto.

13. MMA has prepared and published Guidelines for Licensing that may need minor adjustments. The Guidelines detail the authorization process, the information to be provided, and provide guidance on the criteria MMA uses when assessing the application. The Guidelines elaborate the assessment of the fitness and propriety of major shareholders and administrators, the business plan and financial projections, and include an informal scoring system to facilitate the assessment of the applications. MMA should complement the Guidelines by introducing the assessment of collective suitability of the Board of Directors and the oversight mechanism for the outsourced functions.

14. The MBA also includes an authorization regime for the acquisition of significant shareholdings in banks. The Law defines a major shareholder as any person with an ownership above 10 percent of the bank's capital. Increases in ownership above certain thresholds are also subject to MMA's authorization. The criteria for authorizing these transactions are clear, although, considering the ownership of the banking sector in Maldives, they have been rarely used.

15. Major investments, including cross-border, are subject to supervisory authorization. A merger or other agglomeration transaction, the acquisition of ownership interests above 5 percent of the investee's capital, and the set-up of a foreign branch or representative office is subject to MMA's ex ante authorization. Banks are prevented from acquiring ownership interests in non-financial companies beyond

5 percent of the capital of the investee. There have been no cases where these processes have been activated.

C. Supervisory Cooperation and Consolidated Supervision (CP 3,12,13)

16. MMA needs to improve its coordination with the national authorities. MMA has signed a MoU with the Capital Market Development Authority (CMDA) that includes provisions on coordination, cooperation, and the exchange of information. Coordination has been mainly on demand, but no regular meetings are scheduled between the two authorities. Moreover, there is no specific formal coordination and cooperation between MMA and the Ministry of Finance (MoF) in banking supervision or financial stability, even when the latter may have a key role in banks under receivership.

17. MMA shows a remarkable willingness to engage in cross-border coordination and cooperation. MMA is a “small host”, as 5 out of 8 banks are either branches or subsidiaries of foreign banks, and whereas some of these entities are relevant for Maldives, most of them are very small operations from the banking group and home supervisor perspective. Against this backdrop, MMA has entered into 3 MoUs and is in the process of negotiating two additional MoUs. MMA cross-border coordination also comprises the sharing of information with home supervisors before starting any on-site examination, while it also shares the examination reports. MMA participates in two supervisory colleges. Both the law and MoUs contain confidentiality provisions. No joint inspections have been ever conducted, while no common communication strategy is agreed between MMA and home countries.

18. No bank in Maldives currently owns any subsidiary and therefore no banking group is headquartered in the country. Although the MBA mandates MMA to supervise banks on a consolidated basis, these provisions have not been implemented by the Authority, as for the time being there is no banking group in Maldives. The powers to authorize ex-ante any investments above 5 percent in banks and financial institutions may give MMA the flexibility to implement in time the provisions on consolidated supervision.

D. Supervisory Approach, Techniques and Reporting (CP 8–10)

19. MMA’s supervisory approach has been based on performing on-site examination. MMA is required to examine banks on-site at least every two years, which has been effectively MMA’s default frequency. Examinations can be targeted or full scope. The on-site inspections were first fundamentally focused on credit risk, particularly on the review on credit classification and coverage and concentration and related party limits, whereas after the implementation of the Prevention of Money Laundering and Financing of Terrorism (PMLFT) Act, on-site examinations’ scope also comprised the assessment of the compliance with the rules on the prevention of money laundering and the financing of terrorism and operational risk. On-site inspections for AML/CFT, with the exception of market entry related aspects, are conducted by both the FIU, which is housed in the MMA, and the MMA. On-site examinations by the MMA are currently focused on the assessment of the corporate governance and risk management practices.

20. MMA on-site inspections have been instrumental for reducing banks’ risk profile. MMA’s approach to examinations have involved a high degree of intrusiveness, as examiners commonly review individually credit files amounting to more than half of banks' loan portfolios. The examination report is shared, both as a draft and in its final version, with banks' boards. The full update of the supervisory rating, following the capital adequacy, asset quality, management, earnings, liquidity and sensitivity to markets (CAMELS) methodology, is only done once on-site inspections have finished.

21. The current approach to off-site monitoring is not effective to bring banks' risk profiles in line with MMA risk tolerance. Supervisors prepare quarterly monitoring reports, mainly using the monthly and weekly submissions by banks. The main outcome of the reports is the CAMELS rating, updated on a quarterly basis. Sufficient resources should be allocated for the improvement of the off-site monitoring process. From an input perspective, meetings with the board of directors, independent board members, key senior managers and the external auditors should be regularly scheduled, away from the current on-demand approach. The methodological approach should be revamped, ensuring that it is consistent with the current regulatory framework, and includes sufficient forward-looking elements (such as the business model analysis) and the assessment of qualitative elements involving supervisory judgement (such as corporate governance and the risk control management frameworks). Crucially, the outcomes from the off-site examination process should be shared with banks' boards and senior management, both formally and informally, and be the basis for issuing recommendations and, where applicable, taking a supervisory enforcement action.

22. Manuals and procedures should be prepared or updated. MMA should ensure that the current on-site examination, off-site monitoring practices and other supervisory procedures such as planning should be covered in written methodologies and procedures that reflect MMA's practices. MMA is currently in the process of preparing them.

23. The reporting framework for banks is largely comprehensive and with an adequate frequency, but gaps exist. Banks report weekly and monthly their supervisory returns, including information on banks' financial statements, capital adequacy, asset classification and coverage, large exposures and related parties, limits on interbank borrowings, foreign currency exposures, interest rate risk in the banking book and funding and liquidity. Moreover, MMA requires banks to submit specific reports, such as on quarterly stress test, fraud or cyber-security events. Although the current reporting package is broadly adequate, gaps in capital adequacy, in data on operational losses, liquidity and interest rate risk as well as exemptions on large exposure persist.

