



# Establishment of Republic of Marshall Islands Monetary Authority

Sultan Korean, Peter Dirou and Parmendra Sharma

This Policy Paper (PP) was drafted jointly by Republic of Marshall Islands Office of Banking Commission (OBC) and Griffith Asia Institute's Pacific Islands Centre for Development Policy and Research (PICDPR). The PP was requested by OBC and will be presented to RMI Cabinet for implementation.

## POLICY PAPER

December 2022

## CONTENTS

---

Introduction	1
Policy context	2
Building an effective RMI Monetary Authority	4
Compact Agreement renegotiation	8
Concluding comments and recommendations	8
Notes	10

## ABOUT THE AUTHORS



**Sultan Korean** is the Banking Commissioner of the Republic of the Marshall Islands (RMI). He oversees the licensing and supervision of banks, non-bank financial institutions, and designated non-financial businesses professions (DNFPBs). He is also the Head of the RMI Financial Intelligence Unit and a member of the Republic of the Marshall Islands Compact Trust Fund Committee.



**Dr Peter Dirou** is an adjunct research fellow at the Griffith Asia Institute, working closely with Pacific Islands Centre for Development Policy and Research. He researches and advises on financial sector issues, primarily in Pacific Island countries and Southeast Asia.



**Dr Parmendra Sharma** is the Program Director of Pacific Islands Centre for Development Policy and Research (PICDPR) at Griffith Asia Institute. PICDPR is Pacific's research and policymaking capacity building program.

## Introduction

---

This paper recommends the reconstitution of the Marshall Islands Office of the Banking Commission (OBC) as the Republic of the Marshall Islands Monetary Authority, with an expanded range of financial sector responsibilities.

The establishment of a Monetary Authority 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 (Cabinet Minute 188 (2015), dated 9 December 2015).

That Cabinet decision was prompted by: the 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 further develop the financial system to help counter major economic threats and to ensure financial stability in relation to public and Government deposits; the cessation of the existing Compact of Free Association (Compact) in 2023; and the need to stimulate employment opportunities within RMI.

The establishment of a Monetary Authority did not proceed, but subsequent events to the signing of the 2015 Cabinet Minute have reinforced the rationale behind the original decision and the need to act urgently to address the many financial sector challenges that the RMI currently face today.

Subsequent events have also clarified that any solution to the international correspondent banking relationship problem will need US Government intervention to facilitate the banking arrangements the Monetary Authority and licensed domestic banks will need with US banks, including the Federal Reserve System. The RMI Government will also need financial support from the US Government, as well as technical assistance from the IMF and other organisations to establish the Monetary Authority. Given the critical importance of these issues to RMI's long term economic sustainability, they need to be addressed within the Compact Negotiations that recently commenced.



## Policy context

---

### *Current situation: RMI financial sector issues requiring a policy response*

The core problem confronting the RMI Government is that RMI's continued access to the US banking system is not guaranteed despite the fact that the RMI is authorised under the existing Compact Agreement with the US to use the US dollar as its legal tender.

Without this access the RMI banking system will not be equipped to meet the financing needs of the RMI economy, which would have a major impact on employment, business investment, and long term economic development.

RMI has only two licensed and regulated commercial banks—the Bank of the Marshall Islands (BOMI), which is locally-owned, and the Bank of Guam (BoG), a branch of a US FDIC insured bank. BOMI has seen

a progressive reduction in its correspondent banking relationships—a trend being experienced by all small banks in Pacific Island countries (PICs) due to global de-risking.<sup>1</sup> Its only remaining CBR is with First Hawaiian Bank (FHB)—a former subsidiary of BNP Paribas.<sup>2</sup> FHB has wanted to end that relationship since 2014, and it has only retained the relationship until BOMI finds another CBR. Without that CBR, BOMI customers will not be able to undertake international transactions. BOMI has not been successful in finding another US bank CBR, primarily due to stringent AML/CFT rules imposed under the US Patriot Act and the Bank Secrecy Act. The need to find an alternative mechanism by which BOMI is able to have direct access to the US Federal Reserve Payment System

is now urgent, as FHB has given final notice of its intention to end the existing relationship. Providing BoMI access to US Federal Reserve payment services will ensure that all critical US dollar banking services, including the supply of US notes and coins, are provided to the RMI Government and citizens. Furthermore, this will provide a level playing field for both banks to fairly compete for deposits and thrive within a well-regulated banking system, avoiding the possibility of BoMI potentially facing a liquidity crisis due to loss of deposit funds to BoG.

