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MOROCCO

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October 2016

TECHNICAL NOTE—BANKING SUPERVISION

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BANKING SUPERVISION

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This Technical Note was prepared in the context of a joint IMF-World Bank Financial Sector Assessment Program (FSAP) mission in Morocco during April 2015 led by Ms. Jianping Zhou, IMF and Mr. Gabriel Sensenbrenner, World Bank, and overseen by the Monetary and Capital Markets Department, IMF, and the Finance and Private Sector Development Vice Presidency, World Bank. The note contains the technical analysis and detailed information underpinning the FSAP assessment's findings and recommendations. Further information on the FSAP program can be found at http://www.imf.org/external/np/fsap/fssa.aspx, and www.worldbank.org/fsap.

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CONTENTS

Glossary

ALM	Asset and Liability Management
AML-CFT	Anti-Money Laundering and Combating the Financing of Terrorism
AWB	Attijari Wafa Bank
BAM	Bank Al-Maghrib
BCP	Basel Core Principles for Effective Banking Supervision
BMCE	Banque Marocaine du Commerce Extérieur
BOA	Bank of Africa
BPM	Banque Populaire du Maroc
CAEMU	Central Africa Economic and Monetary Union
CAR	Capital Adequacy Ratio
CCSRS	Systemic Risk Supervision and Coordination Committee
CDEC	Disciplinary Committee for Credit Institutions
CDG	Caisse de Dépôts et de Gestion
CDVM	Conseil Déontologique pour les Valeurs Mobilières (Securities Commission)
DAPS	Insurance and Social Security Directorate
DH	Dirham
DSB	Banking supervision Directorate
FSAP	Financial Sector Assessment Program
FX	Foreign Exchange
GDP	Gross Domestic Product
ICAAP	Internal Capital Adequacy Assessment Program
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
LCR	Liquidity Coverage Ratio
MOU	Memorandum of Understanding
NPL	Non-Performing Loan
OPCVM	Mutual Fund (Organisme de Placement Collectif en Valeurs Mobilières)
PRCI	Internal Crisis recovery Plan
SANEC	Système Analyse Notation Établissements de Crédit
WAEMU	West Africa Economic and Monetary Union
WB	World Bank

EXECUTIVE SUMMARY[1]

Morocco applies international best practices in the area of banking supervision.[2] Nevertheless, it is important that its banking supervision system adapt to both the new international standard[3] implemented following the global financial crisis and the structural changes in the Moroccan banking system. In response to these challenges, the Bank Al-Maghrib (BAM) has adopted a new banking law,[4] which includes principles on the supervision of systemically important banks, the strengthening of governance mechanisms, a framework for the orderly resolution of credit institutions, and expansion of the cooperation between regulators.

The roadmap established by the Banking Supervision Directorate (DSB) following the identification of gaps[5] vis-à-vis the new Basel framework for effective banking supervision involved the adoption of a circular on internal control and the directive on governance that anticipated the implementing regulations for the banking law. These measures form part of the implementation of a supervision system based on the systemic importance, structure and risk profile of institutions. The role of special committees of the board of directors has been strengthened, particularly the risk committee, which guides the board in the area of risk management and strategies. These committees must be made up of at least one third independent board members. Moreover, the risk measurement and management mechanism must be based on key functions (risk control, continuous monitoring, compliance, and internal audit) and must be effective on both a solo and a consolidated basis.

The new banking law has created a Systemic Risk Supervision and Coordination Committee (CCSRS), the operational procedures of which will be established by decree. The latter should include measures to identify and contain potential conflicts of interest that could result from the involvement of its members in the definition of macroprudential policies. In December 2014, BAM identified the three main banking groups in the country as systemically important credit institutions using a mapping process based on criteria of size, interconnectedness and complexity (including cross-border operations). The mission notes that the Caisse de Dépôts (CDG), which is assimilated to a credit institution has not been identified as a systemically important institution. The law provides that BAM may require a systemically important credit institution to prepare a resolution plan, i.e., the so-called "internal crisis recovery plan" (PRCI). The mission recommends appropriate technical

[1] This technical note was prepared by Philippe Aguera, World Bank, and Didier Debals, IMF external expert. The cutoff date of the analysis in this note is July 2015.

[2] Morocco was compliant or largely compliant with 21 of the 25 Core Principles for Effective Banking Supervision at the time of its last assessment in 2007.

[3] Increase in the number of Core Principles for Effective Banking Supervision from 25 to 29 in September 2012.

[4] December 24, 2014.

[5] Banking law, internal control and governance, classification and provisioning of loans, liquidity, treatment of systemic/non-systemic banks, coordination with other supervisors, and country and transfer risks.

assistance for the completion of the resolution manual and preparation of a strategy for outreach and communications with the banks concerned.

In line with the treatment of systemically important banks, other regulations are being prepared or finalized, such as the role of independent board members, the licensing procedure and the treatment of non-bank equity holdings. Supervision tools are being created or modernized, such as the internal manual on the internal resolution of credit institutions, the supervision of financial conglomerates, the updating of the cooperation agreements with supervisors (MOUs), and the revision of the bank rating system (SANEC). The supervisory colleges for systemically important banks are in place. Since 2013, BAM has also undertaken a project to gradually bring banks into compliance with the new Basel III capital requirements and the liquidity coverage ratio (LCR) as from July 2015.