E. Corrective and Sanctioning Powers (CP 11)

24. The MBA creates a comprehensive framework from dealing with banking problems. It covers cases where a bank breaches a legal or regulatory provision or an instruction by MMA, or is engaged in an unsafe and unsound practices. MMA has a broad set of measures to address these situations, including mild measures (i.e., written warnings or voluntary agreements), formal orders to address the problems and compelling banks to take measures, measures to address governance problems (such as removing board members, appointment of an advisor, or directly replace the board of directors, etc.), or imposing administrative sanctions on banks and administrators. More drastic measures would involve placing a bank into conservatorship (i.e., resolution) or receivership (i.e., liquidation).

25. MMA's enforcement approach is largely based on moral suasion rather than on enforcement. MMA has traditionally avoided taking enforcement measures, preferring to issue recommendations following on-site examinations. In egregious cases, it has warned banks using sanctions and other enforcement actions (although it has never sanctioned a bank). The only relevant experience in taking enforcement actions dates back more than a decade and was based on consensual measures. This absence of enforcement background may create the expectation in the banking system that MMA may not take an enforcement action or may also warn banks before taking one, potentially resulting in moral hazard.

26. MMA has not operationalized the enforcement regime, including the receivership regime. For instance, the lack of clarity over the definition of unsafe and unsound practices may preclude MMA from taking enforcement measures against any institutions or its administrators, if the risk of legal challenge is too high. MMA has not issued any guidance on how it intends to use the powers that the law has conferred to it. Moreover, the lack of recovery and resolution planning and other contingency arrangements also result in the authority's little preparedness to tackle a stressed situation.

F. Corporate Governance and Internal Audit (CP 14, 26)

27. MMA has made significant progress with respect to the regulatory framework for corporate governance, but gaps in compensation remains. In 2020, MMA issued regulation on corporate governance that is comprehensive and detailed. The regulation addresses most of the provisions in the Corporate Governance principles except for the ones related to compensation. For instance, the regulation has no requirement that the compensation framework should have appropriate incentives aligned with prudent risk taking and consistent with long-term objectives and financial soundness of the bank. Thus, there is a need to amend the corporate governance regulation to align it with the compensation recommendations issued by the Basel Committee on Banking Supervision (BCBS).[3]

28. The regulatory framework on corporate governance has been updated recently and its implementation has not been fully assessed yet. Supervision of corporate governance used to focus on compliance with the MBA. In 2020, MMA began assessing compliance with the Corporate Governance regulation. Finalizing and extending this process to the whole financial system is paramount to guaranteeing that the new regulation will be adequately implemented and to turning the supervisory process into becoming more comprehensive and principle-based.

29. MMA has not implemented a structured process to assess control and internal audit. MMA does not interact routinely with the internal audit and mainly assesses it in terms of governance and reporting aspects. For instance, there is no assessment on the effectiveness of internal audit. MMA does not engage with the back office. There is no assessment of back office functions or of the balance in skills and resources compared to business origination units.

[3] Basel Committee on Banking Supervision: Compensation Principles and Standards Assessment Methodology, January 2010. https://www.bis.org/publ/bcbs166.pdf

G. Capital (CP 16)

30. MMA has prescribed capital requirements based on Basel I with higher capital adequacy thresholds, but also has a material gap in the RWA calculation. MMA has defined two capital ratios: 12 percent for the total capital ratio and 6 percent for the Tier I capital ratio. The higher overall capital adequacy requirements may be a prudent calibration that considers some higher risk features related to market context and macroeconomic conditions in Maldives in which banks operate, such as concentration on the tourism sector. The capital definition closely follows Basel I. Loans or investments of capital nature to banks and financial institutions are deducted from total capital, which is considered conservative. As in Basel I, RWAs only consider credit-risk, which is by far the most relevant risk in Maldives. However, the risk weights applied to exposures to central government denominated in foreign currency is 0 percent instead of 100 percent.[4] Adjusting the RW would lead to a reduction of the capital adequacy ratio of the banking system from 51 percent to 41 percent. The impact differs between banks, varying from no impact to a 65 percentage point reduction of one bank's capital adequacy ratio.[5]

31. MMA has also implemented a leverage ratio of 5 percent applicable to all banks. The leverage ratio is defined as the ratio between Tier 1 capital and net assets. "Net assets" do not include off-balance sheet items, which currently do not represent a significant exposure in banks' balance sheet. Even though it does not include off-balance sheet items, the leverage ratio is considered a more binding requirement than the capital ratios.

32. MMA has the power to order individual banks to maintain higher capital ratios but has never used such power. MMA can order additional capital based on the operations and financial conditions of banks and on their systemic importance. According to MMA, imposing additional capital requirements would not be binding because banks have large excess capital buffers. This might not be true for all banks if the RW applied to exposures to central government denominated in foreign currency were raised to 100 percent.

H. Risk Management (CP 15, 17–25)

33. MMA has also made significant progress with respect to the regulatory framework for risk management but has not assessed nor enforced it yet. MMA issued the risk management guidelines in 2022 which are paramount for the compliance with the BCP provisions on risk management and on specific risks, such as market, liquidity and operational risks. Since they were only recently issued, the guidelines have not impacted supervisory practices yet. Therefore, risk management supervision is expected to improve, but to what extent is still unclear. In any case, the supervisory process regarding risk management

[4] The recommendation to increase the RW to 100% is not only in line with the Basel I framework adopted in Maldives, but also to the Basel III framework, which states that a 100% RW should be applied to BB+ to B- sovereign exposures. Maldives is currently rated B- by Fitch.

[5] The increase in RW on domestic sovereign exposures denominated in foreign currency to 100% could be gradually phased in to reduce the impact on specific banks.

should evolve into becoming more principle-based and intrusive, as is the case for credit risk, and less compliance-based only.

