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Office of the Minister

Ministry of Finance, Banking, & Postal Services
Government of the Republic of the Marshall Islands

August 20, 2024

Excellency President Dr. Hilda Heine

And Cabinet Ministers

Subject: Circulation of the Monetary Authority Establishment White Paper

Dear Excellency Madame President Heine,

I am honored to present to you the recently drafted Monetary Authority Establishment White Paper, produced by the Monetary Authority Establishment Taskforce (MAET). Since Cabinet's endorsement of setting up the MAET in March 2023, the MAET has taken significant strides to implement the assigned deliverables given by Cabinet. The purpose of this White Paper is to advocate to the Government, businesses, and public that the Monetary Authority provides the best solutions to the many challenges the country is facing in the RMI financial sector. The MAET has set a timeframe of five (5) years beginning October 2024 to establish and fully operationalize the Monetary Authority once the law is passed. The remaining key deliverables of the MAET will be to:

- Introduce draft Monetary Authority legislation to the Parliament this September 2024;
- Complete Funding Proposal to Capitalize the Monetary Authority by September 2024;
- Complete Establishment Plan (for Implementation beginning October 2024)
- Secure Capacity Building Funds from Compact Public Sector Capacity Building Funds-Proposal was submitted to Secretary of Finance;
- Secure Infrastructure funds under the NIIP to build the Monetary Authority Building and to include under Cabinet's Agenda 2030 priority infrastructure projects;

The MAET is available to accompany me to Cabinet should you need further briefing on the status of the project. The White Paper is also in the process of being translated to the Marshallese language for the benefit of the wider public and will be made available in due course.

Sincerely,

Honorable David Paul
Minister of Finance, Banking, and Postal Service

Copy:

Honorable Members of the Nitijela

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ESTABLISHING A MONETARY AUTHORITY IN THE REPUBLIC OF THE MARSHALL ISLANDS

Paper prepared by the Republic of the Marshall Islands
Monetary Authority Establishment Taskforce[1]
August 2024

1. Introduction

Promoting the development of the Republic of the Marshall Islands (RMI) financial sector is crucial for improving living standards and increasing opportunity within RMI. There is a broad consensus in economic and financial literature that a developed financial system underpins faster economic growth through increasing access to finance and improving the allocation of capital through the economy. A developed financial system is both diversified and stable. It meets the financing needs of businesses, whatever their size, and households, leading to increased employment and higher aggregate income, and helping to reduce income inequality and poverty. Through providing a range of financial products tailored to various levels of risk, a diversified financial system encourages business startups and innovation, leading to productivity gains that help maintain economic growth. Financing risk has to be balanced against the continued stability of the financial system, which is achieved through a robust prudential framework that is directed towards strengthening the balance sheets of financial institutions and protecting depositors and investors. If a financial system is both diversified and stable, it is better placed to absorb economic and financial shocks and to help smooth economic fluctuations.

For RMI, those potential benefits will be minimal, or not realized at all, as long as its financial system remains underdeveloped. The current financial system is rudimentary, with total assets of $355 million at end 2022—only 160.92 percent of GDP. The three licensed banks dominate the system, accounting for 76 percent of total financial sector assets, with the Marshall Islands Development Bank (MIDB) accounting for a further 10 percent. But the ratio of private sector credit to GDP was only 55.35 percent of GDP at end 2022, illustrating the constraints businesses and households face in accessing credit. To date, RMI has not experienced the benefits of digital finance technologies and applications; the availability of online and mobile banking products is limited and there are only three ATMs, and these are located only on Majuro. The lack of technological advancement is most evident in the payment system. Where developed financial systems rely on real time gross settlement, an automated clearing house (ACH), and a central securities depository, cash and checks remain the predominant form of payment in RMI. The check clearing system is inefficient and costly; it remains a manual system, despite the significant aggregate value of checks presented. Remittance transfers, which are significant in RMI, are also slow and costly.

Of greater concern than the rudimentary development of the financial system are the structural vulnerabilities inherent in the current system, vulnerabilities that stem from the reliance on the services provided by the Bank of Guam (BOG), RMI's sole foreign licensed bank, and which

[1] This paper draws on IMF TA Report, PICDPR Policy Brief, and material provided by OBC.

threaten RMI's ability to provide critical banking services. Most of the government's domestic bank accounts are held with BOG, raising concerns about the risks to the Government from its banking arrangements being concentrated in one bank and also about protecting the confidentiality of information. BOG is currently the only FDIC-insured bank operating in RMI, and it is the only bank with access to the Federal Reserve's Check 21 enabled services, a suite of services that allows image cash letters to be sent and received electronically, Fedwire Funds Service and other critical services offered by the Federal Reserve System. Furthermore, it is the only bank operating in RMI that has not been affected by the removal of correspondent banking relationships (CBR) in foreign jurisdictions. The reduction in CBRs is part of a more general de-risking movement in international banking where bigger banks reduce their exposure to money laundering and terrorist financing risks by cutting CBRs with banks in smaller countries with weak AML/CFT system oversight. Such moves clearly have an impact on the ability of the RMI banking system to make international payments through the banking system—both business and personal. But they also threaten the ability to make cash transactions, as CBRs provide the channel for ordering fresh supplies of U.S. notes and coins and replacing old and mutilated banknotes. When this service is impeded, the banking system has difficulty maintaining the supply of banknotes needed for domestic payments.

To reduce vulnerability and achieve the benefits of financial sector development, RMI needs to modernize its financial sector and create the conditions for continued improvement and innovation in the availability and quality of financial services. Effective government intervention is needed to create policy space and an institutional framework that enables financial institutions and financial markets to flourish. That institutional framework will provide an architecture for the financial sector, and its continued development. This framework can be thought of as the architecture of a diversified and stable financial system. The architecture provides opportunity for finance providers to meet business and household financing needs alongside providing a regulatory framework that protects depositors, consumers and investors, promotes competition to reduce costs, and underpins continued innovation and development.

The immediate tasks confronting RMI policymakers are to transform the RMI financial system to one which meets the ongoing banking and financing needs of the RMI Government, businesses, and households, and which facilitates fast and secure domestic and international payments. That transformation will not occur without a significant intervention from the Government to formulate and implement the policies and regulatory framework that will be needed, but also to provide selected banking services and financial system infrastructure that are needed to underpin the system as a whole. For these reasons, the Government has decided to establish the Republic of the Marshall Islands Monetary Authority (RMIMA) as a specialized public financial authority. RMIMA will have a focused and long-term mandate to respond to the current challenges confronting RMI's financial system and to provide the foundations for a diversified and stable financial system that meets the needs of Marshall Islanders.