To this ambitious but necessary program, the mission recommends adding a review of local regulations for the identification and provisioning of nonperforming loans (NPLs) as a priority, in order to bring them into line with international standards.[6] This reform, which would open the way to the adoption of the advanced approach in the area of credit risk by the largest institutions, would place Morocco in compliance with international best practices. The mission also notes that the development of the international activities of the main Moroccan banks requires even stronger supervision, given the weight that these activities already represent in the consolidated banking sheet and income. The identification of discrepancies between the prudential and accounting regulations in the host and home countries and the adoption of the IFRS, as required by BAM, for all entities in the group would make it possible to better identify and measure risk. The updating and effective implementation of guidelines on the deployment of an Internal Capital Adequacy Assessment Process (ICAAP) in the banks also seems necessary to allow for better control by the supervisory authority over the effectiveness of governance in the areas of risk management and internal capital adequacy vis-à-vis the risks identified.

Beyond the strengthening of macroprudential supervision, the mission recommends an in-depth asset quality review at systemically important banks on a consolidated basis every three years. This work would help to identify the completeness and reliability of the loan portfolio data. It would also provide an opportunity to verify the method of valuation of the collateral, particularly real property, and to identify credit concentrations. This review would round out the financial stability toolkit, particularly by providing greater relevance to stress tests.

The success of this effort to modernize the laws and regulations, upgrade the supervision tools and effectively implement best practices in credit institutions is dependent on a reorganization of the DSB and a net increase in its capacity, in terms of both staffing levels and staff quality. Consideration could be given to refocusing the DSB on its fundamental missions (micro- and macroprudential supervision). Currently, the DSB does not have sufficient operational

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[6] Moroccan credit institutions are applying IFRS rules for establishing consolidated accounts.

resources to deal with a simultaneous crisis in the three systemically important banks, particularly as two of them are part of financial conglomerates.

Table 1. Main Recommendations

Recommendations	Priority [1/]
A. Supervision of cross-border activities	
Inventory the prudential and accounting regulations in the host country and home country (Morocco) and identify discrepancies.	I
Supplement the existing MOUs in light of the provisions of Articles 108 and 112 of the banking law and international best practices in the area of banking crisis resolution, particularly those concluded with regulators where subsidiaries of Moroccan banks are systemically important.	NT
Accelerate in cooperation with the host banking supervision authorities, the reduction of Bank of Africa (BOA) cross holding (BMCE group).	I
B. Prevention of difficulties, crisis management and resolution	
Develop an overall communications policy for periods of crisis, both between regulators and vis-à-vis the general public.	I
Plan appropriate technical assistance for the completion of the manual for the resolution of failures of systemically important banks and outreach and communications with the groups concerned.	I
Organize a cross-border crisis simulation exercise as soon as possible.	I
C. Supervisory approach and techniques	
Enhance the identification of red flags and early warning signals in the SANEC tool.	NT
Automate all tools used by the banking supervision department.	NT
Update and implement the 2007 ICAAP directive and use the results to calculate economic capital.	NT
Enhance the contribution of on-site inspections by producing formal reports.	I
Establish a prudential framework to track risks created by financial conglomerates.	NT
Implement an asset quality review every three years at systemically important banks.	NT
D. Risk classification and provisioning	
Specify the criteria for the identification of special mention (watch) loans in light of Articles 58 and 59 of the circular on internal control.	I
Conduct an impact study to bring local standards for the identification of nonperforming loans in line with the IFRS by completing the notion of default.	I
Reconsider tax's rules on the deductibility of prudential provisions regarding non-performing loans and special mention loans.	NT
E. Management of concentration risk	
Introduce a legislative requirement for the preparation of consolidated accounts by unlisted industrial and commercial groups.	NT

Table 1. Main Recommendations (concluded)	
Recommendations	**Priority 1/**
Adopt a risk-based approach (pillar 2) for the application of the threshold of 20 percent in order to adjust it on the basis of the systemic nature of the credit institution and the soundness of its internal control system.	NT
Lower the 20 percent threshold for exposures to related parties.	NT
F. Management of liquidity risk and introduction of the LCR	
Schedule thematic on-site inspection missions to assess the reliability of the calculation of the LCR.	NT
Introduce guidelines for the development of emergency plans.	I
Study the possibility of calibrating liquidity requirements on the basis of the risk profile of the institution, at least for systemically important banks.	MT
G. Banking supervision conditions	
Refocus DSB activities on its core responsibilities (micro- and macrobanking supervision).	NT
Adopt a matrix organization by creating a specific unit for each systemically important bank and units with crosscutting responsibilities for cross-border activities and sensitive risks (real estate risk, money laundering) or risks requiring particular expertise (market risk, ALM, and financial conglomerates).	NT
Prepare a recruitment plan to cover BAM's expanded responsibilities in the areas of both micro and macroprudential supervision of the banking system.	MT
Review the salary scale to enable BAM to recruit and retain experienced staff.	NT
Include a provision in the draft new charter for BAM to authorize the coverage by credit institutions of some of the DSB's operating costs.	I
Authorize the use of external experts with the professional skills needed to assist the DSB during exceptional missions or missions that require special expertise.	NT
1/ Immediate (within one year), Near Term is 1–3 years, Medium term is 3–5 years.	

MISSION CONTEXT[7]

1. **At the request of the authorities, the mission identified the discrepancies with the Core Principles so as to enable BAM to prepare a roadmap leading to full compliance with the new framework.** When preparing for the BCP assessment, the mission agreed with the authorities not to undertake a full BCP assessment due to the recent overhaul of the banking supervision framework (new banking law and regulations) which is not fully effective yet. Together with BAM, the mission identified seven main areas on which the working sessions focused: supervision of cross border activities, prevention of difficulties, crisis management and resolution, supervisory approach and techniques, risk classification and provisioning, management of concentration risk, management of liquidity risk and introduction of the LCR and banking supervision conditions. Wide-ranging discussions took place with all of the banking supervision teams, the main banks and the auditors. The mission also met with the other regulators in the financial sector. The mission would like to make particular mention of the quality of the proactive approach adopted by BAM since late 2012 to ensure the implementation of the new principles as quickly as possible. The enactment of the banking law in late December 2014 will make it possible to complete the implementing regulations and apply them in the coming months.