34. Internal capital and liquidity planning processes should be required. MMA assesses capital and liquidity compliance to regulatory and internal limits. There is no requirement or expectation from MMA that banks perform an internal capital and liquidity planning processes that could be considered an initial step towards Internal Capital Adequacy Assessment Process (ICAAP) or Internal Liquidity Adequacy Assessment Process (ILAAP).

35. The stress testing framework is mostly a sensitive analysis exercise and should therefore be remodeled. Banks perform standardized stress tests based on non-performing loans (NPLs) and withdrawals scenarios. These do not include market risk exposures or concentration risk, nor do they assess vulnerability to losses from adverse interest rate movements. MMA does not require banks to have forward-looking stress testing programs, commensurate with their risk profile and systemic importance, as an integral part of their risk management process nor regularly assesses banks' internal stress test programs. Moreover, MMA does not assess if stress tests results are integrated into banks' decision-making and risk management processes or impact capital and liquidity levels. In this sense, the stress testing framework should be remodeled and aligned with the related BCBS document[6], in a proportionate way.

36. MMA performs an intrusive supervisory process on credit risk. During on-site supervisions, credit files undergo a thorough assessment. MMA evaluates the file on a loan-by-loan basis, covering a significant part of the loan book, including most large loans, loans on watchlist, NPLs as well as some rescheduled and special mention loans. MMA verifies loans' classification and provisioning and requires adjustments frequently.

37. MMA has implemented a simple local provisioning standard. MMA has issued the Regulation on Asset Classification, Provisioning and Suspension of Interest that mandates all loans to be classified using the classification grades pass or acceptable, special mention, substandard, doubtful and loss. Regulation does not cover off-balance sheet items, which should be included. Classification is based both on days in arrears (objective factors) and on financial condition and repayment history of a borrower (subjective factors). Provisioning rules are relatively simple. Each grade is assigned a percentage of provisioning requirements, which varies depending on whether loans are secured or not for doubtful and loss categories.

38. A large exposure limit of 15 percent applies to both single-borrowers and group of connected counterparties, while the aggregate amount of large exposure is limited to 500 percent. Some exceptions to the single borrower apply, mostly raising it to 30 percent. Institutions are required to develop their own limit structure while remaining within the exposure limits set by MMA. Internal limits should also be set for respective products, activities, specific industry, economic sectors and/or geographic regions, where possible, to avoid concentration risk. Around 35 percent of loans are granted directly to the tourism sector, but since the whole economy is dependent on tourism, even loans to other sectors are

[6] Basel Committee on Banking Supervision: Stress testing principles, 2018: https://www.bis.org/bcbs/publ/d450.pdf

likely to be indirectly impacted in stress. The concentration to the tourism sector is monitored by banks and MMA, but no regulatory limits have been imposed. Since 2009, direct concentration to the tourism sector has declined from 53 to 34 percent.

39. The regulatory and supervisory approach in Maldives does not encompass country and transfer risk. Country and transfer risk is not even defined under national standards, and MMA receives no information on these risks. MMA has no breakdown on geographic exposures. At most, MMA receives information on time balances, debt securities, loans and other exposures abroad with no country breakdown. However, for the whole banking system, the sum of total assets abroad amounts to 3 percent (or 12 percent of the capital base). Therefore, currently, country and transfer risk are considered not material in Maldives. Even though this assessment might change in the future, it is not expected to change soon. It is important for MMA to define country and transfer risk in its regulation so it can request information on banks' exposures to country risk. Having adequate information is paramount for MMA to properly monitor the risk and be able to act if it becomes significant.

40. Market risk is mainly related to foreign exchange risk and interest rate. Banks' investment portfolios are concentrated in plain vanilla instruments. Derivatives, shares and other equity investments are small compared to total banks' assets (0.2; 0.4 and 0.2 percent, respectively). Market risk arises mainly from holdings in foreign currencies, loans (both in local and foreign currency) and T-bills and T-bonds (both in local and foreign currency). Assets in foreign currency are mostly held in US dollars, representing around 44 percent of total assets. There is no segregation of banking and trading book. Due to the characteristics of the market, most exposures to interest rate risk typically lie in the banking book.

41. Supervision of market risk mainly focuses on verifying compliance with limits on foreign currency exposures. MMA has implemented limits on foreign currency exposures. According to the regulation, the following limits have been established: overall (short and long positions for all currencies) of 40 percent, single currency long position of 25 percent, and single currency short position of 15 percent of the capital base. MMA supervision closely monitors compliance during both on-site and off-site, and analyses trends of foreign currency ratios. Therefore, supervisory processes do not comply with what is expected in the BCPs. For this purpose, it is necessary that market risk supervisory processes assess the provisions in the risk management guidelines.

42. Interest Rate Risk in the Banking Book (IRRBB) is not adequately covered in the regulatory or supervisory framework. IRRBB is included in the risk management guidelines within market risk. Provisions on IRRBB are scarce and do not cover the principles detailed in the BCBS document.[7] On- and off-site supervision do not assess IRRBB. A proportional application of the principles could be pursued to implement supervisory processes, such as opting for the standardized approach explained in the BCBS document. Consequently, supervisors could use the information that is received by MMA in the interest rate sensitivity spreadsheet in banks' returns.

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[7] Basel Committee on Banking Supervision: Interest rate risk in the banking book, 2016: https://www.bis.org/bcbs/publ/d368.pdf

43. MMA has not imposed requirements on liquidity risk, and its supervisory process should be improved. MMA has drafted but not yet issued regulation for the Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR). The regulation is expected to be issued still in 2023. The supervisory process is not intrusive nor comprehensive. For instance, MMA does not assess or challenge the capacity to sell high quality liquid assets nor assess the feasibility of contingency funding plans.