The purpose of this paper is to explain to all stakeholders, including the general public, why RMIMA is being established, the responsibilities it will have, and how it will operate. The paper provides a basis for further consultations with stakeholders before the Nitijela enacts governing legislation for RMIMA. The remainder of the paper discusses why the RMI Government has decided on a monetary authority, the responsibilities of RMIMA, what it will do and how it will operate, and the mechanisms that will be put in place to ensure a high standard of governance and accountability for RMIMA. The concluding section summarizes

the key points of the paper and outlines further work that will be done during the consultation phase prior to the enactment of RMIMA's governing law.

2. Establishing a Monetary Authority in RMI

The establishment of a monetary authority in the Republic of the Marshall Islands (RMI) has been under discussion for the greater part of the last decade, and Cabinet previously approved such action within an appropriate legal framework and alongside a wider Financial Sector Development Strategy in 2015.[2] A bill establishing the RMIMA was drafted by the Government with the help of an external adviser, but the establishment of the RMIMA did not materialize due to the lack of resources and capability.

That original Cabinet decision was prompted by difficulties RMI banks faced in maintaining international correspondent banking relationships (CBRs) in the face of stricter international standards on anti-money laundering (AML) and countering the financing of terrorism (CFT); the need to ensure that the Government funds were secured and protected; the need to further develop the financial system to help counter major economic threats and to stimulate employment opportunities within RMI; and the imperative of preparing for the expiry of the then current Compact of Free Association (Compact) in 2023. These problems have magnified since 2015. And implementing solutions for these problems has become more challenging, exacerbated by the difficulties in ensuring adequate and high-quality banknotes are in circulation and uncertainty surrounding the introduction and impact of a privately issued digital currency.

It is clear that a significant public sector institutional response was needed to confront these challenges, and that any response needs to go beyond the mandate and existing capability of the Office of the Banking Commission (OBC), the only public authority established in the RMI dealing with financial sector matters. Any institutional response needs to encompass the entire financial sector, and to emphasize financial sector development in addition to financial system stability. It has to provide a capability to respond to digital innovation, including promoting digital solutions as part of financial sector development strategies, protect against digital fraud and cyber threats, and assess the merits of proposals to introduce virtual assets. This type of public sector institutional response would allow the assessment of the benefits, risks, and challenges of issuing a digital currency and would lay a foundation for a central bank digital currency (CBDC), as opposed to an earlier initiative to establish a privately sponsored digital currency in RMI, an initiative that carried significant macroeconomic and financial stability risks, and which would have undermined the integrity of RMI's financial system.

Consequently, the Government intensified its efforts to establish a monetary authority. With the support of Griffith University's Pacific Islands Centre for Development Policy and Research, OBC published a policy paper—The Establishment of Republic of Marshall Islands Monetary Authority[3]—in December 2022, and through 2023 the International Monetary Fund provided comprehensive guidance on the responsibilities and structure of an RMI monetary authority, including guidance on a law governing the operations of a RMI monetary authority in a final Technical Assistance Report.[4] The IMF recommended establishing a taskforce to progress the implementation of a monetary authority, a recommendation endorsed by the

[2] (Cabinet Minute 188 (2015), dated 9 December 2015).

[3] Policy paper reference.

[4] IMF TA Report reference.

current and previous governments. Cabinet formally approved the establishment of the RMI Monetary Authority Establishment Taskforce in March 2024.[5]

3. Why is RMI establishing a Monetary Authority and Not a Central Bank?

Most countries have a central bank or monetary authority, those two terms often being used interchangeably as there is no defining characteristic of each. According to the Bank for International Settlements (BIS), there are around 150 central banks throughout the world, but only nine monetary authorities.[6] The monetary authority nomenclature is used in mostly small countries—Bermuda, Bhutan, Brunei Darussalam, Cayman Islands, Hong Kong SAR, Macao SAR, Maldives, Palestine, and Singapore. The Monetary Authority of Singapore (MAS) is widely known, and while Singapore is a small country in land size and a relatively small country in terms of population, it does have a sophisticated financial system.

Despite their prevalence in the international financial landscape, there is no generic central bank model. Central banks have varying policy objectives and undertake varying functions to meet any policy objective, and these objectives and functions reflect a country's history, economic policy priorities, the relative importance of a national currency, and the impacts of major events such as the Global Financial Crisis. While there is no generic model, some functions—monetary policy formulation and implementation, currency issue and management, fiscal agent, and some involvement in the operation of the payment system—are common to most central banks.

There is far less uniformity in the institutional approaches countries adopted for regulation and supervision aimed at underpinning the stability of the financial system. There are two broad models—a single, integrated financial supervisory authority, or the "Twin Peaks" approach where there are separate regulators for prudential oversight of the financial system—promoting the maintenance of a sound and efficient financial system supervision—and one for market oversight—ensuring consumers are adequately informed and that market participants act with integrity, with a focus on product disclosure and the behaviour of financial services providers. The single regulator model is favored in Scandinavian countries, Germany, Japan, and Korea, for example, on the grounds that it provides more effective oversight of financial conglomerates and because it places less demand on available resources, compared to multiple regulators. The Twin Peaks model is favored by countries such as the UK, Australia, and New Zealand on the grounds that it is more effective in avoiding conflicts between monetary policy implementation and prudential supervision of banks where one regulator has responsibility for both. Outside of these two broad approaches, some countries have additional regulators for securities markets and for some issues around competition in the financial system are the responsibility of an authority such as a Commerce Commission that aims to improve competition throughout the economy. The US provides yet another example, which has some elements of the Twin Peaks model, but its approach has been described as "a foggy mountain range" due to having multiple regulators, sometimes with a blurred demarcation between these

[5] Under the Cabinet approval, MAET comprises six members: the RMI Banking Commissioner as chair, three people representing Government, the banking industry, and the legal industry, an external central banking expert, and another person from OBC to provide the secretariat for the Taskforce.

[6] See the Bank for International Settlements Register of central banks and monetary authorities. Available at https://www.bis.org/about/factmktc/cbregister.htm.

regulators, and with the added complication of dual Federal and State regulatory frameworks.[7] When there are several regulators, their work has to be coordinated in some way, such as through the Financial Stability Oversight Council in the US or the Council of Financial Regulators that exists in Australia and New Zealand.