A. Supervision of Cross-Border Activities[8]

2. **Over the past few years, Morocco has seen an unprecedented expansion in the cross-border activities of its main banks (AWB, BPM and BMCE).[9]** At end–2013, they were present in 23 countries, with a particular concentration in Francophone Africa (eight in the WAEMU zone and five in the CAEMU zone). This international expansion has been reflected in the distribution of credit (15.4 percent at end–June 2014) and net income (16.7 percent at end–June 2014) of the three main Moroccan banking groups. In addition, the subsidiaries of Moroccan banks are systemically important in several sub-Saharan African countries[10] where they represent more than 25 percent of loans. In these circumstances, economic and financial difficulties in one or more host countries can significantly impact one or more of these groups and, as a result, the entire Moroccan banking system by contagion effect. These three large banks are also systemically important because they account for two-thirds of the deposits and loans of the Moroccan banking system, so that, in the same way, serious financial difficulties in one or more of these Moroccan banks would have repercussions for their establishments abroad, particularly in Africa, and this could mean upheaval for local banking systems, which are still fragile. Moroccan banking supervision has taken the

[7] The cutoff date of the analysis in this note is July 2015.

[8] This topic refers primarily to Principles 3 (cooperation and collaboration, 5 (licensing criteria), 6 (transfer of significant ownership), 7 (major acquisitions), 12 (consolidated supervision), 13 (home-host relationships), 21 (country and transfer risks), and 26 (internal control and audit).

[9] Banque Marocaine du Commerce Extérieur (BMCE): 16 countries; Attijariwafa Bank (AWB): 9 countries; Crédit populaire du Maroc (CPM): 9 countries.

[10] Côte d'Ivoire, Central African Republic, Niger, and Mali.

measure of this challenge by laying the groundwork for cross-border supervision based on three key pillars:[11] control of cross-border expansion, supervision on a solo or consolidated basis, and enhanced cooperation with the host countries.

Control of Cross-Border Expansion

3. **With the new banking law,[12] any proposal to create or purchase subsidiaries abroad or to expand direct or indirect holdings of the capital of the banking group beyond a threshold of 5 percent is subject to the prior authorization of the supervisory authority.** This provision is clarified in the circular on acquisitions currently being prepared. The DSB examines the prudential impact on the group of any operation to establish a presence abroad, in terms of capitalization and the capital adequacy ratio. The assessment also takes into account the capacity of the group to adequately guide its new subsidiary, in particular by taking into account the opinion of the regulator of the host country. As well, credit institutions must advise BAM of the annual program for the expansion of their network in Morocco and abroad (Article 45).

4. **This control of cross-border expansion is supplemented by biannual meetings between BAM and the banking groups concerned in the context of the Africa Committee, which was established following the adoption of a code of good conduct.** In this context, the banking groups concerned "undertake, in particular, to not expand in particular geographic areas if the conditions for the exercise of their activities on a sound basis are not present there or if there is a risk of concentration, so as to avoid any competitive practices that could be harmful to their financial or organizational balance, to adopt a cooperative approach in information-sharing and co-development between Morocco and the host countries, and to work toward the respect of sound ethical practices."

Supervision on a Solo and Consolidated Basis

5. **BAM has since 2013 been receiving a whole range of prudential and accounting documents, enabling it to establish a constantly expanding database of the cross-border activities of a banking group, particularly: financial and prudential statements, audit reports, and reports on inspections conducted by parent companies and host country supervisory authorities.** Moreover, risk-based supervision is being implemented by means of the preparation of a rating for each establishment, taking into account the quality of the assets, their weight in the total balance sheet of the group, profitability, capitalization, the country risk level, and the assessment of the host country regulator.

6. **To supplement this remote supervision, joint on-site inspection missions[13] are conducted when the risk indicators show cause for concern.** Priority attention is given to the

[11] See the policy on the supervision of the foreign subsidiaries of Moroccan banking groups. BAM, September 2014.

[12] Articles 9 and 40 of the banking law.

[13] The WAEMU Banking Commission participated in the mission on the mechanism for the monitoring of foreign subsidiaries at AWB and CPM.

quality of the assets, the organizational structure of the functions within the group and the subsidiary and the interactions between them, governance, internal control arrangements, risk management, and monitoring systems, and the accounting system for purposes of the consolidation of the accounts. BAM and the WAEMU regulator began to coordinate their on-site inspection missions in 2014.

7. Consolidated supervision covers not only the respect of the prudential standards but also the effectiveness of the parent company's mechanism for monitoring its cross-border activities. In this context, BAM's ongoing supervision or off-site inspection activities focus in particular on the capacity of the parent company, through its governance system, to provide appropriate guidance regarding risks incurred, the solid anchoring of the local monitoring arrangements in those of the parent company to ensure convergence of the risk management, audit, and compliance mechanisms. Moreover, the banking groups concerned are also subject to prudential standards[14] (solvency, Tier 1 capital, risk diversification), and to international accounting standards for the preparation of their consolidated accounts, particularly as regards loan depreciation. From a prudential standpoint, the Moroccan regulations impose rules for the deduction of bank equity holdings from the capital of banks and sovereign risk weightings based on the country ratings. A country monitoring function is being put into place to compile quantitative data and track qualitative data on the political, economic, and security situation in the countries in which Moroccan banks have a presence.