44. The supervisory process has recently focused on operational risk, in particular on information and communications technology (ICT) and AML but has not covered other material aspects. Since 2019, MMA has performed different on-site inspections on ICT and AML. MMA also collects information on cyber security and fraud events. Other areas of operational risk such as the fixed asset register and cash handling and management have also been assessed. However, MMA has not covered material aspects of operational risk. MMA has not assessed: (i) if operational risk policies have been implemented effectively by management and integrated into the bank's overall risk management process; (ii) if banks have policies and processes to assess, manage and monitor outsourced activities; and (iii) the quality and comprehensiveness of banks' disaster recovery and business continuity plans nor challenged their feasibility. MMA does not collect information on operational errors or losses. Finally, legal risk is not covered under operational risk definition in the regulation, and therefore, has not been assessed either.

I. Disclosures and Transparency (CP 27–28)

45. The regulation does not explicitly grant MMA with the power to rescind the appointment of an external auditor. The MBA gives powers to MMA approve external auditors. Additionally, the Regulation on External Audit states that a bank shall notify MMA of any change in its external auditor. However, there is no provision that grants power to MMA rescind the appointment of an external auditor who is deemed to have inadequate expertise or independence or is not subject to or does not adhere to established professional standards.

46. Banks are not required to disclose information on risk management strategies and practices or risk exposures. Regulation only requires disclosure of financial statements by banks. The financial statements are prepared according to International Financial Reporting Standards (IFRS) standards. Banks have been disclosing information on risk in practice, but no supervisor or government agency effectively reviews and enforces compliance with disclosure standards.

J. Abuse of Financial Services (CP 29)

47. The regulatory framework for prevention of money laundering and the financing of terrorism is included mainly in the PMLFT Act and related regulations. The Financial Intelligence Unit (FIU), with the MMA, is responsible for preventing money laundering and the financing of terrorism for the country, although MMA also has powers to undertake supervisory measures for certain types of financial institutions to ensure compliance with the AML/CFT requirements. The legal and regulatory framework imposes broad AML/CFT obligations on banks, including on know your customer, customer due diligence , reinforced due diligence for high-risk clients and including for politically exposed persons and reporting of suspicious transactions; however, gaps in the overall AML/CFT legal framework remain and bank-wide training programs for staff and policies and procedures for the prevention of money laundering. The framework does not explicitly request a risk-based client approval policy (although it prohibits banks to engage with certain clients) and does not request that banks include relevant provisions in their outsourcing contracts.

48. Since 2015, the review of banks' mechanisms, policies and procedures for complying with the prevention of money laundering has been a priority for MMA. The Authority has conducted multiple on-site examinations focused, totally or partly, on reviewing compliance with the AML/CFT standards, with particular emphasis on customer identification and verification, customer due diligence and reporting of suspicious transactions. MMA's focus on this topic was complemented by the FIU conducting its own examinations, frequently at even the same bank. MMA activities have contributed to the improvement of the risk management standards in this area.

Appendix VIII. Table 1. Maldives: Summary Compliance with the Basel Core Principles – ROSC

Core Principle	Comments
1. Responsibilities, objectives and powers	The legal framework currently in place (MMA Act and MBA) provides the necessary powers to authorize banks, conduct ongoing supervision, address compliance with laws, and undertake corrective actions to address safety and soundness concerns. MBA contains broad delegations to MMA to develop any regulation, instruction or otherwise any regulatory act to ensure the implementation of the Act. The enforcement regime contained in the MBA contemplates broad measures.
2. Independence, accountability, resourcing and legal protection for supervisors	MMA is organized through a board of directors with 7 members: the Governor, the Deputy Governor, one employee from MMA, 2 representatives from two Ministries and two representatives from the private sector. Government and private sector representatives may undermine MMA's independence. MMA Act's definition of conflicts of interest excludes professional interests, that may affect the decision-making process of the representatives of the Government, especially for the implementation of enforcement actions. The internal governance framework established by the MMA Act is complemented with a delegation system that envisages the senior managers that can sign the different documents for communicating purposes, in accordance with their relevance. However, there is a lack of granularity in the decision-making delegation structure for banking supervision. Although the staff working in banking supervision has increased by 50% during the last years, human resources unlikely to be sufficient to develop the supervisory approach. In particular, there is a lack of modelling/statistic profiles. The Authority does not engage in formal resource planning, taking stock of their resources and comparing them with its needs.
3. Cooperation and collaboration	MMA is the only authority in charge of banking and financial supervision in Maldives. CMDA is responsible for regulating and supervising securities markets. A MoU was signed between the two authorities in 2014. No regular meetings are scheduled between the two authorities, as the cooperation/coordination has happened mostly on demand. There is no MoU signed between MMA and the MoF and no evidence of coordination or cooperation.

Appendix VIII. Table 1. Maldives: Summary Compliance with the Basel Core Principles – ROSC (Continued)

4. Permissible activities	The MBA clearly defines "bank", "banking business" and "banking activities and services". The law also details the list of activities that can be undertaken by licensed banks, although some of them (securities services and insurance brokerage) require a separate license by MMA. The taking of deposits is reserved for institutions licensed and supervised as banks, although MMA can waive this requirement in certain cases, but has not happened up to date.
5. Licensing criteria	The conditions upon which MMA may provide or reject the license are included in the MBA. MMA has further detailed the assessment criteria and the procedure in the Licensing Guidelines. The Guidelines include an informal scoring of the application, which lacks guidance. MMA does not review the collective suitability of the proposed board structures and the oversight arrangements for outsourced activities. The MBA lays out a strong framework for licensing, however it does not provide enough guidance on the authorization for providing Islamic banking licenses.
6. Transfer of significant ownership	The MBA contains a definition of "major shareholder". Any transaction whereby a person will become major shareholder is subject to MMA's previous authorization. The acquisition of shares above certain ownership thresholds also demand an ex-ante authorization. The supervisor has the power to review, reject and impose prudential conditions on any proposals to transfer significant ownership or controlling interests held directly or indirectly in existing banks to other parties.
7. Major acquisitions	The MBA lays out several rules ensuring that any major investment or acquisition by banks is subject to the authorization of MMA, including any cross-border transaction. The acquisition of more than 5% of the capital of any bank or other financial institution, or the set up of a foreign branch or representative office is subject to MMA's previous authorization, however the legal framework does not flesh out the criteria for assessing the acquisition of capital instruments above 5% of banks and other financial institutions.
8. Supervisory approach	The current supervisory approach assesses the exposure of the different banks to the different risks they are or might be exposed to. MMA also assesses, even if informally, the systemic relevance of the banks under its supervision. Nonetheless, MMA does not sufficiently consider banks' systemic relevance and risk profile when adjusting its supervisory intensiveness, or, to a lesser extent, in its allocation of supervisory resources. MMA approach to banking supervision includes few forward-looking elements. Even when banks annually report their budget and strategic plans, supervisors rarely use them for assessing banks' business model viability and sustainability. Both bank-run and supervisory-driven stress test are undertaken quarterly, but are linear, single factor, point in time exercises. Banks do not prepare forward-looking capital, funding, or recovery plans. MMA's supervisory approach entails the combination of off-site examination and on-site monitoring. There is insufficient formal communication with banks during off-site monitoring. MMA does not engage in resolution planning and resolvability assessment. MMA has not issued any regulation, guidelines or otherwise standard to operationalize the crisis management framework and managing weak banks.