While BoG continues to maintain direct access to payment services of the US Federal Reserve system as

a result of its status as a US chartered bank, there is no guarantee it will retain an ongoing presence in the RMI. It has at various times expressed concerns over the costs of regulatory compliance, particularly AML/CFT requirements. If BoG was to cease operations in RMI, this would clearly exacerbate an already serious CBR problem, reduce the availability of banking services and place deposits of RMI citizens and government at risk. BoG has a reputational advantage due to being FDIC insured and a US chartered bank. It services large value customers, including holding a significant share of government deposits that are mostly sourced from Compact funds, and provides banking services for the RMI government.

Concerns over CBRs and the continuity of banking services also highlight the need for RMI to diversify sources of finance and broaden its financial sector. A wide ranging financial sector development plan is needed to respond to these challenges. That exercise underway, but it is inherently complex given the rise of FinTech. The recent passage of the RMI SOV Act, which authorises a privately operated decentralised digital currency to operate as legal tender for the RMI, potentially exposes the RMI to ML/TF and financial risks in the absence a sound legal and regulatory framework. Many other crypto-asset related proposals have been submitted to the Banking Commission but have been put on hold due to the fact the RMI still lacks an adequate regulatory regime for virtual assets and virtual asset services providers (VAs and VASPs) in line with FATF standards. The RMI Government will also need to build on OBC's existing regulatory capability so that the risks associated with FinTech related products and services are adequately addressed.

Inter-bank clearing and settlement is not currently regulated by the Banking Commission and is highly check-based. Both BoG and BoMI voluntarily cooperate to facilitate a manual check clearing process where checks are cleared daily. This process has generally worked well, but the Banking Commission has occasionally intervened to ensure that the manual interbank clearing arrangement between the two licensed banks continues without disruption. BoG has expressed concerns about the check clearing process being too costly and inefficient to maintain, and has urged BoMI seek approval for a US Bank Routing Number and membership with the US Federal Reserve in order to participate in its Check 21 clearing services.

## Recommended policy action

### Establishment of RMI Monetary Authority

The Banking Commission's extensive financial sector expertise and the fact it has already begun carrying out central bank related functions according to its legal mandate under the Banking Act 1987 and Cabinet Directive places it in an ideal position to evolve into a new RMI Monetary Authority. It will be more cost-effective to add new central bank functions to the Banking Commission rather than build this capability in another, or new, institution, as regulatory and policy work will account for most of any personnel costs in a new monetary authority; establishing a completely new central bank would place further pressure on already limited human resources, and it would also take a long time for a new institution to build relationships and international credibility. Accordingly, it is recommended that the RMI Government acts to expedite the establishment of the RMI Monetary Authority.

## General features of monetary authorities

Monetary authorities are a common feature of the international financial landscape, including in some PICs. These authorities typically have responsibility for currency issuance (whether that be a domestic or regional currency), government banking services, inter-bank payments and clearing, monetary

policy directed towards price stability, government cash and debt management, and foreign reserves management. Other responsibilities vary, often as a function of population size and the level of financial sector development. These other responsibilities may include banking licensing, regulation and supervision, and sometimes wider financial sector regulation

and supervision, financial sector development policy, financial inclusion, and oversight of any unit responsible for implementing and complying with

international AML/CFT standards. (The responsibilities recommended for the RMI Monetary Authority are elaborated in the next section).

The pressing practical policy consideration is whether a monetary authority is a suitable institutional arrangement for RMI, a small country with a largely underdeveloped financial system and where there is no national currency—the US dollar being the sole official currency, pursuant to Section 251 of the 2003 Compact Agreement.

## Pacific Islands experience

There are no like-for-like precedents among PICs. The Asian Development Bank recognises 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. The distinguishing features of PIC central banks, other than issuing a domestic currency, are the provision of banking and payments services to government and banks that are part of the clearing system, wide-ranging financial sector regulatory responsibilities, responsibility leading government for financial inclusion policies and initiatives, and in-house financial sector and economic research capability. Generally, the wider the range of responsibilities and capabilities PIC central banks have, the easier it has been for them to respond to new threats to the financial system and adapt to technological innovation.