Cooperation among Regulators

8. Cooperation agreements on supervision have been signed with most of the supervisory authorities of the host countries in which Moroccan banks have subsidiaries. A new generation of Memorandum of Understanding (MOU) is being introduced to take account of the new international standards or practices so as to achieve enhanced cooperation between regulators. Two initial MOUs of this type have been signed with Madagascar[15] and Djibouti.

9. Sharing of information on a quarterly basis is taking place with some foreign counterparts (particularly in the WAEMU zone), resulting in better information on the operation of entities belonging to the groups. This exchange of data on banking groups and their subsidiaries is based on a framework established in advance by BAM.

10. In order to enhance the cooperation begun by means of these remote exchanges, supervisory colleges dedicated to Moroccan banking groups with a foreign presence have been set up. These annual meetings, in which the banking group concerned also participates, make

[14] A consolidated LCR is being studied.

[15] March 13, 2015.

it possible to review the financial and prudential position of the banking group and its subsidiaries, and the supervision actions taken and planned by the home and host authorities.

B. Prevention of Difficulties, Crisis Management and Resolution[16]

11. As part of its preventive actions, BAM has a series of tools adapted to the implementation of corrective measures: formal notice to the managers of a credit institution, caution, injunction for the restoration of a declining financial or prudential position including the possibility of requiring a recovery plan, warning, prohibition or limitation on the distribution of dividends, and call on shareholders. Moreover, when there is no response to the caution or warning, BAM may suspend one or more managers, prohibit or restrict certain activities, and after seeking the opinion of the Disciplinary Committee for Credit Institutions (CDEC), appoint an interim administrator or withdraw the license. However, between 2010 and 2014, only 4 of the 14 disciplinary sanctions issued by BAM have involved banks.

12. The manual for the handling of difficulties in credit institutions prepared in 2006 by the DSB is being updated following the enactment of the new banking law. It covers the actions to be taken when the management or position of a credit institution no longer offers sufficient guarantees of its solvency, liquidity and profitability (Article 86 of the banking law) or its internal control environment. Based on the score provided under the system for rating credit institutions (SANEC), the manual identifies corrective measures that can be taken when one of the aforementioned risk criteria is rated 4 or 5. In these cases the institutions concerned are subject to "closely watched supervision," which involves additional reporting requirements, enhanced on-site inspections, and periodic meetings with the managers and auditors. More specifically, there are measures to issue an injunction against any institution rated 4 (on a scale of 5) for the criterion "capital and capital adequacy." The injunction may be accompanied by a requirement to prepare a recovery plan supported by an independent expert when certain criteria are present (size and complexity of the credit institutions, poor governance, etc.). The manual lists the required contents of the recovery plan and the measures that BAM can take. When the credit institution is rated 5, the list of restrictions applied by the supervisor is more restrictive, including, in particular, the possibility of prohibiting all operations with connected parties or payments on subordinate debts.

13. In April 2014 BAM signed a protocol for information sharing, in normal times and in times of crisis, with the Securities Commission (CDVM) and the Director of the Insurance and Social Security Directorate (DAPS), covering all financial institutions, financial markets, and market infrastructure. The information exchanged is covered by a detailed framework.

14. A Crisis Committee was created in 2012. It is chaired by the Minister of Finance and includes the Governor of the Bank Al-Maghrib, the Director General of the CDVM, and the Director of the DAPS. Its mission is to coordinate the actions of its constituent authorities in the management of financial crises that are likely to require the financial intervention of the government. Two crisis simulation exercises were held in 2009 and 2014 that made it possible to test the new mechanisms

[16] This topic covers primarily Principles 8, 11, and 15.

introduced in the legal framework. They did not result in the development of a comprehensive crisis communications policy, which remains to be defined. In fact, the 2014 exercise was halted prior to the meeting of the Crisis Committee, the effectiveness of which thus remains to be tested. Moreover, given the rapid international expansion of Moroccan banks, it would be useful to conduct a cross-border crisis simulation exercise as soon as possible.

15. The new banking law significantly increases BAM's powers in the event of difficulties in systemically important institutions. The Governor of BAM chairs the Systemic Risk Supervision and Coordination Committee (CCSRS), which replaces the Financial Sector Supervisors Coordination Committee and the composition of which has been expanded to include the Minister of Finance. The CCSRS, which is an advisory body for which BAM acts as secretariat, is responsible for coordinating crisis resolution actions involving systemically important institutions and coordinating cooperation and information sharing with foreign supervisory authorities. The decree on the composition and operating procedures for the committee has not yet been enacted. It should include measures to identify and contain potential conflicts of interest that could arise from the involvement of its members in the definition of macroprudential policies.

16. As long as the two other organizations have not finished upgrading their crisis management procedures, BAM could be hampered in its ability to comply with best practices. For example, the future Moroccan Capital Market Authority (AMMC) has not been given exceptional powers for crises, particularly systemic crises, as BAM has for the resolution of credit institutions. The CDVM may suspend the listing of a security but only for a maximum of five days, and it cannot suspend the market as a whole. Moreover, it cannot suspend mutual fund (OPCVM) subscriptions and redemptions, in contrast to the case of asset management banks. Finally, the information requirements established by the regulator for the market could hamper the resolution of a bank issuer. The supervision of conglomerates, as defined by the new banking law (Article 21), must still be covered by a joint circular issued by the financial system regulatory authorities. Owing to the sectoral approach taken, the CCSRS is a cooperative body and each authority remains responsible for the application of the measures taken in its sector.

17. The governor now has the power, in case of emergency and when circumstances threaten the stability of the banking system, to appoint an interim administrator for a credit institution without seeking the opinion of the Disciplinary Committee for Credit Institutions (CDEC) and to decide on the application of one or more of the resolution measures expressly provided in the new law (total or partial sale of an institution, division including the creation of a bridge bank or bad bank, sale of assets). BAM is thus fully vested as the resolution authority for the banking sector. The company managing the deposit insurance fund for credit institutions and Islamic financial institutions established by the new banking law also participates in the resolution of difficulties in credit institutions (Article 128).