Appendix VIII. Table 1. Maldives: Summary Compliance with the Basel Core Principles – ROSC (Continued)	
9. Supervisory techniques and tools	Off-site monitoring involves the review of banks' annual report and management letter and prepares a quarterly report where banks' ratings are updated. Supervisors use several information sources, both public and private, to prepare their reports, including stress tests. However, there are several shortcomings: - not oriented to address the weaknesses and deficiencies of banks; - no communication of the results to the senior management/board of banks; - no regular supervisory actions are linked to the outcomes, other than in cases of regulatory breaches and other extraordinary circumstances; - no qualitative elements (internal governance and risk management framework) assessed; and - does not follow up consistently on the on-site inspection findings. In addition, there are other issued related to the techniques and tools used by supervisors: - there are insufficient regular meetings with banks' senior management and board of directors, including independent members; - on-site inspection frequency does not regularly consider the risk profile and the systemic relevance of banks; - there is no assessment of the viability and the sustainability of the business model of the bank; - procedures and methodologies for both off-site monitoring and on-site examinations are insufficient; - risk management and corporate governance practices still not fully assessed; - there are no written procedures for supervisory planning, including identification of supervisory priorities, emerging risks, and supervisory examinations; - there is no systematic evaluation of the work by the internal audit function and - stress tests do not usually result in supervisory action.
10. Supervisory reporting	Information requirements do not consider the risk profile and the systemic relevance of the bank. The current reporting package can be improved, through ensuring that the information provided on capital adequacy is fully aligned with the rules included in the Regulation on Capital Adequacy, by forcing banks to report the exemptions of large exposures and related parties in a standardized manner, and devise new reports on operational risk (including operational risk losses beyond fraud and cyber-security incidents), interest rate risk in the banking book and liquidity risk. Improvements should also be made regarding the systematic reporting of credit risk forbearance. The information requested on strategic plans and budget can be standardized to readying it for business model viability and sustainability assessments.
11. Corrective and sanctioning powers of supervisors	BA includes a comprehensive enforcement regime that provides MMA with the ability to take a broad array of enforcement actions to banks. Regardless of the legal regime's comprehensiveness, the effectiveness of the regime raises substantial doubts. MMA has not issued any regulatory act for operationalizing the regime, including the definition of unsafe and unsound practices.

Appendix VIII. Table 1. Maldives: Summary Compliance with the Basel Core Principles – ROSC (Continued)

	There is little capacity in using the enforcement regime, as the only relevant measure taken by MMA (a voluntary agreement) was implemented more than a decade ago. MMA has shown itself reluctant to take enforcement measures, preferring moral suasion or warnings to enforcement. Especially for conservatorship, capacity building may need to be built, by engaging in crisis preparedness and recovery and resolution planning. There is insufficient communication with the bank's boards and senior management and there are no administrative sanctions applicable to senior managers which are not considered executive officers.
12. Consolidated supervision	MBA mandates MMA to supervise banks on consolidated basis, and mandates banks to prepare consolidated financial statements. No bank licensed in Maldives own any subsidiary and therefore no banking group is headquartered in Maldives. MMA supervises subsidiaries and branches of foreign banks applying the same prudential standards than to domestic banks.
13. Home-host relationships	MMA is exclusively a host supervisor, as no banking group is currently headquartered in Maldives and 5 out of 8 banks operating in Maldives are either branches or subsidiaries of foreign banks. MMA has exhibited as significant willingness to cooperate and coordinate with home authorities. MoUs are not in place with two home supervisors. There is no common planning of supervisory activities with home authorities. MMA has not conducted any examination with a home supervisor, nor it has agreed any common communication strategy with them, despite MMA communication efforts.
14. Corporate governance	The MBA and the Regulation on corporate governance are very comprehensive and detailed. MMA made a great progress related to the Corporate Governance framework when it issued the Corporate Governance regulation in 2020. However, regulation has no requirement that compensation framework has appropriate incentives which are aligned with prudent risk taking. Nor that the compensation system, and related performance standards, are consistent with long-term objectives and financial soundness of the bank and is rectified if there are deficiencies. With respect to the corporate governance supervision process, there is room for improvement into becoming more comprehensive and principle-based. MMA has not fully assessed nor enforced compliance to regulation on Corporate Governance. MMA does not meet the board regularly and does not meet the CRO outside on-site inspections. There is a lack of consistency and details on banks' compliance reports.
15. Risk management process	The Risk management Guidelines for banks, finance companies and insurance companies were issued on March 10, 2022, to provide guidance on minimum standards of risk management. However they are recent and have not yet been assessed, enforced nor reflected in the supervisory practices. There is significant room for improvement in the risk management examination process into becoming more comprehensive and principle-based. The guidelines represent an important step towards it.