Beyond financial supervision and core central banking services, central banks vary in the extent to which they have responsibility for government cash and debt management, foreign reserves management, financial sector development, financial inclusion, and oversight of any unit responsible for implementing and complying with international AML/CFT standards.

In emerging and developing economies, central banks are more likely to have a wider range of responsibilities than is the case in bigger countries. This is a function of population size and the level of financial sector development. There is limited capacity in the countries, in terms of resources and technical capability, and one public institution dealing with all monetary and financial matters is seen to be able to leverage economies of scope and scale.

Singapore offers an example of a model that can be adapted to RMI's context. One public institution—MAS—is responsible for all monetary and financial matters. MAS describes itself as Singapore's central bank and integrated financial regulator, and it also works with the financial industry to develop Singapore as a dynamic international financial center.[8] MAS' emphasis on developing the financial systems is also relevant to RMI, as the need to increase the availability of finance and range of financial products is an important public policy issue, alongside the importance of maintaining a sound financial system.

Given RMI's small population and capacity constraints, it is more appropriate to have one public entity with a broad range of financial sector responsibilities—an entity that acts as both a central and integrated financial sector regulator. The relevant question is not whether RMI needs a single regulator or multiple regulators, but rather whether OBC should be that regulator. OBC is a banking supervisory agency, set up under Title 17 Chapter 1 Banking Act 1987, to ensure the safety and soundness of the RMI banking sector, including protecting depositor funds, and deterring money laundering and terrorist financing activities within RMI's financial system. To achieve its mandate, OBC issues regulation and rules, and regularly conducts prudential supervision of banks. The Banking Commissioner directs the work of OBC through three separate units: the Financial Institution Supervision Unit, the Financial Sector Development/Administration and IT Unit, and the Financial Intelligence Unit which oversees Anti-Money Laundering/Countering the Financing of Terrorism (AML/CFT) supervision). Grafting core central banking and wider financial sector regulatory and supervisory responsibilities onto OBC has some superficial appeal, but it is not the best option for RMI, as RMIMA will deal with a much wider range of financial sector policy and regulatory issues than currently addressed by OBC. Expanding out from OBC risks bank-centric thinking and approaches dominating RMIMA's approach to policy making, regulation, and supervision. Those approaches need to be adapted to the distinct types of financial institution and the risks inherent in the finance they provide—insurance risks are different to pension risks, and are different to banking risks, for example. Furthermore, RMIMA will provide central banking and treasury management services in addition to any financial regulation. A better strategy is to

[7] https://www.cambridge.org/core/books/abs/cambridge-handbook-of-twin-peaks-financial-regulation/us-financial-regulatory-structure/E4D16B38632F164959B2E980BD339382, cited on May 16, 2024.

[8] Monetary Authority of Singapore, Who We Are, https://www.mas.gov.sg/who-we-are, cited on April 30, 2024.

reconstitute OBC as an operating directorate within RMIMA effective from the time RMIMA commences operations, and then progressively build other capabilities within RMIMA.

4. Pacific Island Country Precedents

The Asian Development Bank recognizes 14 Pacific developing member countries—PICs in this paper. Six have central banks—Fiji, Papua New Guinea, Samoa, Solomon Islands, Tonga, and Vanuatu—but these countries issue their own currencies. The three North Pacific countries—Federated States of Micronesia, Palau, and RMI use the US dollar and have a banking regulator; Kiribati, Nauru, and Tuvalu use the Australian dollar, with Tuvalu having a banking regulator; and the Cook Islands and Niue use the New Zealand dollar, with the Cook Islands having a financial services regulator.

PICs have small populations, and, not surprisingly, PIC central banks have a range of responsibilities beyond issuing a domestic currency and implementing monetary policy. This range of responsibilities is often wider than for central banks in more developed countries and includes: the provision of banking and payments services to government and banks that are part of the clearing system; banking supervision and selected financial sector regulatory responsibilities, responsibility for leading government financial inclusion policies and initiatives, and in-house financial sector and economic research capability. While the PIC experience is useful to RMI policymakers and should provide confidence that establishing a monetary authority is within RMI's capabilities, PICs have struggled to diversify their financial sectors, especially when there is no mandate, or only a limited mandate for financial sector development. The mandates of smaller PIC central banks—Samoa, Tonga, Solomon Islands, and Vanuatu—do not extend to regulation and supervision of the entire financial system, nor do they expressly address financial sector development. Papua New Guinea—the largest PIC—does have a separate securities regulator. Bank PNG's legislation has an explicit objective focused on development of the financial system, but operationally the focus is on the regulation and supervision of the current configuration of the financial system. The Reserve Bank of Fiji (RBF) is responsible for capital market regulation, having absorbed the earlier and separate Capital Markets Development Authority into its operations in 2009. RBF also has a separate Financial System Development Group that has responsibilities beyond the banking system.

Timor-Leste's experience is relevant. Timor-Leste is a small, independent island state (albeit with Indonesia having sovereignty over the western half of the island), with an underdeveloped financial system; it also uses the US dollar. Timor-Leste is seen as a southeast Asian country and is seeking to join ASEAN, but it maintains close relationships with Pacific states through its geographical proximity to Australia and Papua New Guinea, and its association with PIC regional groupings, including being a member of the South Pacific Central Bank Governors forum. Timor-Leste's monetary authority is the Central Bank of Timor-Leste (Banco Central de Timor-Leste—BCTL). BCTL was established in September 2011, succeeding the Banking & Payments Authority (2001–2011) and the Central Payments Office (2000–2001).

5. Continued Use of the US Dollar

It is commonplace for monetary authorities and central banks to issue their own currency, but the US dollar will remain the sole legal tender in RMI with the establishment of RMIMA; and the RMIMA Act will affirm this position. While the US dollar is entrenched in the independent North Pacific states of Federated States of Micronesia, Palau, and RMI, and the neighbouring US territories of the Commonwealth of the Northern Marianas and Guam, all of which have a shared heritage in the former US Trust Territory of the Pacific, it is unusual for the US dollar

to be the sole legal tender outside of the US and US territories.[9] There are examples throughout the world of countries where the US dollar is widely accepted and the preferred medium of exchange in many cases—as happens in some South American countries, for example—but the US dollar is not usually legal tender in those countries. These economies are often referred to as dollarized economies, but they are not officially so, and they often have an unstable monetary history.