18. In December 2014, BAM identified the three main banking groups in the country as systemically important credit institutions using a mapping exercise based on criteria of size, interconnectedness and complexity (including cross-border operations). The mission notes that the

Caisse de Dépôts (CDG), of which only the subsidiary CDG Capital has the status of credit institution, has therefore not been identified as a systemically important institution.

19. The law provides that BAM may require a systemically important credit institution to prepare a resolution plan, the so-called "internal crisis recovery plan" (PRCI). The law refers to an implementing circular as regards the terms and conditions for the preparation and communication of these plans, which aim to remedy a significant deterioration in a financial position, protect the viability of a credit institution and prepare for an eventual resolution procedure. The local banks with which the mission met have not begun work in this area, but the DSB is planning outreach meetings in the very near future. Moreover, the work to calculate the capital surcharge for systemically important institution have begun in 2014 and the size of this surcharge should be communicated to institutions in 2017 for implementation of Basel III in 2019. An internal BAM manual on the resolution of systemically important banks is being prepared.

C. Supervisory Approach and Techniques[17]

20. At the time of the global financial crisis, the DSB stepped up its risk-based supervision approach, which it had used since 2005 when the SANEC rating tool for financial institutions was implemented. In 2008/2009, early warning indicators, along with specific reporting requirements, were identified to track exposures against nonresident interbank counterparties and vulnerable sectors, particularly property development, exports and tourism. BAM also had the banks sign two "codes of ethics" relating to the financing of the property sector and the leveraged financing of financial assets.

21. The degree of supervision is adjusted to the risk profile identified. The purpose of the SANEC tool for scoring financial institutions, which was partially overhauled in 2014 (addition of new criteria, introduction of greater granularity in the scores to refine the analysis of future trends), is to define the risk profile for each bank and financing company. The criteria used are divided into eight areas (asset quality, capital adequacy, liquidity and rates, profitability, governance and risk management, and sensitivity to market risks). The tool is used to adjust the intensity of the ongoing supervision and the frequency and content of on-site inspection missions and also, as of certain thresholds, to trigger particular preventive actions identified in the manual for the handling of difficulties in credit institutions. SANEC has also become a tool for dialogue with the financial institutions, since each year their scores are sent to the management teams and are subsequently the subject of technical monitoring meetings by risk area.

22. However, the DSB has not yet fully implemented the principle of proportionality, by, for example, imposing a capital requirement that is higher than the minimum for the sector as a whole on a particular financial institution given its individual profile. The 2007 directive on the Internal Capital Adequacy Assessment Process (ICAAP), which sets out the general principles to be observed by credit institutions in the assessment of their internal capital adequacy, has not been implemented. As part of the implementation of the second pillar of Basel II, this directive was aimed

[17] This topic primarily covers Principles 8, 9, and 16.

at making institutions subject to more restrictive prudential regulations, particularly in the form of additional capital requirements, unless a credit institution was able to demonstrate to BAM that the arrangement in place corresponded to its risk profile and its business development plans.

23. Analyses by the ongoing supervisors now include macroprudential aspects, tracked by a specific analysis unit within the directorate, which specifically conducts stress tests of the banks' balance sheets. Working groups are organized with the supervisory teams to look at the results of these tests. Moreover, sectoral analyses have been stepped up, particularly through the establishment of an internal database that tracks the financial conditions of the main Moroccan groups that are counterparties to the banks: about 30 have been identified of which about a dozen have already been subject to more in-depth analyses.

24. Monitoring of the resolution of systemically important banks will be focused around the analysis of the PRCIs called for by the new banking law: the preparation of these resolution plans has not yet begun. The methodological approach should cover "the credit institution's resolvability," taking account of the risks posed by other entities in the group, which presupposes the use of a consolidated supervisory approach that is better able to capture the potential risks of double gearing of regulatory capital and so-called group risks (contagion risk, complexity of management, risk concentration, or conflicts of interest).

25. A "Standards and Methodology" unit responsible for coordinating the upgrading and updating of the supervision methodology notes, is also responsible for second-level controls within the DSB (quality control). Finally, the DSB is periodically audited by BAM's Audit and Risk Prevention Directorate.

26. In parallel with its ongoing supervision, the DSB conducts on-site inspections of credit institutions on the basis of an annual program approved by the Governor and established in coordination with the Ongoing Supervision Department, which prepares detailed pre-audit records. The teams are led by 1 of the 5 mission chiefs, assisted by 12 on-site inspectors for 85 licensed entities, including 19 banks and 35 financing companies. Ongoing supervisors may also participate in missions on an ad hoc basis for training purposes. In this context of limited resources, in face of the need for close supervision of certain risks (credit risk, governance and internal control, network of sub-Saharan subsidiaries, ALM and preparation of models, operational risk, and PCA), so-called crosscutting or horizontal missions have taken precedence over general missions: since 2007, each systemically important bank has been subject to only one general mission. In contrast, thematic missions are frequent, allowing for a regular presence in systemically important or fragile institutions.

27. The fact that missions are no longer the subject of formal reports, which have been replaced by follow up letters with a list of technical recommendations that are not placed in context, weakens the existing mechanism: it is now difficult for an ongoing supervision manager to obtain the summary view that a mission chief may have regarding a credit institution or even a single function or to have an overall view regarding the organization, operation and risks of a credit institution that might result from systematic investigations expanded to cover all functions.

Moreover, audit files are not archived in any organized way or communicated to the Ongoing Supervision Department (including the loan file analysis records), hampering any traceability and documentation of investigations.