Timor-Leste does provide a precedent, however. 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. While Timor-Leste is seen as a southeast Asian country and is seeking to join ASEAN, 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).<sup>3</sup> BCTL has operational autonomy and is viewed as a highly credible institution, and it has enhanced that credibility while progressively expanding its capabilities. A World Bank study concluded that the key elements behind BCTL's success were:

*early and uninterrupted assistance from development partners, a simple institutional and legal framework, reliance on a building-block approach for organisation development, sustained emphasis on improving the capacity of national staff and organisational learning, and stability of middle and senior management.*

*The consistent financial and technical support from donors and the government has given the institution the space and resources to pursue capacity building at a steady pace. At the same time, senior and middle management have strongly supported the institutional development roadmap and kept a consistent focus on reaching milestones and, ultimately the goal of becoming a fully independent central bank. Early successes have contributed to creating a strong organisational identity and culture, including demonstrating the importance and benefits of transparency and reaching out to stakeholders.<sup>4</sup>*

The BCTL experience provides a useful blueprint for the establishment and growth of the RMI Monetary Authority.

## **Building an effective RMI Monetary Authority**

---

The three key features of the BCTL experience are:

1. Building on an existing but narrowly focused entity;
2. Strengthening the operating and governance framework of the new entity; and
3. Gradually expanding operations, while building the necessary capability.

The RMI Monetary Authority could replicate this approach, progressively building on OBC's existing policy, regulatory, and operational capabilities. To do so, two broad sets of policy issues need to be addressed— institutional foundations and institutional strengthening.

### *Institutional foundations*

The foundational institutional issues are closely interrelated, with decisions on organisation form and funding being dependent on the scope of responsibilities for the Monetary Authority. The operations of the Monetary Authority will be governed by appropriate legislation that allows for future growth, and which also provides for robust governance arrangements.

While the imperative is to find a solution to the international correspondent banking relationship problem, supported by a financial sector development strategy, these considerations should not limit the institutional design of a new Monetary Authority. Any design needs to provide the flexibility policymakers need to be able to respond to emerging and new policy challenges. Any design should also permit the new authority to incrementally build its capability to meet the mandate it has been given: that was a key lesson of the BCTL experience.

The small size of RMI and the associated personnel and budget constraints will also influence institutional design. It will be more cost-effective to concentrate a wide range of responsibilities within the new authority, as opposed to developing several organisations with specialised but narrow skillsets. The institutional experiences of smaller countries, particularly PICs, will be more relevant than the experiences of bigger countries in this regard. Monetary authorities in small countries typically have a mandate to work across the financial sector and to engage in policy issues affecting consumers of financial services as well as providers of financial services.

### *Organisational form*

Whether a new institution is called a monetary authority or central bank is immaterial. The more critical issue for the RMI government is establishing the credibility of a new monetary authority so that it can establish international correspondent banking relationships and provide other banking services, such as taking government deposits and facilitating banking transactions on behalf of the RMI Government, interbank clearing and settlement, and liquidity support to RMI banks. These are newly added responsibilities to the ones that are currently carried out by the OBC. To do so, the Monetary Authority needs to operate off its own balance sheet.

### *Scope of responsibilities*

The new Monetary Authority will be a central participant in the banking system, as well as the regulator for the entire financial system. It will contribute to policy development and implementation in these areas, as well as on wider financial sector development and the Government's overall economic management, based on strong research and analytical capabilities. It will also provide national coordination of AML/CFT efforts with other key law enforcement counterparts to effectively implement international standards to combat money laundering, terrorist financing, and proliferation financing.

The core functions would be:

- Banking, clearing and currency services
- Government funds management
- Financial sector stability
- Financial sector development policy
- Economic research
- Management of specialised finance-related government administrative units.

## *Banking, clearing and currency services*

As a bank, the RMI Monetary Authority will provide correspondent banking, clearing, and settlement arrangements for the RMI Government. It would act as the Government's fiscal agent, providing deposits and payment services for the Government's operating expenditures. It could also provide a similar service to the Social Security Administration System.