On establishment of RMIMA, RMI will become only the fifth independent state with a central bank or monetary authority where the US dollar is the sole legal tender. The existing four include three Latin American states—Ecuador, El Salvador, and Panama—plus Timor-Leste. This rarity should not be seen as a negative factor for RMIMA's operations. RMI has little to gain from issuing a national currency at this stage. RMI has a stable monetary history, unlike some dollarized countries that adopted the US dollar to bring monetary stability and have directed monetary policy towards maintaining that stability. Furthermore, the recently renegotiated Compact Agreement acknowledges the US Government's acceptance that the US dollar will continue as legal tender in RMI, and it will be easier for RMIMA to develop its linkages with the Federal Reserve and US financial system as a user of USD rather than as an issuer of an illiquid foreign currency. The main drawback to not issuing a national currency, is that RMI loses some policy flexibility through not being able to implement an independent monetary policy. Again, Timor-Leste provides a useful precedent for RMI, as its use of USD has provided space for its central bank to progressively build its core banking and payment system capabilities and address financial sector development policy issues, without responsibility for formulation and implementing an independent monetary policy.

The rarity of the US dollar being the sole legal tender in countries with a central bank or monetary authority does suggest that many countries have found it beneficial to issue a national currency and have monetary policy independence. RMI needs to keep this option open. The increasing interest in the issuance of central bank digital currencies (CBDC) reinforces this point. RMIMA will need to stay abreast of these developments, assess the implications for RMI, and advise the Government and the Parliament of these implications. The critical point is that the establishment of a national currency is a decision for parliament. If the Nitijela decides on this course of action in the future, it would amend the RMIMA Act to make a new national currency legal tender. Under any amended law, RMIMA would be the only entity permitted to issue that currency, whether paper-based or digital. A CBDC would still be a liability of RMIMA, be convertible at par with cash and reserves, and would serve as a medium of exchange and store of value. Private issuance of digital currencies, such as the proposal to issue the SOV as a decentralized digital currency via an initial coin offering and to function as a second legal tender, will not be permitted under any RMIMA legislation.

6. What Will RMIMA Do?

The RMIMA Act will stipulate the objectives and functions for RMIMA. The detail of these objectives and functions is broadly consistent across monetary authorities and central banks, in a large part due to the role the IMF has played in advising on the policy roles, structure, and legal foundations of monetary authorities and central banks within the international financial system. Where there is a variation from the norm, that variation reflects policy priorities for

[9] The US territories are American Samoa, Commonwealth of Northern Marianas, Commonwealth of Puerto Rico, Guam, and The Virgin Islands of the United States. The US dollar is also the sole legal tender in the UK territories of The British Virgin Islands, Turks and Caicos, and the Dutch Caribbean municipality of Bonaire.

the country in question, the level of financial sector development, and local features of the systems and processes of government.

7. RMIMA Objectives

Objectives, or purposes, are high-level constructs that answer fundamental questions: What is the public policy role of the monetary authority? And why is it necessary to establish a new government-owned financial entity?

For the RMI, the public policy imperatives are to:

- Ensure that RMI has the financial services it needs—for the Government, banks, businesses, and households; and
- Continue the prudential oversight activities of OBC and its AML/CFT supervision and national coordination tasks.

RMIMA also needs to be positioned to take the leading role in the development of a diversified and stable RMI financial system through its policy and regulatory roles, and it will need an explicit mandate to do so.

As noted, continued use of the US dollar will limit RMIMA's ability to operate an independent monetary policy, but this is still a policy choice on the monetary regime that best suits RMI. Continued use of the USD should not, therefore, be seen as a binding policy choice. Stable prices are still a policy objective, even with continued use of USD, and RMIMA can still influence liquidity conditions in local financial markets aimed at stabilising prices.

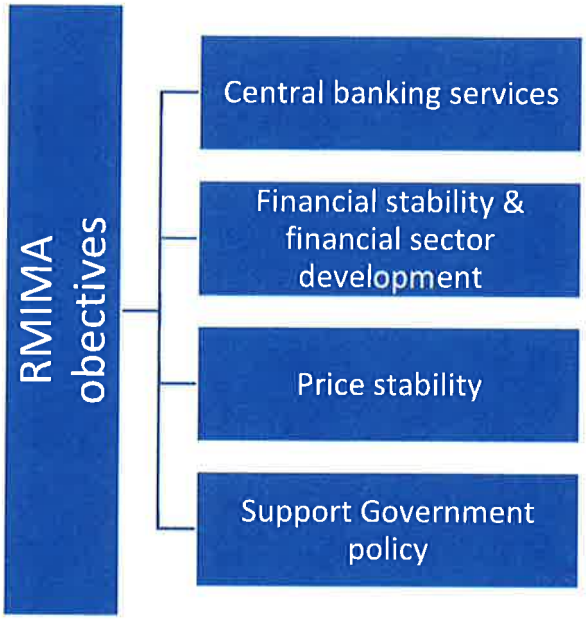
The RMIMA is the institutional response to those policy objectives. The policy and regulatory functions must be conducted by a government entity, and at this stage of RMI's economic development a government-owned entity is best placed to ensure the continuity of critical banking and payments services. Conceptually, these services could be provided by private parties, but the RMI does not have a strong private sector foundation. And as a government-owned entity, RMIMA needs to be mindful of the Government's wider economic policy agenda. The task for RMIMA is to support that agenda without compromising its own policy objectives.

It follows that the core objectives for RMIMA are to:

- Provide central banking services;
- Maintain financial stability and promote the continued development of a sound and reputable financial system; and
- Contribute to achieving and maintain price stability.

And, in addition, RMI will support the general economic policy of the Government.

Figure 1. RMIMA objectives.



8. RMIMA Functions

Functions expand on the core objectives. They answer the questions on what is involved in meeting these objectives, and what will RMIMA do to achieve its objectives?

Functions can be mapped onto RMIMA's three core objectives, as shown in Table 1.