28. Aware of these gaps, the DSB is currently developing an on-site inspection mission management tool (GMC), which should allow for better tracking of recommendations, corrective measures and action plans. However, in the absence of the formalization of its investigations, which is in contradiction, moreover, with the internal procedure memorandum ("Preparation of On-Site Inspection Mission Reports" of September 18, 2013), and of an acceptable frequency for its general missions (every seven years for systemically important banks), the DSB is now in risky territory.

D. Risk Classification and Provisioning[18]

29. According to the financial indicators published by BAM, nonperforming loans have reached a NPL rate of 7.1 percent at end-2013, as against 6 percent at end-2011. The deterioration in the quality of the assets, due in part to the international crisis, has particularly affected the construction materials, tourism, property development, steel production, and textile sectors.

30. Since 2009, banks, especially the largest banks, have gradually put in place, at the BAM request, a system to track special mention loans via a watch list. BAM supervision was enhanced with the introduction of indicators to monitor special mention loans, including the list of the top 20 customers in terms of detailed exposure by sector and by internal rating. Article 58 of the Circular on Internal Control provided some indications regarding the establishment of a mechanism for the management of special mention loans, but did not define the criteria for their inclusion on the watch list (financial and operational indicators for the account, sector, restructuring, etc.). In fact, the practices of the banks are not homogeneous and there is no guarantee of a level playing field as the rules are not known.

31. The classification of nonperforming loans (NPLs)[19] is based, in particular, on how long they have been past due: more than 90 days past due for loans classified as substandard, more than 180 days past due for doubtful loans, and more than 360 days past due for loans classified as loss. However, the notion of default in Circular 19G is not in line with the IFRS or Basel II (internal credit risk model) on at least two points: breaches of an overdraft limit for more than 90 days and restructuring of a loan.

[18] This topic refers primarily to Principle 18 (problem assets, provisions, and reserves).

[19] Circular 19G of December 23, 2002.

Table 2. IAS 39 Impairment Triggers

Significant financial difficulty of the obligor[20]	BAM is formally compliant but no specific criteria have been designed
Breach of contract such a default or delinquency: 90 days or more past due on any facility (for overdrafts, days past due commence once an obligor has breached an advised limit or has drawn credit without authorization and the underlying amount is material)	BAM is not compliant regarding the overdraft on a solo basis
The lender is granting the borrower a concession that the lender would not otherwise consider in the absence of borrower's financial difficulty	BAM is not compliant on a solo basis
It is becoming probable that the borrower will enter bankruptcy	BAM is compliant

Source: FSAP team.

32. **Beyond the notion of default, quantitative criteria for the classification of loans as substandard should be clarified:** outstanding financing loans and/or signature commitments, the total or partial recovery of which is likely to be in jeopardy, regardless of any arrears, owing to considerations related to:

- The debtor's ability to pay (persistent financial imbalance, significant decline in turnover, excessive debt, etc.);
- Difficulties in the sector in which the counterparty operates.

33. **BAM has provided indications to the banks regarding the establishment of provisions for general risks (PRG) to cover special mention loans at a rate of 10 percent.[21]** At end–December 2014, the general provisions covered 16 percent of gross exposures. The minimum provisioning amount is respected by the three systemically important banks, but based on different methods: some use "collective provisioning" within the IFRS meaning, while others use the line-by-line approach, as in the case of nonperforming loans. The lack of clear indications is an obstacle to the proper application of provisioning methods and is likely to skew the reading of the financial indicators. The transition by the largest Moroccan banks to internal credit risk models should enable them to use probability of default and loss given default to calculate the collective provisions for special mention exposures that are not yet in default.[22]

[20] Examples: equity reduced by 50 percent due to losses, material decrease in estimated future cash flows, current debt service ratio is below 1.1.

[21] Without taking account of any potential collateral.

[22] In this case and for the corporate portfolio, individual provisions are calculated.

34. Loans classified as substandard, doubtful and loss should give rise to the establishment of provisions equal to at least 20 percent, 50 percent and 100 percent of the amount involved, respectively, after deduction of collateral. Real property collateral (mortgages) is taken into account only up to the initial risk amounts weighted at 50 percent. These mortgage guarantees are gradually brought down, through annual reductions, to 25 percent in 5 years and 0 percent in 10 years. It is specified that mortgages in amounts equal to or exceeding DH 1 million are taken into account if the mortgaged property has been subject to a recent appraisal, properly performed by the credit institution or, at its request, by a qualified expert and is free of any liens. Finally, the rule on the reversal of provisions on a restructured loan at the end of six months (in the absence of arrears) is not in line with international standards (not less than 12 months).

35. Looking at the tax situation, the tax administration does not recognize BAM Circular 19G, except for loans classified as loss for which a judicial collection procedure is generally undertaken. Actually, prudential provisions are recognized as tax deductible when the banking relationship is completely terminated. This attitude on the part of the tax administration has the effect of delaying the reclassification of problem loans as nonperforming loans.

E. Management of Concentration Risk[23]

36. Article 76 of the recent banking law (December 2014) sets out the principles for appropriate management of concentration risk so as to preserve the soundness of a credit institution. Concentration risk must be evaluated on a solo and a consolidated basis. This same law[24] specifies that institutions must adopt an internal control system that is aimed at identifying, measuring, and monitoring all risks incurred. Finally, a committee[25] responsible for monitoring the risk identification and management process must be operational and must include independent board members.