The Monetary Authority could extend loans to banks and other financial sector participants to, for example, support individual bank/system liquidity or solvency, as many monetary authorities did in response to COVID-19 and the Global Financial Crisis. It is also possible that the Monetary Authority could play a role in selected policy lending—to further financial inclusion, for example, or to underpin economic activity—but the merits of this type of lending would require a rigorous policy assessment and would have to be rationalised with the mandate and activities of the Marshall Islands Development Bank.

Unlike most monetary authorities, a RMI Monetary Authority would not issue currency—issuance of US currency being a responsibility of the Federal Reserve System. However, it could be provided the flexibility under its legislation to issue a national currency of the RMI and undertake monetary policy if needed. The RMI Monetary Authority would be responsible for ensuring that there is an adequate stock of US dollars in circulation to meet the demand for currency. This could mean that the Monetary Authority might have to play a warehousing role to ensure that banks could meet customer demand for currency. In Timor-Leste, BCTL does issue local currency coins—centavos—where 1 centavo is equivalent to US 1 cent. RMI is unlikely to follow this precedent, but it is conceivable that RMI could issue a sovereign central bank digital currency that is equivalent to the US dollar, but which carried a name that identified it as a RMI sovereign currency. The RMI Monetary Authority would be responsible for formulating and implementing any policy on the issuance and use of a sovereign central bank digital currency.

## *Government funds management*

Given that the Monetary Authority is the Government's fiscal agent, it can play a wider role in government funds management—a treasury function. As a treasury, the Monetary Authority would manage: (i) Government cash flows to avoid holding unnecessary working balances and to earn interest on other balances; (ii) Government debt, being responsible for preparing a debt management strategy, issuing debt, and managing the maturity and risk profile of this debt; and (iii) other financial assets, including investments held outside RMI.

## *Financial sector stability*

The Monetary Authority's responsibility for financial sector stability would encompass financial sector regulation and supervision, lender of last resort facility, and deposit insurance.

While OBC's primary focus has been on the banking system, its mandate extends to non-banks—licensing of designated non-financial businesses and professions or non-financial services providers (DNFBPs) and to the AML/CFT obligations of banks and DNFBPs. This mandate needs to be broadened to include financing other than credit, such as capital raising. Capital raising is critical to longer-term economic development and businesses should not be forced to rely on bank or non-bank credit. Capital raising is not limited to initial public offerings that are listed on a stock exchange. Smaller businesses also need capital to finance their growth, typically equity shares or long-term debt instruments, but a legal framework is needed. This can be provided through corporations' law or law specific to small-scale capital raising. Innovations in small-scale capital raising, such as equity crowd funding and peer-to-peer lending, are well-suited to financing small businesses and would be captured under this expanded regulatory framework. As is the case for banking regulation,

the broad objective is to develop and implement a regulatory framework that finds an appropriate balance between incentivizing the issuance of securities and protecting those that invest in those securities. The framework would cover licensing, regulation, and supervision.

FinTech is now a feature of the financial sector landscape, and the regulatory framework also needs to cover FinTech innovations, including virtual assets. Internationally, policymakers are adjusting regulatory frameworks to respond to the associated opportunities and threats through, for example,

regulatory sandboxes, innovation hubs, and developing regulations to cover virtual assets and virtual asset service providers. RMI needs to develop this regulatory capability, drawing on international experiences. Not doing so would leave a serious gap in the regulatory framework and undermine the credibility of the Monetary Authority.

Lender of last resort facilities and deposit insurance facilities are respectively aimed at providing emergency liquidity for banks to avoid severe economic disruption and protecting depositors in the event of bank insolvency. The Monetary Authority will need to develop a policy on the use of this type of lending.

It will also need to develop a policy and design an insurance scheme for any local banks that are not FDIC-insured.



## *Financial sector development and policy*

The broad policy brief for the new RMI Monetary Authority should be to design a financial sector architecture that will meet the financing needs of RMI businesses and households. Describing a financial sector architecture is, in essence, an exercise in mapping risks to be financed against the type of financial institution needed to finance that risk. If the financial system comprises institutions that are only prepared to finance low-risk activities, then economic development will be compromised as the risk finance needed to underpin economic development will not be provided. Insurance and capital raising are important components of the risk spectrum.