8.1 Central banking services

- Banker, advisor, fiscal agent for Government and public bodies, and treasury management for Government
- Payment system operator
- Currency management
- Foreign reserves management

8.2 Financial system stability and development

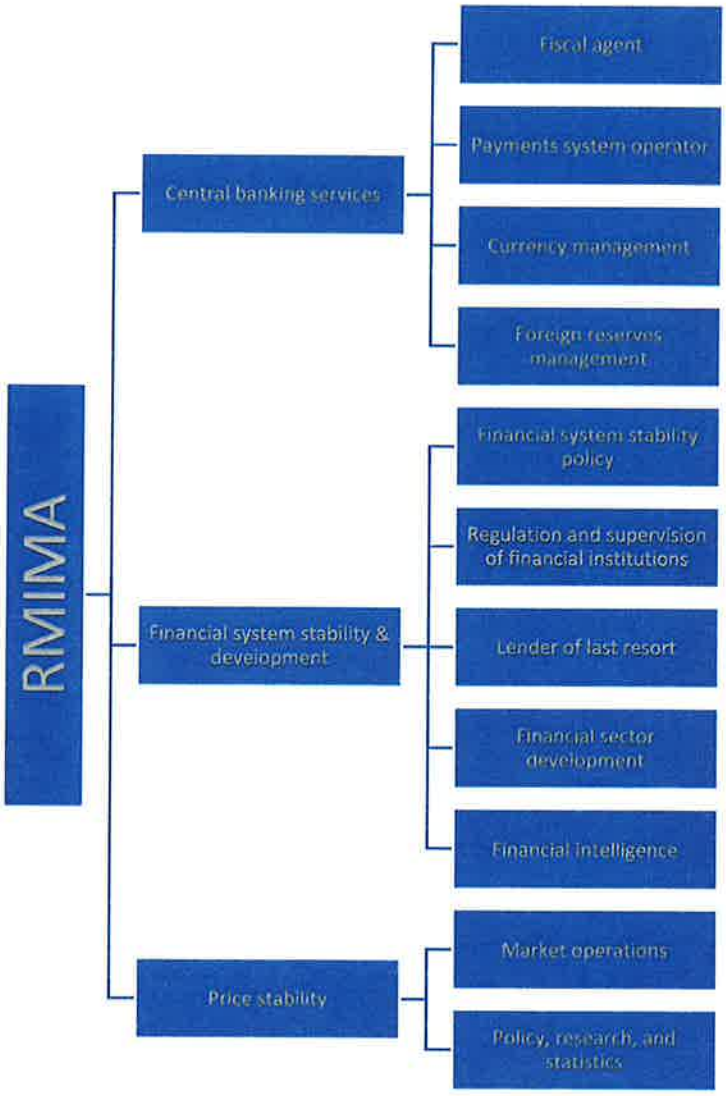
- Financial system stability policy
- Regulation and supervision of financial institutions
- Lender of last resort
- Financial sector development
- Financial intelligence

8.3 Price stability

- Market operations
- Research, policy analysis, and statistics

The functions of RMIMA are shown in Figure 1, which also maps these functions onto the core objectives.

Figure 1. RMIMA functions by objective.



The striking feature of this table is the breadth of functions, of which the existing OBC mandate only covers 'Regulation and supervision of financial institutions' and 'Financial intelligence'. This reinforces the decision to establish a new monetary authority rather than gradually add onto OBC's existing capability.

Table 1 explains the nature of these individual functions in more detail, concentrating on those functions not currently covered by OBC's mandate. It differs slightly from Figure 1 in that some functions are combined within an organizational grouping to provide a basis for the organizational structure RMIMA will need. For example, managing the Government's cash

balances and managing RMI's official foreign reserves are both treasury management activities. The lender of last resort (LOLR) function has been combined with the banking supervision function because the LOLR function will not be an ongoing activity, and assessments by the Banking Supervision unit will be a key factor in triggering any use of the LOLR facility.

Table 1. RMIMA functions by organizational grouping.

Banking Operations Department	
Government Banking, Treasury, and Debt Management	RMIMA will provide deposit and payment services associated with the Government's operating expenditures and revenues. As treasury manager, RMIMA will (i) manage these cash flows to ensure that funds are available to meet any domestic financial commitments, investing any surplus funds in low-risk financial assets to generate a return on the surplus funds; and (ii) manage RMI's official foreign exchange reserves—financial assets held outside RMI, any gold reserves, and RMIMA's reserve position in international monetary agencies—to ensure that funds are available to meet any external financial commitments, and also to provide liquidity buffers to cushion large budgetary fluctuations in government finances and to provide liquidity to the financial system to maintain financial stability. As a debt manager, RMIMA will issue and manage government bonds if needed to finance government expenditures, including operating a central securities depository for registering ownership and making coupon and redemption payments.
Payment & Settlement System Operator	The RMI payment system is underdeveloped and impedes economic growth. Substantial change is needed to meet the payment needs of government, businesses, and households and provide impetus for increased digitalization of the payment system and wider financial system. At an early stage RMIMA will develop a national payment system strategy for consultation with stakeholders. This strategy will assess the suitability of various payment technologies for RMI, including an ACH using check imaging and online payments via a dedicated network. As part of any future payment system, RMIMA will also assume responsibility for the final settlement of banks' mutual claims arising from payments clearing since banks will hold reserve accounts at RMIMA.
Currency Management	While the authority to issue US dollar currency—banknotes and coins—rests with the Federal Reserve, RMIMA will have responsibility for ensuring that there is an adequate supply of currency in circulation within RMI to meet the demand for legal cash

	transactions, and for ensuring that the quality of these notes and coins meets the standard for acceptance by correspondent banks and the Federal Reserve when older and mutilated currency needs to be taken out of circulation. In effect, RMIMA will operate a currency warehouse for which it will need a currency forecasting capability, diagnostic to test the authenticity and fitness of banknotes, equipment for managing the banknote inventory, secure storage premises, and agreements with the Federal Reserve and correspondent banks for the acquisition and disposal of banknotes.
Financial Stability and Development	
Banking Supervision Department	OBC will continue to license, regulate, and supervise the banking sector in the RMI. Currently, this extends to three licensed commercial banks—BOMI and PRB, which are locally-owned, and BOG, a branch of a US FDIC insured bank.
Nonbank Financial Institutions & Infrastructure	OBC will continue to license, regulate, and supervise non-bank financial institutions.
Lender of Last Resort	A lender of last resort (LOLR) function is needed to backstop banks that are facing temporary liquidity shortages, but which are fundamentally solvent, with an excess of assets over liabilities. RMIMA would provide this emergency liquidity by making a loan, collateralized against eligible securities or other assets, or it can purchase securities held by the bank, again through making a deposit to the bank's account at the central bank. As this ability to "print money" will not be available to RMIMA, it will need to have access to USD liquidity through, for example, a contractual line of credit arrangement with the Federal Reserve or foreign commercial bank.
Financial Sector Development	The Financial Sector Development unit will be tasked with advising on the architecture of a financial system that meets the financing needs of all actors within the RMI economy. That architecture must attract private investment into the financial sector, and it needs to promote digital solutions wherever possible. A well-designed financial architecture will also promote inclusiveness, and the Financial Sector Development Unit will also be responsible for promoting financial inclusion within a broader financial sector strategy and within a commercial delivery model wherever possible. Digital finance solutions will be a cornerstone of financial inclusion strategies. The work of the Financial Sector Development Unit will be formalized in a financial sector development strategy and a financial inclusion strategy and associated sector plans.
Financial Intelligence	RMIMA will continue to have responsibility for AML/CFT supervision and associated national coordination tasks.