37. The banking law is coordinated with the circular on internal control (October 2014), which also provides that the concentration risk mechanism put in place must be adapted to the risk profile, size and complexity of the credit institution (Article 3). It is clearly stated that the degree of risk aversion of the bank must be established by the board of directors. Consequently, the system of delegation of lending authority must provide that certain exposures (determined on the basis of the amount, complexity and term of the loan) must be approved by a general management committee or even by the board of directors. The bank's information system must allow for a daily listing of the main exposures and must provide a monthly report on large exposures broken down by geographic area and country. Concentration risk is deemed to exist in the sub-

[23] This topic refers primarily to Principles 19 (concentration risk and large exposure limits) and 20 (transactions with related parties).

[24] Article 77.

[25] Article 78.

Saharan African subsidiaries, where large exposures represent a large proportion of banks' total loan book.

38. The threshold for the identification of large exposures and the limit on exposures to a group of related parties are 5 percent and 20 percent[26] of the credit institution's capital, respectively, and are thus more restrictive than the international standards (10 percent and 25 percent), which do, however, recommend using core Tier 1 capital for the calculation of the ratio. The concept of group has been expanded beyond capital links to capture de facto groups. Moreover, business relations that are likely to transmit difficulties from one counterparty to another are deemed to constitute a single group of debtors, which is then subject to the threshold of 20 percent. However, some exposures are subject to special treatment. For example, liabilities against residential real estate may be reduced by up to 50 percent of the value of the property secured by a mortgage. The appraisal of the value of the real estate must be carried out prudently at least once every three years. The appraisal of a commercial property follows the same system, with the specification that the commercial property must be entirely constructed, leased, and produce adequate rental income. In the area of large exposures, international practices[27] tend to refuse to take account of physical collateral for reasons of availability and liquidity.

39. The circular on the maximum risk concentration ratio increased the weighting of credit institutions from 20 percent to 100 percent but with a transitional regime. Similarly, BAM may authorize a weighting of 0 percent for intragroup bank subsidiaries. An impact study is being conducted to establish the appropriate weights. Concentration risk including connected lending, which is covered by many provisions in the circular on internal control, remains a matter of concern in certain credit institutions.

40. Ongoing supervision assesses the degree of concentration of credit portfolios and the mechanism for tracking this risk through a series of controls and reporting statements,[28] the summary of which serves as a basis for the SANEC rating ("large exposures and concentration" component). At the time of the mission, large exposures concerned about 100 groups out of 1,400 counterparties. The most represented sectors, apart from the financial sector at 39 percent, were manufacturing (12 percent), property development (11 percent), and hydrocarbons (10 percent). BAM is in the process of establishing a database that can be used to identify exposures, key financial analysis indicators, and the internal rating for the 30 largest Moroccan groups. On-site inspections supplement this control mechanism by endeavoring, in particular, to determine the accuracy and completeness of the large exposures reported by the credit institution, analyzing procedures and limits, ensuring that adequate information is provided to the board of directors, and that the board is involved in the monitoring of concentration risk. Large

[26] Circular on the maximum risk concentration ratio (April 2012), Articles 1 and 2.

[27] Supervisory framework for measuring and controlling large exposures, BIS April 2014.

[28] Periodic reporting on the breakdown of portfolios, quarterly indicators on exposures to the 20 largest customers in economically sensitive sectors (property development, textiles, construction, and automobile).

exposure reporting thresholds (5 percent to 20 percent) are subject to consistency checks on a solo and consolidated basis. In case of persistent overruns, the overruns are deducted from the capital of the institution.[29]

F. Management of Liquidity Risk and Introduction of the LCR[30]

41. Liquidity risk is covered by a circular (15/G/2013) requiring banks to respect a minimum liquidity ratio on a solo and consolidated basis, which constitutes the transposition of the liquidity coverage ratio provided in Basel III. As of July 1, 2015, banks must respect a minimum ratio of 60 percent, moving gradually to the threshold of 100 percent by 2019. The calculation of net outflows is based on that of the Basel Committee. For the numerator, the central bank has decided not to include certificates of deposit among high quality liquid assets, which has resulted in some banks no longer holding certificates of deposit, although the latter remain acceptable for refinancing by BAM. Similarly, the "look through" treatment of mutual fund (OPCVM) shares will encourage banks to directly acquire the securities considered liquid. The only local difference concerns the holding of private or public sector bonds, which may be admitted in the stock of liquid assets to the extent that they have received a very high internal rating in the absence of any external rating. Finally, until now, high quality liquid assets consist almost entirely of Treasury bills. Securitization shares and future covered bonds will for some time yet be considered marginal in the banks' liquidity reserves.

42. Two of the three large systemically important banks[31] are already fully LCR compliant. The LCR is apparently less restrictive than the former liquidity ratio. BAM should look at the calibration of the ratio to determine whether the liquidity requirements prescribed reflect the liquidity profile of the banks, given the market context and the macroeconomic conditions in which they operate, particularly the systemically important banks. Indeed, the 2011 liquidity crisis resulted from a decline in foreign currency revenues (exports, tourism, and MREs) in a context of rapidly increasing lending. This sensitivity of deposits to the international economic situation should be captured by the LCR.

43. The calculation of the LCR on a consolidated basis has been discussed with the banks that have international networks. The lack of transferability of local currencies, particularly in sub-Saharan Africa, reduces the relevance of such a calculation. BAM has a whole series of regular risk indicators that identify sources of refinancing (trends in the gap between deposits and loans) and other sources of refinancing (essentially certificates of deposit, refinancing with BAM), on the one hand and, liquidity reserves to cover liquidity problems (liquid and quick assets and the unused part of collateral eligible for BAM refinancing), on the other.

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[29] Circular on capital (2013), Article 47.

[30] This topic refers primarily to Principle 24 (liquidity risk).

[31] AWB and CPM.