Appendix VIII. Table 1. Maldives: Summary Compliance with the Basel Core Principles – ROSC (Continued)	
	MMA assesses capital and liquidity compliance to regulatory and internal limits. There is no requirement or expectation from the MMA that banks perform an internal capital and liquidity planning processes. And there is no requirement or assessment of banks internal models (that banks use for internal purposes). MMA does not require banks to have forward-looking stress testing programs, commensurate with their risk profile and systemic importance, as an integral part of their risk management process nor regularly assesses bank's stress testing program. Currently, MMA only requires and assesses standardized stress tests that are merely a sensitivity analysis. In addition, MMA does not assess if stress tests results are integrated into its decision-making, risk management processes (including contingency arrangements) and the assessment of its capital and liquidity levels. MMA does not assess if macroeconomic environment is considered in risk management. Even though all banks are required to elaborate the Risk Appetite Statement, MMA has not been able to verify them. There is no requirement that if the CRO of a bank is removed, this should be done with the prior approval of the Board and discussed with MMA and generally should be disclosed publicly. MMA engagement with banks' is considered insufficient. MMA does not meet the board regularly and does not meet the CRO outside on-site inspections. MMA does not assess contingency plans and there are no requirements regarding recovery plans.
16. Capital adequacy	Maldives has prescribed capital requirements based on the so-called Basel I Capital framework, both in terms of capital definition and in RWA calculation. Compared to Basel I capital ratios MMA requires higher thresholds. With respect to the calculation of the risk-weighted assets, there is a material deviation where exposures to central government denominated in foreign currency are risk-weighted at 0%. MMA has the power to order individual banks to hold higher capital ratios if MMA determine that the operations and financial condition of such banks warrant the imposition of such higher capital levels. MMA also has the power to require a bank to maintain higher capital ratios if the banks is systemically important. However, MMA has never used these powers to impose additional capital requirements. Leverage ratio definition does not include off-balance sheet items. MMA has no provision to request a forward-looking approach to capital management.
17. Credit risk	MMA has comprehensive approach to the supervision of credit risk, combining offsite scrutiny with onsite investigation. However, there is no requirement that major/risky credit exposures are to be decided by the bank's Board or senior management. There is room for improvements regarding the stress testing, frequency of reporting on write-downs, extensions/rollovers or restructured loans and access to credit bureau.

Appendix VIII. Table 1. Maldives: Summary Compliance with the Basel Core Principles – ROSC (Continued)	
18. Problem assets, provisions, and reserves	MMA performs an intrusive supervisory process on provisioning and has implemented a simple (except for the undue complexity related to 3 different "types" of classification) provisioning standard. The standard does not cover off-balance sheet items, which should be included. No assessment is made on the concentration in the risk mitigation strategies.
19. Concentration risk and large exposure limits	MMA has issued the regulation on single borrower (15%, with exceptions up to 30%) and large exposures limits (500%). Reporting template does not properly allow for the identification, calculation and assessment of the exceptions mentioned in the regulation. Around 35% of loans are granted directly to the tourism sector, but since the whole economy is dependent on tourism even loans to other sectors are likely to be indirectly impacted in stress. The concentration to the tourism sector is monitored by banks and MMA, but no specific limits have been imposed. There is no standardized sectoral limit under Basel standards either.
20. Transactions with related parties	MMA has issued the both the regulation on transactions with related persons and regulation on limits on loans to related persons. The regulations provide a clear and comprehensive definition of a "related party" aligned with the footnote of the Principle. Aggregate amount of all loans to all related parties is limited to 50% of capital. Transactions (other than loans) are not included in the limits.
21. Country and transfer risks	No regulation or supervision related to country and transfer risk, but risks are not considered material, which is not expected to change in the near future.
22. Market risk	Risk management Guidelines issued in 2022 are the main regulation that establish requirements on market risk management policies and processes. MMA has not yet assessed nor enforced compliance to the risk management guidelines. Market risk in Maldives arises mainly from holdings in foreign currencies, loans (both in local and foreign currency) and T-bills and t-bonds (both in local and foreign currency). MMA does not assess market risk policies in detail. Currently, supervisory process mainly involves assessing compliance to FX limits (overall: 40% and single currency: 25% long position/15% short position). Market risk exposures are not included in stress tests.
23. Interest rate risk in the banking book	The risk management guidelines require banks to establish suitable measures for all market risks that are assumed. The regulation does not provide any further details, and, even though, interest risk is somehow embedded in the provisions related to market risk, they do not cover a proportional application (that considers the simplicity of the Maldives banking system) of the principles for IRRBB. Currently, IRRBB is not assessed in on and off-site supervision. MMA does not require banks to include appropriate scenarios into their stress testing programs to measure their vulnerability to loss under adverse interest rate movements.
24. Liquidity risk	Currently, there are no prescribed requirements for liquidity. A draft regulation that establishes liquidity requirements, such as the LCR and the NSFR, has been formulated and it is expected to be issued in 2023.