In addition to the need for more emphasis on long-term investment finance discussed earlier, financing climate change adaptation is a critical policy issue for RMI (as it is for other PICs), and the Monetary Authority has a key role to play in developing the policies that are needed. A Monetary Authority with banking capability and international correspondent relationships can be expected to open up sources of

climate change financing, such as that provided by the Green Climate Fund (GCF), which channels financing through accredited national institutions. Accredited entities develop funding proposals for consideration by the Fund and oversee, supervise, manage, and monitor their respective GCF-approved projects and programs. The threshold set by GCF for achieving accreditation is high: very few PIC banks have met the standard, and it is unlikely to be met by existing RMI banks. Monetary authorities in small countries often become the lead agency for furthering financial inclusion on behalf of government, developing policies and strategies to achieve this end. That is the norm in PICs with central banks and for Timor-Leste.

The financial development plan is the key instrument for structuring policy on financial sector development, and any plan needs to be periodically reviewed and updated. Financial inclusion could be a component of the master plan, or it could be addressed in a separate exercise.

## *Economic and other research*

Central banks typically have an in-house economic research department, as overall economic structure and performance is inextricably linked to financial sector policy. The RMI Monetary Authority should also have this capability, aiming to have a small research team that can contribute to both economic and financial sector research, including financial inclusion. It is not efficient to have this research capability spread across several organisations in small countries.

## *Specialist finance-related government administrative units*

It is not uncommon for the Financial Intelligence Unit (FIU) of a small country to be housed within its

Monetary Authority, where that authority exists. The head of the authority is empowered to oversee the operations of the FIU, but the level of operational autonomy and extent of its integration with the wider activities of the authority can vary. The RMI FIU is integrated into the existing OBC structure, and that arrangement can be transferred to a new RMI Monetary Authority.

## *Funding and capital*

OBC is currently funded through annual appropriations from the government budget. In contrast, a new Monetary Authority would provide banking services and would need to operate as a financial institution off its own balance sheet.

There are two key policy considerations. First, the Monetary Authority needs to be able to meet any financial liabilities arising from its own banking

activities—for example, government deposits and settlement balances held by banks—and from providing support to the financial system—for example, repurchasing government securities for monetary management purposes; and second, the operating expenditures of the Monetary Authority need to be financed in a way that encourages the efficient use of resources. A mixed funding model could be employed—a mix of budget allocation and the Monetary Authority's own financial resources—but this could compromise the operational autonomy of the Monetary Authority. A better model would allow the Monetary Authority to fund all its expenditures and financial liabilities from its own balance sheet,

with some agreed mechanism to constrain operating expenditure.

Capital requirements of monetary authorities are relatively small, compared with other banks, on account of their government ownership and ability to create money when they issue their own currency. Even

when they do not issue their own currency, the capital requirements are not large. In BCTL's case it held capital of USD 70 million against total assets of USD 991 million at end-2021. Its asset base largely comprised deposits at other central banks (53%) and investments in securities (25%). Its liabilities largely comprised government deposits, including deposits of the social security fund (55%), and deposits of domestic financial institutions (32%).

Determining the capital requirements of a monetary authority is not a formulaic exercise, as policy responsibilities vary across monetary authorities.

The general approach is to ensure that any monetary authority has sufficient financial strength, where “financial strength refers to the ongoing ability of the central bank to fund and implement operations in line with the policy aims for which it is independently responsible”.<sup>5</sup> The initial capital of the Monetary Authority could be allocated capital (for example, through an allocation of government securities or a transferring ownership of foreign reserves held by the government to the Monetary Authority) sufficient to fund operating expenditure and provide a buffer to cover future contingencies.

Capital requirements are also influenced by any legislative provisions covering retained earnings and dividend payments to government, and by recapitalisation arrangements, whenever this becomes necessary. The Monetary Authority either needs to maintain a capital buffer to protect against losses, or there could be a standing commitment from the government to recapitalise when needed (for example, if the Monetary Authority suffered losses as a result of providing financial support to the banking system). The choice of approach turns on what arrangement is seen as the more credible in the eyes of market participants and international counterparties.<sup>6</sup> For RMI, a standing commitment to capitalise and recapitalise the RMI Monetary Authority, when necessary, could be incorporated into the renegotiated Compact agreement, and this would likely enhance perceptions of the RMI Monetary Authority’s credibility.