Monetary Stability Department	
Policy, Research, and Statistics	Central banks and financial regulators typically have a research unit responsible for analyzing domestic and international economic and financial conditions and for contributing research support to policy development across the organization. Given the scale of RMIMA's operations, the research unit will be the primary source of research support for all RMI's operations and policy development. The research unit will prepare RMIMA's annual economic report and annual financial stability report. In time, as the unit develops its capabilities, it will publish occasional research reports and discussion papers. The research unit will be complemented by a statistics unit empowered to collect information necessary for monitoring and analyzing economic and financial conditions, in addition to information RMIMA collects as supervisor of financial institutions. The statistics unit will not duplicate statistical collections undertaken by other government agencies.
Market Operations	Interest rates in RMI will be primarily determined by the policy stance of the Federal Reserve. Nevertheless, RMI will retain some ability to influence domestic monetary conditions through influencing bank liquidity. RMIMA will be able to use on open market operations (purchasing and selling securities), reserve requirements, and credit operations (through repo transactions, or by providing intraday, overnight, or short-term liquidity loans) for this purpose. Loans are granted to solvent banks and secured by eligible collateral, such as securities issued by sovereign states.

9. How Will RMIMA Operate?

While a public entity, RMIMA will have a distinctive structure that reflects its hybrid nature: it is part policy agency, part regulatory agency, and part financial institution. That blend has implications for the way in which RMIMA will be financed. Another distinctive feature of RMIMA is the extent of its operational autonomy, which will be balanced by correspondingly higher standards of governance and accountability. Accordingly, the RMIMA Act will have an explicit statement on autonomy.

RMIMA's legal status will be that of a body corporate. As such it may sue and can be sued in its corporate name. It will have the capacity to contract and incur obligations; institute legal proceedings and itself be subject to legal proceedings; and acquire, administer, hold, and dispose of movable and immovable property.

10. Organization Structure

The objectives and functions of RMIMA, as specified in the RMIMA Act, point to the shape of the organizational structure that will be needed to perform those functions.

10.1 Decision-making

The decision-making bodies for RMIMA will be the Board of Governors and the Governor.

The Board of Governors is responsible for formulating RMIMA policies to meet the objectives of RMIMA mandated in the RMIMA Act; supervising the implementation of these policies; formulating internal policies, including risk, accounting, audit, IT and HR policies; and oversight of the administration and operations of RMIMA. The Governing Board will have five members: the Governor as chair, the Deputy Governor, and three non-executive members.

The Governor will be the CEO of RMIMA and will be responsible for the day-to-day management of RMIMA and implementation of policies decided by the Board of Governors. The Deputy Governor will assist the Governor in the day-to-day management of RMIMA through delegated authorities and as head of one of RMI's functional departments. The Deputy Governor will have authority to fulfill all the functions of the Governor in the absence of the Governor.

10.2 Departments

As shown in Figure 2, RMIMA will have four functional departments and one administrative department: Banking Operations, Financial Supervision, Monetary Stability, Financial Intelligence, and Administrative. The Deputy Governor will have day-to-day responsibility for the Financial Supervision Department, while the other four departments will be led by an Executive Manager.

The Banking Operations Department will focus on providing banking and treasury management services to the RMI Government, operating the payment system, and managing currency in circulation.

The Financial Supervision Department will focus on maintaining financial system stability and promoting financial sector development, including financial inclusion activities. The Financial Supervision Department is, in effect, a transplant of the current OBC but its functions will progressively expand beyond those currently undertaken by OBC.

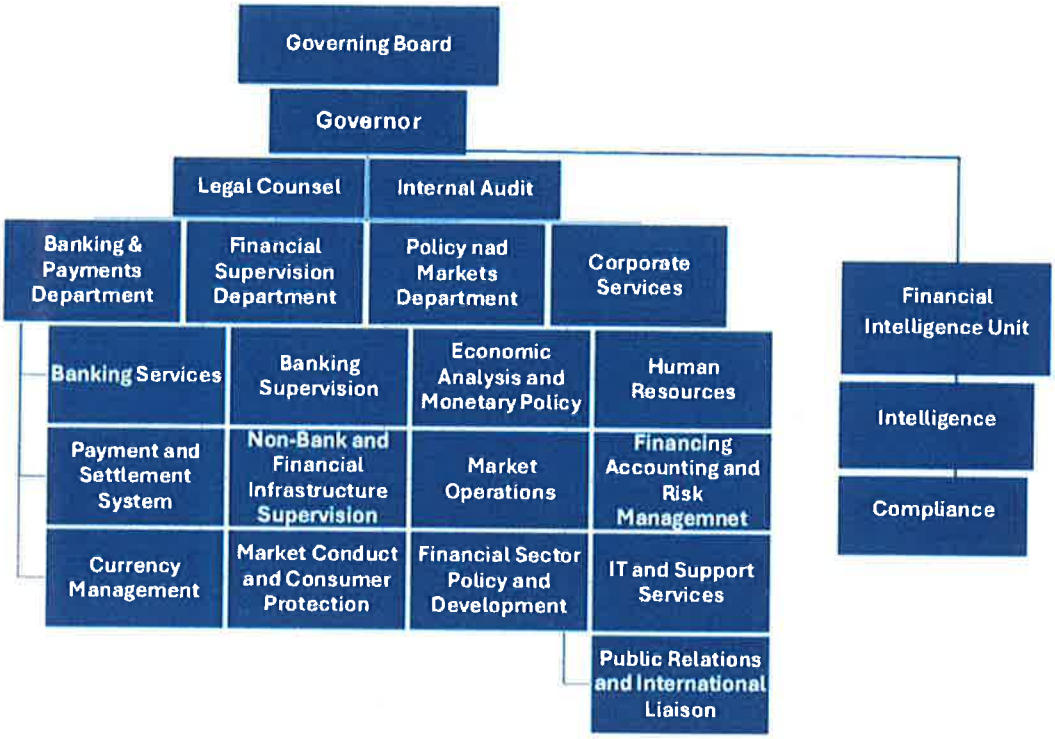
The Monetary Stability Department will provide RMIMA with a research capability, supported by the collection of statistics. The Monetary Stability Department will also monitor financial market conditions and recommend appropriate liquidity management operations when these are needed to underpin price stability.