44. Each month, BAM analyzes the liquidity stress tests submitted by the banks, enabling it to assess the resilience of banks to extreme liquidity shocks over a one-month horizon. BAM also receives reports on liquidity gaps at various terms (ALM reporting) from banks quarterly. Finally, the largest banks transmit their annual refinancing plans. The reduction of the required reserves to 2 percent of sight deposits requires intraday monitoring of liquidity. The three largest banks have liquidity and resource diversification policies approved by their governance bodies and implemented by the ALM committees. Moreover, emergency plans are activated as soon as severe liquidity problems appear and trigger appropriate actions (sale of liquid assets, drawings on available liquidity reserves).

G. Banking Supervision Conditions[32]

45. Since the last FSAP in 2007, the Moroccan banking landscape has changed profoundly, with the significant development of a presence abroad[33] by the main banking groups (AWB, BPM, and BMCE). This international expansion strategy has a direct impact on the implementation of effective banking supervision to the extent that cross-border activities require enhanced supervision on a consolidated basis, monitoring of the main local subsidiaries and implementation of greater cooperation with the host country regulators. To this is added the new responsibilities assigned to BAM in the banking law, such as the supervision of microcredit institutions,[34] six offshore banks,[35] financial conglomerates,[36] and future payment institutions. The scope of BAM supervision also extends to the establishment of the regulatory framework for Islamic financing (or participatory financing), the principles of which have been defined in the banking law. Finally, the banking law assigns BAM new responsibilities in the area of financial stability.

46. The increasing responsibilities of the DSB come at a time of tighter budgets owing to BAM's declining income (in particular from foreign investments). As a result, the BAM salary scale is no longer in line with that of the commercial banks and the DSB is forced to recruit junior staff,[37] who require training and are likely to leave once they have gained a few years of experience, when interesting opportunities arise on the market. Overall, the DSB must deal with a constantly increasing workload without adequate increases in its staff. This situation can be harmful to the long-term maintenance of the high level of banking supervision that the BAM has achieved.

47. The draft law on the BAM charter currently being prepared strengthens the independence of BAM in a number of areas, particularly the conditions for the appointment

[32] This topic refers primarily to Principle 2 (independence, accountability, resourcing, and legal protection for supervisors).

[33] 40 subsidiaries abroad in 30 countries, including 23 in Africa.

[34] 13 microcredit institutions covering 900,000 loan recipients (DH 5 billion at end–December 2014).

[35] They represent 2 percent of the total balance sheet of the banking sector.

[36] SNI/AWB, Financecom/BMCE, Saham, and CDG.

[37] The share of staff between the ages of 20 and 35 is 31.5 percent in the DSB, as against 23.6 percent in other BAM departments.

and removal of the Governor. The Governor will now be appointed for a term of six years, renewable once, and may be dismissed only on serious grounds, which will be made public. Moreover, the Governor is prohibited from receiving or acting on instructions from the government or any other person. In the area of communications, since 2013 the DSB has regularly reported on its activities in press briefings. Finally, the banking law also improves the BAM's proactiveness by authorizing it to take emergency measures in the event of serious crises that are likely to threaten financial stability.

48. The disciplinary mechanism has not been substantially changed by the banking law since it remains under the exclusive authority of the Governor, although he must obtain the opinion of the Disciplinary Committee for Credit Institutions, which is chaired by BAM's General Manager. As well, financial penalties are limited to one-fifth of the minimum capital, which would seem to have little deterrent effect. In fact, the moral authority of the Governor takes precedence over any other body, with the result that the disciplinary committee has met only 10 times since 1993.

Appendix I. Secondary Recommendations

Recommendations
A. Supervision of cross-border activities
Improve the quality and availability of the data on local subsidiaries in order to obtain an accurate and full view of exposures, particularly nonperforming loans.
Enhance cooperation with the host country authorities as regards the approval of managers and appointment of directors. Agree on a common fit and proper test.
Enhance the parent company's supervision of local subsidiaries.
Complete the circular on equity holdings.
Define a maximum country risk concentration threshold in the context of cross-border supervision.
Complete the introduction of the country monitoring function for the compilation of quantitative data and tracking of qualitative data on the political, security and macroeconomic situation of countries.
B. Prevention of difficulties, crisis management and resolution
Complete the updating of the manual for the treatment of difficulties in credit institutions, bearing in mind the implementing circulars to be prepared.
Finish the draft decree on the composition and operating procedures of the CCSRS.
Establish the terms and conditions for the supervision of conglomerates in liaison with the DAPS.
Establish a framework for the management of cross-border crises.
C. Supervisory approach and techniques
Adapt the SANEC tool to make the calculation of indicators more secure and to incorporate the amendments made to the rating manual, including the rating scale;
Launch the project for the incorporation of the module for scoring banks' foreign and subsidiaries in SANEC;
Include a specific module in SANEC for systemically important banks;
Supplement the bank rating tool (SANEC) with a component dedicated to cross-border risk;
Accelerate the deployment of the mission and recommendations management tool (GMC) to obtain a complete real-time status report on the recommendations not implemented, classified according to their criticality for the three systemically important banking groups.
E. Management of concentration risk
Undertake an on-site inspection mission to identify de facto groups or business relations (economic interdependence) to supplement the monitoring of concentration risk by the Ongoing Supervision Department and the Macroprudential Analysis Unit.
Change the basis for the calculation of the maximum risk concentration ratio to include Tier 1 capital.
F. Management of liquidity risk and introduction of the LCR
Schedule thematic on-site inspection missions to assess liquidity management on a consolidated basis by banks with international networks.
Establish consolidated liquidity management.
G. Banking supervision conditions
Create a banking resolution and crisis management department.
Enhance the training of junior staff by having them participate in on-site inspections to enable them to obtain a hands-on understanding of how banks operate.