### *Governance and Autonomy*

Compared to OBC, a new RMI Monetary Authority would have wider responsibilities and it will operate in a fundamentally different way—as a financial institution with operational autonomy operating

off its own balance sheet, and potentially outside the coverage of the Public Service Commission and financial management oversight of the Ministry of Finance. Not only will the new Monetary Authority have to understand the banking system and wider financial system, but it will also have to operate as a financial institution and to a high standard: ongoing credibility will be critical to being able to discharge its policy functions and maintain international financial relationships.

The greater the operational autonomy and the greater the financial values at risk, the more extensive the oversight arrangements that are needed. At

a minimum, a regular review mechanism will be needed, but a governor and a governing board would provide greater oversight. External advisors could be appointed to advise the governor and the governing

board, strengthening the governance framework, and compensating for any local resource constraints. Ideally, external advisors would collectively bring relevant governance experience, financial sector experience, and specialist technical skills. Appointees from outside RMI could be considered to strengthen a team of external advisors.

The governance arrangements will be specified in the law governing the Monetary Authority.

### *Legal framework*

The legal framework constitutes the monetary authority, provides its powers, and governs its operations. The framework stipulates:

- policy and regulatory responsibilities and associated powers to make regulation;
- governance arrangements, including respective roles of the responsible minister, governor, governing board, and senior staff, and the appointment and terms of board and senior executive staff;
- financial operations, including funding arrangements, ongoing financial relationship with government (covering, for example, banking services, distribution of any surplus, and access to recapitalisation resources); and permissible investments and types of financial instruments that can be used to achieve policy goals; and
- reporting and other information requirements, such as an annual report and policy statements.

The law governing the Monetary Authority would also cover the relationship of that law to other financial sector legislation—separate legislation on banking or the payments system for example. In RMI’s case, the introduction of a Monetary Authority act would have wide-ranging implications for existing legislation. The Bill introducing the Banking (Amendment) Act 2021 would need substantial revisions, given the proposed scope of the Monetary Authority’s responsibilities, and the Financial Management Act 1990 and associated regulations would have to be reviewed in light of the proposed changes in government banking and payment arrangements. If the Monetary Authority is given powers to regulate securities issuance, then new capital raising laws may be needed, especially for small-scale capital raising, and these laws would also need to be aligned with any financing provisions under corporations law. AML/CFT legislation may also need to be reviewed.

The IMF is well-placed to provide any technical support that is needed to draft a new law governing the operations of a new RMI Monetary Authority.



## *Institutional strengthening*

Given its responsibilities and economic impact, the RMI Monetary Authority will need to have a highly competent technical staff, as well as being a well-managed and well-governed organisation. Human resources policies will have to be aligned to these objectives, especially policies on remuneration and staff development. Staff remuneration will need to be delinked from prevailing Public Service Commission remuneration arrangements, and staff will need to continue to develop technical capacities to address emerging policy challenges and respond to financial sector innovation.

The World Bank's case study on BCTL highlighted the importance of "sustained emphasis on improving the capacity of national staff and organisational learning, and ... consistent financial and technical support from donors and the government" in allowing BCTL "to pursue capacity building at a steady pace".<sup>7</sup> RMI is well-placed to emulate BCTL's experience, given its strong existing multilateral—IMF, World Bank, ADB— and bilateral—particularly the US—relationships.

These relationships have provided access to training and technical assistance. The IMF has already offered to provide technical assistance to RMI to establish

a monetary authority and introduce a sovereign central bank digital currency, and OBC is a member of the Association of Financial Supervisors of Pacific Countries, for which IMF provides the Secretariat

through its Pacific Financial Technical Assistance Center (PFTAC). OBC has recently signed a research support agreement with Griffith University in Australia, through its Pacific Islands Centre for Development Policy

and Research (formerly the South Pacific Centre for Central Banking). It is also conceivable that the South Pacific Central Bank Governors' forum would expand membership to include new PIC monetary authorities, in the way that it invited BCTL to join the forum.