The Financial Intelligence Unit will continue to assume AML/CFT tasks as mandated under the AML/CFT provisions of the Banking Act and act as the national coordinator for APG matters and AML/CFT efforts in the RMI.

The Administrative Department will provide essential internal organizational support to RMIMA operations through a Human Resources Division, a Finance and Accounting Division, and an IT and IT Support Services Division, and a Risk Management Division.

In addition, internal audit will be performed by an internal audit function, which will report directly to an audit committee established by the Governing Board. Similarly, RMIMA's Legal Counsel will report directly to the Governor.

Figure 2: RMIMA organization structure.



11. Operational Autonomy

RMIMA will be entrusted with a critical public policy mandate, as expressed through its objectives to:

- Provide central banking services;
- Maintain financial stability and promote financial sector development;
- Maintain price stability; and
- Support general government economic policy.

This mandate will be compromised unless RMIMA can operate autonomously and without interference from the government, parliament, or industry. It is important that RMIMA not to be permitted to seek or take instructions from third parties, or for third parties to give it instructions. Institutional autonomy also requires that government representatives, including the Minister of Finance or any other person that may represent the government, do not participate in meetings of central bank's decision-making bodies so as to avoid political imperatives influencing the central bank's decision-making process.

It is standard practice for central banks and monetary authorities to have this level of institutional autonomy, and many countries have found, often at a significant cost, that without it the monetary and financial sector stability that is desired is not achievable.

Operational autonomy extends to the performance of RMIMA's core functions, as specified in the RMIMA Act. This functional autonomy will allow RMIMA to go about its daily business without the government or any third parties having the right to suspend, block or otherwise direct the central bank's decisions. But in performing these functions RMIMA will be guided

by advice and research from the IMF and BIS on best practice standards for monetary authorities and central banks, and by developments in banking and finance practice. RMIMA will also be able to build its capabilities through technical assistance programs offered by the IMF and RMI's other development partners.

In line with the operational autonomy under which RMIMA will operate, the Board of Governors will be afforded personal autonomy from political bodies and private interests. Personal autonomy will be strengthened through a "double veto" appointment and dismissal procedure; clear eligibility requirements and incompatibilities; safeguards against conflicts of interests; limited and specific grounds as well as due process for dismissal; prevention of a decrease in the remuneration of officials during their terms of office; a provision on the limitation of liability of central bank decision-makers and staff; and security of tenure longer than the standard electoral cycle.

12. Financial Autonomy

RMIMA will also need to be financed in a manner that gives it the ongoing capability to continuously perform its functions—functions that are critical to the financial operations of the Government and financial institutions, and all those who participate in the payments system. If RMIMA is to operate autonomously, then it will need to manage its financial position autonomously.

RMIMA will not have its operations funded through annual Government appropriations in the way that government departments do. It will receive an initial capital injection and continuation of an appropriation level needed to inject additional capital to strengthen its' balance sheet for a few years. It needs autonomy to set its own budget and buy and sell financial instruments, consistent with its legal mandate.

That financial autonomy comes from RMIMA being able to finance its operations directly from its own balance sheet. That balance sheet will resemble a bank's balance sheet. RMIMA assets will be primarily financial assets, such as deposits held with the US Federal Reserve and investments in low-risk US dollar securities. RMIMA will be able to make loans to domestic banks, but those loans would usually be for short-term liquidity management purposes. RMIMA will not make loans to finance government expenditures. The RMI Government may also issue a long-term bond to capitalize RMIMA, in which case this bond would be an RMIMA asset. In time, RMIMA will own its own building, but this will not be a major asset of RMIMA. Similarly, RMIMA liabilities will be primarily financial liabilities. Initially, those liabilities will be bank deposits to settle interbank payments as part of the payment and clearing system and government deposits. At a later stage, RMIMA could issue its own securities for monetary management purposes. Most central banks issue their own currency, and that issuance is a liability of the central bank because it is a promise to redeem the value of that currency. In contrast, RMIMA will not have currency liabilities as it is not issuing a national currency, the US dollar remaining legal tender. But RMIMA will hold a stock of US dollar banknotes as part of its currency management services and that stock of banknotes will be an asset of RMIMA.

The foreign reserves portfolio is invested in low-risk instruments that generate a financial return while safeguarding capital value and ensuring liquidity is available when needed.

While RMIMA will have a critical role in the financial system and will take on relatively large financial assets and liabilities, the amount of capital needed to underpin its operations will be

relatively small. The initial capital needs to fund income earning assets sufficient to provide an operating surplus and to provide a buffer against unexpected losses. RMIMA will build its capital base through the accumulation of operating profits. The IMF has suggested authorized capital of $20 million, and the MAET will work with the Ministry of Finance to finalize a funding proposal for RMIMA's capitalization and access to grants to help build RMIMA's capabilities and core system. . The profits and losses of RMIMA will be determined in accordance with the US GAAP accounting standards and the RMIMA Act will stipulate how profits and losses will be distributed. The level of profits will vary due to the nature of RMIMA's operations: earnings on foreign reserves will reflect changes in US dollar interest rates and the value of market operations with banks will vary depending on underlying monetary conditions. Sufficient capital is needed to absorb any losses should they occur because of financial market conditions, and the RMIMA Act will stipulate protocols for distributing profits. Unrealized gains and losses on foreign reserves and other assets will be booked to an unrealized revaluation reserve account, and not be eligible for distribution. Distributable earnings will be credited to a general reserve account until that reserve is equivalent to 10 percent of the monetary liabilities of RMIMA. This will allow RMIMA to build up its capital without calling on the Government for additional capital. The Board of Governors may also determine that a further portion of distributable earnings be credited to any special reserve accounts. Any remaining distributable earnings will be paid as dividend to the RMI Government and recognized in Government revenue accounts. RMIMA's capital will also be protected by recourse to the Government for additional capital should liabilities exceed assets, and restrictions on financing government and SOE activities.