Appendix VIII. Table 1. Maldives: Summary Compliance with the Basel Core Principles – ROSC (Continued)	
	Stress testing requirements is not bank specific and supervision does not assess its use in liquidity risk management. There is no assessment or challenge of capacity to sell high quality liquid assets and of feasibility of contingency funding plan. The risk management guidelines set detailed requirements on liquidity risk management strategies, policies and processes, but MMA has not assessed nor enforced compliance to the risk management guidelines.
25. Operational risk	The supervisory process has recently focused on AML and on operational risk, in particular on ICT. However, MMA has not covered material aspects of operational risk. MMA has not assessed: (i) if operational risk policies have been implemented effectively by management and integrated into the bank's overall risk management process; (ii) if banks have policies and processes to assess, manage and monitor outsourced activities; (iii) the quality and comprehensiveness of banks' disaster recovery and business continuity plans nor challenged their feasibility. MMA does not collect information on operational errors or losses. Finally, legal risk is not covered under operational risk definition in the regulation, and therefore, has not been assessed either.
26. Internal control and audit	MMA has not implemented a structured process to assess control and internal audit. MMA does not interact routinely with the internal audit and mainly assesses it in terms of governance and reporting aspects. For instance, there is no assessment on the effectiveness of internal audit. MMA does not engage with back-office. There is no assessment of back-office functions or of the balance in the skills and resources compared to business origination units.
27. Financial reporting and external audit	The regulation does not explicitly grant MMA with the power to rescind the appointment of an external auditor. MMA does not meet routinely with the external audit, therefore engagement is considered insufficient.
28. Disclosure and transparency	Regulation only requires disclosure of financial statements by banks. The financial statements are prepared according to International Financial Reporting Standards (IFRS) standards. Banks are not required to disclose information on risk management strategies and practices or risk exposures. Banks have been disclosing information on risk in practice, but no supervisor or government agency effectively reviews and enforces compliance with disclosure standards.
29. Abuse of financial services	Since 2015, the review of banks' mechanisms, policies and procedures for complying with the prevention of money laundering has been a priority for MMA. The legal and regulatory framework for prevention of money laundering and the financing of terrorism is included in the AML Act and the AML Regulation. The framework does not explicitly request a risk-based client approval policy (although it prohibits banks to engage with certain clients) and does not request that banks include relevant provisions in their outsourcing contracts. Compliance reporting is not standardized sufficiently, and there is no requirement for banks to also (in addition to FIU) require banks to report the suspicious transactions to the banking supervision department.

RECOMMENDED ACTIONS AND AUTHORITIES' COMMENTS

A. Recommended Actions

Appendix VIII. Table 2. Maldives: Recommended Actions to Improve Compliance with the Basel Core Principles and the Effectiveness of Regulatory and Supervisory Frameworks

Reference Principle	Recommended Action
Principle 1	
Principle 2	Strengthen the independence of MMA's board of directors by removing Government and private sector representatives from it. Amend MMA's Act definition of conflicts of interest, to cover professional conflicts. Increase the staffing in the banking supervision department in a manner commensurate with the responsibilities of the function. Implement a formal planning process in the supervision department, to take stock on the available skills and those required by the banking supervision responsibilities.
Principle 3	Intensify the efforts towards the signing of the MoU with the two remaining home supervisory authorities. Schedule regular meetings with CMDA to discuss topics relevant to Maldives' financial stability.
Principle 4	
Principle 5	Amend the Licensing Guidelines to reflect the need for assessing the board of directors' collective suitability and the arrangements for overseeing the outsourced functions. Define a policy with actions to monitor the compliance with the licensing conditions of new entrants. Provide more guidance on the authorization for providing Islamic banking licenses.
Principle 6	
Principle 7	Prepare and publish the criteria upon which the acquisitions of ownership of voting rights and/or capital in banks and financial institutions will be assessed.
Principle 8	Consider the systemic relevance and the risk profile in the allocation of supervisory resources. Standardize the reporting templates for submitting budget and strategic plans and use them during the business model assessment. Request banks capital and funding plans, covering a period of at last 3 years Request recovery plans for the largest institutions.
Principle 9	Review the off-site monitoring process, to ensure its consistency with the current regulatory framework, to include mandatory meetings with the senior management, board members and auditor of the bank, and ensure that the findings of the process are annually communicated to the bank and that off-site monitors the follow up from on-site examinations.

Appendix VIII. Table 2. Maldives: Recommended Actions to Improve Compliance with the Basel Core Principles and the Effectiveness of Regulatory and Supervisory Frameworks (Continued)	
	Continue with the on-site examinations focus on corporate governance and risk management. Redefine the methodology for off-site monitoring, assessing the suitability of the current CAMELS approach for the current and intended regulatory and supervisory approach. Ensure that aspects related to corporate governance and risk management are sufficiently assessed during off-site monitoring. Prepare an approach for assessing business model viability and sustainability, involving the standardization of the information for the budged and strategic plan, the business model benchmarking, identification of core business lines and developing a methodology for business model assessment. Draft written procedures reflecting the MMA's supervisory practices and processes, including on-site examinations, off-site monitoring and supervisory planning.
Principle 10	Review the current reporting package in the areas of capital adequacy, credit risk (forborne loans), large exposures and related parties (on the exemptions), interest rate risk, liquidity and operational risk to ensure that information is comprehensive and useful for supervisory purposes. Review the adequateness and relevance to introduce standards on prudent valuation for those elements valued using the fair value in banks' balance sheets Implement a supervisory review process of the adequateness of the supervisory reporting with a predetermined frequency.
Principle 11	Amend the MBA to extend the administrative sanctions regime to the banks' senior managers that are not currently consider executive officers. Issue regulations and guidelines to operationalize the crisis management framework, including by defining unsound and unsafe practices, proving guidance on the predictable use of the different enforcement actions, regulate the use of the different resolution tools (including bridge bank, purchase and assumption and recapitalization) in conservatorship. Engage in crisis preparedness, by building capacity on bank recovery and resolution, by requesting recovery plans for the largest banks, drafting resolution plans for these banks. Undertake a crisis simulation exercise, with the participation of the MoF and the CMDA involving the crisis of a systemic bank in Maldives. Ensure that not compliance actions by banks are met with enforcement action by the authority.
Principle 12	
Principle 13	Intensify the efforts towards the signing of the MoU with the two remaining home supervisory authorities.
Principle 14	Amend the corporate governance regulation with respect to the compensation framework for it to be aligned with the BCBS Compensation Principles and Standards Assessment Methodology (2010) and elaborate survey and perform thematic inspection on compensation practices across the banking system. Perform in-depth thematic corporate governance inspections to assess and enforce the implementation of the regulation on corporate governance commensurate with banks' profile. Meet the board and the CRO regularly, at least annually. Issue instructions on how to elaborate compliance reports.