## **Compact Agreement renegotiation**

---

Given the importance of a monetary authority to a nation's economic performance, the establishment and ongoing operation of the RMI Monetary Authority is closely aligned with the objectives of the Compact Agreement between the RMI and the US governments to promote RMI economic development and budgetary self-reliance. A 2020 memorandum from the Banking Commissioner to the Chairman of the Economic and Trust Fund Steering Committee identified the opportunity to potentially access sector grants under

the Agreement; it recommended the addition of a new Article VI concerning banking and financial sector development within the existing Title Two—Economic Relations.<sup>8</sup> The impetus for that recommendation was the international CBR problem, but that reasoning could be broadened to include any aspect of the capitalisation, establishment, and ongoing operation of the RMI Monetary Authority. There is also an opportunity to link the proposed new article with the existing Title TWO Article I—Grant Assistance – and Article V—Finance and Taxation—to address the capitalisation of the new RMI Monetary Authority and its ongoing financial relationship with the RMI government.

The CBR problem has worsened since that recommendation. BOMI has not been able to secure replacement CBRs, as bigger banks have become even more reluctant to have international CBRs with small banks in PICs. Furthermore, the Federal Reserve has indicated that it would not be able to provide banking services through an RMI government account, where transactions through that account were on behalf of RMI commercial entities. Access to the US banking system for an RMI licensed bank does not seem possible under the existing institutional framework and a government-to-government agreement is needed to break the impasse.

Linking the establishment and ongoing operation of the RMI Monetary Authority to a new Compact Agreement would also provide additional pathways to building capacity within the Monetary Authority and underpin its sustainability, more generally. This approach offers the opportunity for close cooperation between the RMI Monetary Authority and key US government entities—Federal Reserve System, the Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency, and the Securities and Exchange Commission (SEC)—as well as private financial institutions.

## **Concluding comments and recommendations**

---

The RMI financial system rests on an extremely insecure footing due to the inability of BOMI to find replacement CBRs and uncertainties over the continued presence of BoG. There is a very real prospect of losing access to the US banking system, which would preclude individuals, businesses, and the government from transacting with non-RMI parties. Private investment would be blunted.

Establishing a new RMI Monetary Authority is needed to underpin the security of financial services in RMI,

with support from the US Government to facilitate the Monetary Authority holding accounts within the US banking system. Establishing the Monetary Authority would provide the foundation for managing currency circulation in RMI, including development work on a central bank digital currency. It would offer banking services to the government, domestic clearing and settlement services for banks operating in RMI, as well as liquidity support to banks through lender of last resort facilities, and possibly in the future the issuance of a national currency and the conduct of monetary policy to support economic development. The Monetary Authority would be responsible for the stability of the financial system and would assume wide-ranging financial sector regulatory responsibilities, including AML/CFT supervisory oversight, intelligence gathering, and investigative support work for RMI law enforcement agencies. The regulatory framework would provide impetus for the development of non-bank financial institutions and investment finance mechanisms to underpin private sector development in RMI, while protecting consumer and investor interests. The Monetary Authority would also be responsible for economic and financial sector research, including preparing a financial sector development plan.

The Timor-Leste experience provides a useful precedent for RMI. This experience demonstrated the usefulness of a building block approach—building on existing responsibilities and competencies to add new responsibilities and more technical skillsets—in a phased manner. This experience also demonstrated the importance of building international credibility through good management and strong financial discipline.

The World Bank concluded that BCTL succeeded by “starting with a simple structural design and setting modest goals on the basis of which more complex functions and structures could be added” and by “[i]ntroducing transparency and communication strategies to reach a wide audience early on”.<sup>9</sup> It also demonstrated the importance of international networks to building local capability. There is no reason RMI cannot replicate this experience.

### *Recommended policy action*

1. Agree to the reconstitution of OBC as the RMI Monetary Authority;
2. Authorise the Commissioner of the Office of the Banking Commission to lead work on the reconstitution of OBC as the RMI Monetary Authority and provide the necessary funding for this work;
3. Direct the Commissioner of the Office of the Banking Commission to
  - I. Develop an implementation plan, and
  - II. Request technical assistance from the IMF to help prepare this implementation plan, design the structure of the RMI Monetary Authority, and draft a governing law;
4. Incorporate the establishment and ongoing financial support for the RMI Monetary Authority as part of a comprehensive financial sector development plan within a renegotiated Compact of Free Association.