13. Governance and Accountability

As a government-owned entity RMIMA is accountable to the Government, as owner, and to the wider public that the Government represents. The Government needs mechanisms to ensure that RMIMA is acting in accordance with its mandate and governing legislation and that its policy actions are in the public interest. The RMIMA Act is the fundamental mechanism for ensuring RMIMA remains accountable. RMIMA's activities must be consistent with the objectives and functions prescribed in that law.

The governance and accountability standards to be applied to RMIMA will be higher than those applying to other government-owned incorporated entities, for several reasons:

- RMIMA will have operational autonomy in formulating and implementing policy, preventing the Parliament and Government from intervening in those decisions;
- RMIMA's policy decisions will have economy-wide impacts; and
- Since RMIMA will operate off its own balance sheet, it will have control over significant financial resources, including the Government's domestic and foreign accounts, and bank account balances essential to payment system settlements.

13.1. Governance

Overall responsibility for the operations and performance of RMIMA rests with its Board of Governors. The Board is charged with the formulation of all RMIMA policies, overseeing the implementation of these policies, and overseeing the operations and administration of RMIMA. These responsibilities extend to oversight of RMIMA's financial strength, financial performance, and risk management policies and practices.

The complexity of a monetary authority's policy decisions and operations, alongside the authority's operational autonomy demands that board members are suitably qualified and able

to protect stakeholder interests through not being too closely aligned with, or influenced by, both RMIMA management and the executive branch of government. Accordingly, the RMIMA Act will:

- Prescribe professional and technical experience requirements for Board members;
- Prohibit elected representatives of both national and local governments from serving as Board members, as well as officials of political parties; persons who have a professional relationship with any public agency or corporation, or who provide services to those entities; and any person who holds an equity interest in a financial institution; and
- Include conflict of interest and fiduciary provisions, to ensure that members of the Board of Governors act solely for the benefit of RMIMA and put the interests of RMIMA above their private interests. These requirements require disclosure of business, personal, and family interests; restrict benefits, rewards, remuneration or gifts from outside parties; and prohibit the use of confidential information for private transactions.

RMIMA will have robust auditing processes. In addition to the internal audit function, there will be an Audit Committee of the Board of Governors and external audit requirements. The Audit Committee can only comprise non-executive members of the Governing Board. The Committee's responsibilities will include overseeing the accounting processes, and financial reporting and disclosure processes; monitoring internal audits and control processes; ensuring that recommendations from internal auditors and external auditors are effectively carried out by the Governor and RMIMA senior management.

The accounts, records, and financial statements of RMIMA will, at least once a year, be audited in accordance with the International Standards on Auditing by independent external auditors, who shall be of good repute and have recognized international experience in the auditing of large financial institutions. The external auditor will report to the Audit Committee on key matters arising from the audit, particularly if there are concerns about material weaknesses in internal controls relating to the financial reporting process. The report of the external auditors will be published with the Monetary Authority's financial statements.

13.2 Accountability

Operational autonomy does not imply that RMIMA is not accountable to the Nitijela. Operational autonomy is, in effect, a mandate to undertake policy actions that are in the public interest, where that mandate is conferred through RMIMA's governing law, a law enacted by the Nitijela. It follows that RMIMA must operate in a transparent manner and that the Nitijela will actively monitor the continued suitability of that mandate and RMIMA's performance against that mandate. Accordingly,

- RMIMA must report to the Nitijela at least once a year, and more often if directed by the Nitijela or parliamentary committees, on its activities and performance against its mandate. The Governor can also request meetings with the Nitijela or its committees;
- Submit to the Nitijela and publish an annual economic report that reviews economic and financial sector conditions, policy settings, and RMIMA's performance against its mandate, as well as providing an economic and financial outlook for the following 12 months;
- Publish an annual financial stability report;

- Submit an annual financial report that has been externally audited to the Nitijela, and publish this report on the RMIMA website; and
- Publish any regulations issued by RMIMA in the Gazette.

The President can order an additional audit of RMIMA's financial statements, but this intervention cannot extend to assessments of the merits of policy decisions and the way such policy is implemented.

Under the RMIMA Act, RMIMA will be obliged to hold regular meetings with the Ministry of Finance on policy issues of mutual interest, and to generally cooperate with the Ministry of Finance and other government agencies. This includes providing the Ministry of Finance with information the ministry requests on Government accounts and investments held by RMIMA.

Operational autonomy is a qualified autonomy, as RMI is obliged to act in accordance with its governing law. Any party can apply for a judicial review of RMIMA's actions where these actions are not compliant with that law.

14. Concluding Comments

This paper has provided background to the Government's decision to establish the RMIMA as a public entity that will provide central banking services and act as an integrated financial sector regulator. RMIMA is needed so that the RMI Government can better respond to the critical vulnerabilities within the RMI financial system and implement a policy and regulatory framework that is aimed at the continued diversification and stability of RMI's financial system. This is a much wider set of responsibilities than covered by OBC's mandate and it will be more effective to incorporate the existing OBC within a new public authority than gradually expanding the mandate of OBC.

The structure of RMIMA will be different to the structure of the administrative organs within the RMI Government. RMIMA will be entitled to own goods or assets in its own name; take economic decisions and engage in economic and financial activities; to incur liabilities on its own behalf; and (iv) have a complete set of financial accounts, including a balance sheet of assets and liabilities.

RMIMA will operate autonomously off its own balance sheet so that it can provide core central banking services and to ensure the continuity of its operations. But it is still accountable to the Nitijela and ultimately RMI citizens through high standards of transparency and accountability and parliamentary oversight.

The Government intends to introduce the RMIMA Bill during the September 2024 session of the Nitijela, after extensive public consultation on the role of RMIMA and the Bill. This paper provides a basis for this consultation process.

In the interim, the MAET will do further work and consult with the Ministry of Finance on the capitalization of RMIMA—the amount of authorized capital to provide the financial strength RMIMA will need to operate and deal with any financial sector contingencies, and the amount that initially needs to be subscribed for RMIMA's establishment and early years of operation—as well as on the structure of that capital. MAET will also be developing a detailed plan to migrate OBC into RMIMA on RMIMA's establishment and to progressively add mandated functions to RMIMA's operations after its initial establishment. MAET will begin discussions with the Federal Reserve to clarify its procedures for opening accounts for RMIMA and access

to contractual credit lines. Throughout this establishment phase, and after RMIMA commences operations, the RMI Government will continue to liaise with IMF and other development partners to access technical assistance to build RMIMA's capability and to advise on specialist functions.