Appendix VIII. Table 2. Maldives: Recommended Actions to Improve Compliance with the Basel Core Principles and the Effectiveness of Regulatory and Supervisory Frameworks (Continued)	
Principle 15	Perform in-depth thematic risk management inspections to assess and enforce the implementation of the risk management guidelines. Assess risk appetite framework and contingency plans in details. Require and enforce that macroeconomic environment is taken into account in risk management. Improve supervision of new products or systems. Remodel the stress testing framework, a proportional application of the "Stress testing principles" (2018) that considers the simplicity of the Maldives' financial system could be pursued. Require banks perform to internal capital and liquidity planning processes and establish regulatory process to challenge the plans. Meet the board and the CRO regularly, at least annually. Amend regulation to: 1. include requirements related to CRO dismissal and verify. 2. require recovery plans for large and complex banks. 3. set high-level requirements for internal models and validation, back testing, outputs and board involvement and focus its supervisory processes on the few models that are relevant for banks' risk management.
Principle 16	Amend capital regulation to: 1. apply 100% risk-weight to exposures to central government denominated in foreign currency (the increase in risk-weight could be gradually phased-in to reduce the impact on specific banks). 2. align capital definition with (a simplified version of) Basel III. 3. adjust leverage ratio definition to include off-balance sheet items based on credit conversion factors. Require additional capital both based on the risks identified and on the systemic importance. Introduce a forward-looking approach to capital management, for instance, by improving stress testing framework.
Principle 17	Allow supervisors to access the credit bureau. Amend regulation to require that major credit exposures above a certain limit or exposures that are especially risky or otherwise not in line with the mainstream of the bank's activities exposures are to be decided by the bank's Board or senior management. Introduce frequent reporting on write-downs, extensions/rollovers and restructured loans. Improve stress testing framework.
Principle 18	Amend the Asset Classification and Provisioning Regulation to: 1. adjust the regulation to require provisions on off-balance sheet items. 2. Simplify the provisioning categories and improve communication. Adjust the report on provisioning. Introduce frequent reporting on write-downs, extensions/rollovers and restructured loans (or adjust credit bureau information) to allow for matching rescheduled loans to the original ones. Assess concentration in the risk mitigation strategies.

Appendix VIII. Table 2. Maldives: Recommended Actions to Improve Compliance with the Basel Core Principles and the Effectiveness of Regulatory and Supervisory Frameworks (Continued)	
Principle 19	Assess adequacy of banks' internal limits. Amend regulation to introduce requirement that material concentration should be regularly reviewed and reported to the board. Amend the large exposures reporting to allow for proper exception reporting. Incorporate concentration scenarios into standardized stress tests.
Principle 20	Amend regulation to: 1. set at 15% limit to aggregate amount of all loans to all related parties to be in line with the limits to the single counterparties. 2. include transactions in related parties' limits.
Principle 21	Define country and transfer risk in the regulation, introduce reporting and continuously monitor its materiality.
Principle 22	Assess and enforce the implementation of the risk management guidelines. Perform thematic inspections on market risk. Include market risk exposures in the stress tests.
Principle 23	Amend regulation aligning it with the BCBS document "Interest rate risk in the banking book". Improve on-site and off-site supervision to incorporate IRRBB. Perform thematic inspections on IRRBB. Remodel the stress testing framework, a proportional application of the "Stress testing principles" (2018) that considers the simplicity of the Maldives' financial system could be pursued.
Principle 24	Issue regulation on liquidity risk requirements (LCR and NSFR). Improve stress testing framework: require banks' specific scenarios and use in liquidity risk management. Assess banks' capacity to sell high quality liquid assets. Assess feasibility of contingency funding plan. Assess and enforce the implementation of the risk management guidelines.
Principle 25	Amend regulation to include legal risk in the operational risk definition. Require report on operational errors and losses. Assess and enforce the implementation of the risk management guidelines. Assess if banks have policies and processes to assess, manage and monitor outsourced activities. Assess the quality and comprehensiveness of the bank's disaster recovery and business continuity plans and challenge their feasibility. Perform inspections that consider operational risk beyond ICT and AML.
Principle 26	Assess back-office functions and balance in the skills and resources. Assess if compliance is suitably trained or have relevant experience. Establish structured process to assess control and internal audit.

Appendix VIII. Table 2. Maldives: Recommended Actions to Improve Compliance with the Basel Core Principles and the Effectiveness of Regulatory and Supervisory Frameworks (Concluded)	
	Meet routinely with the internal audit. Assess the effectiveness of the internal audit.
Principle 27	Meet routinely with the external audit. Amend regulation for MMA to have the power to rescind the appointment of external auditor.
Principle 28	Amend regulation to introduce disclosure requirements related to risk management strategies and practices and risk exposures. Review and enforce compliance with disclosure standards.
Principle 29	Amend the AML/CFT legal, regulatory, and supervisory framework to align with international FATF standards. Integrating the results of ML/TF risk assessments into the prudential risk-based supervisory framework, in an appropriate manner.

B. Authorities' Response to the Assessment

49. The MMA appreciated the work of the IMF and the World Bank in conducting the comprehensive assessment on compliance with the Basel Core Principles (BCP) and valued the recommendations provided to strengthen and improve the effectiveness of banking supervision. Furthermore, the MMA would like to thank the members of the BCP assessment team for the insightful discussions during the mission.

50. The MMA generally agreed with the recommendations made to address the identified gaps and affirmed its commitment to implement the recommendations in a phased approach, based on priorities.

51. However, regarding the capital adequacy principle, while the MMA acknowledged that there were deviations, such as the risk weighting for foreign currency government securities being zero percent instead of 100 percent, the MMA disagreed with the FSAP's assessment on this principle since the capital ratios will still be well above the minimum requirements as a result of this adjustment, at 21 percent even for the bank with the lowest ratio.