## Notes

1. Global financial institutions threatening to cut off access to global financial system for local banks and remittance companies in certain regions, putting them at risk to the global financial system;
2. FHB recently bought back its shares from PNB Paribas;
3. Both the Banking & Payments Authority and the Central Payments Office were set up by United Nations Transitional Administration of East Timor, prior to Timor-Leste gaining independence in 2002.
4. Lorena Viñuela, 'Timor-Leste Case Study: The Central Bank of Timor-Leste', in *Institutions Taking Root: Building State Capacity in Challenging Contexts* (World Bank Group: 2014).
5. David Archer and Paul Moser-Boehm, 'Central bank finances', BIS Papers No 71 (Bank for International Settlements: 2013) 66.
6. See Archer and Moser-Boehm 70–72 for a more detailed discussion.
7. Viñuela, 348.
8. Memorandum, Republic of the Marshall Islands Office of the Banking Commissioner (November 27, 2020).
9. Viñuela, 372.

## ABOUT THE REPUBLIC OF MARSHALL ISLANDS OFFICE OF BANKING COMMISSION

---

The Office of the Banking Commission (Commission) was established under Title 17 Chapter 1 Banking Act 1987 (the Act) to ensure the safety and soundness of the Republic of the Marshall Islands (RMI) banking sector and also deter money laundering (ML) and terrorist financing (TF) in the financial system.

## ABOUT THE PACIFIC ISLAND CENTRE FOR DEVELOPMENT POLICY AND RESEARCH

---

Pacific Islands Centre for Development Policy and Research (PICDPR) 's predecessor, the South Pacific Centre for Central Banking (SPCCB) was founded in 2016 to bring together world-class economic and finance experts, with a clear aim to help build capacity for research and policy formulation and has been committed to developing capacity for research and policy formulation at the South Pacific Central Banks.

The PICDPR intends to expand SPCCB's capacity development goals and objectives to policymaking and research institutions and organisations beyond the central banks in the region. The COVID-19 pandemic has demonstrated yet again the need for various institutions to collaborate within the country and regionally.

## ABOUT THE GRIFFITH ASIA INSTITUTE

---

The Griffith Asia Institute (GAI) is an internationally recognised research centre in the Griffith Business School. We reflect Griffith University's longstanding commitment and future aspirations for the study of and engagement with nations of Asia and the Pacific.

At GAI, our vision is to be the informed voice leading Australia's strategic engagement in the Asia Pacific—cultivating the knowledge, capabilities and connections that will inform and enrich Australia's Asia-Pacific future.

We do this by: i) conducting and supporting excellent and relevant research on the politics, security, economies and development of the Asia-Pacific region; ii) facilitating high level dialogues and partnerships for policy impact in the region; iii) leading and informing public debate on Australia's place in the Asia Pacific; and iv) shaping the next generation of Asia-Pacific leaders through positive learning experiences in the region.



**REPUBLIC OF THE MARSHALL  
ISLANDS OFFICE OF THE BANKING  
COMMISSION**

PO Box 1408  
Majuro, Marshall Islands 96960

**Email:** : [administration@rmibankingcomm.org](mailto:administration@rmibankingcomm.org)

---

[rmibankingcomm.org/](http://rmibankingcomm.org/)

**PACIFIC ISLANDS CENTRE FOR  
DEVELOPMENT POLICY AND  
RESEARCH**

Griffith University Nathan campus  
Nathan Queensland 4111, Australia

**Email:** [p.sharma@griffith.edu.au](mailto:p.sharma@griffith.edu.au)

---

[griffith.edu.au/asia-institute /our-research/pacific-islands-centre-development-policy-research](http://griffith.edu.au/asia-institute/our-research/pacific-islands-centre-development-policy-research)

**GRIFFITH ASIA INSTITUTE**

Griffith University Nathan campus  
Nathan Queensland 4111, Australia

**Email:** [gai@griffith.edu.au](mailto:gai@griffith.edu.au)

---

[griffith.edu.au/asia-institute](http://griffith.edu.au/asia-institute)