Financial Sector Monitoring in PIC Countries and Potential Covid-19 impact on Financial Stability

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Introduction

This report provides an assessment of economic and financial stability issues for some of the Pacific Islands (PICs). The report includes a summary of the PICs' policy responses to the pandemic economic shock, including fiscal and monetary policy (the latter being relevant only for those PICs with their own currency and central bank). It discusses the actions taken by supervisory authorities in the region to identify and respond to the potential financial stability implications of the pandemic. The paper also identifies areas where further analysis would be beneficial and provides an initial view on possible priorities for technical assistance to strengthen financial system stability in the region. Information for this report has been drawn from a combination of published material from the World Bank, International Monetary Fund and Asian Development Bank, and from confidential prudential data provided by the PIC supervisory authorities that are participating in this study.

This paper has the following structure:

- *Executive Summary*

- *Section 1: Overview of PIC economies and financial sectors.* This includes descriptions of the:

    - size and nature of economies;
    - composition of GDP; and
    - size and composition of financial systems, with a primary focus on banking systems.

- *Section 2: Impact of Covid-19 on PICs.* This includes an analysis of the:

    - impact on tourism and exports generally;
    - impact on remittance income;
    - information on banks' asset quality, profits, capital and liquidity.

- *Section 3: Government policy responses to Covid-19.* This section provides an overview of policy responses by PIC governments to date, including a brief discussion of fiscal support measures, monetary policy responses, loan guarantees, funding support to households and SMEs.

- *Section 4: Conclusion.* This section summarises key vulnerabilities and gaps/deficiencies in policy and capacity to minimize impacts on financial stability, and identification of key areas where further strengthening would be desirable to mitigate impacts on financial stability.

- Appendices provide further detailed information:

    - Appendix 1: Overview of financial systems in selected PICs
    - Appendix 2: Summary of policy responses to Covid-19 in selected PICs
    - Appendix 3: Corporate insolvency frameworks in PICs

Executive Summary

This report assesses the financial stability implications arising from the Covid-19 pandemic for selected Pacific Island Countries (PICs). The countries covered in this report are: Federated States of Micronesia; Fiji; Palau; Papua New Guinea; Samoa; Solomon Islands; Timor-Leste[1]; Tonga; and Vanuatu, with some information also provided for the Cook Islands[2]. The report has been prepared as part of a wider World Bank project designed to assist participating PIC authorities in responding to the pandemic to maintain and strengthen their financial stability.

Most of the PIC economies have been severely impacted by the pandemic. This is reflected in severe contractions in GDP for a number of PICs over 2020, with some forecast to sustain further declines in economic activity in 2021. The main impact has been the sharp fall-off in international tourism as a result of PIC border closures. The economic impact has been compounded by adverse weather events in some countries in the region, which have caused severe damage to agricultural production and infrastructure. As a consequence of these developments, and a weakening in the exports of some primary produce, most PICs have sustained significant deteriorations in balance of payment current account positions and a worsening in external debt positions. Unemployment and under-employment have increased significantly in a number of PICs.

The governments in the region responded proactively to the pandemic and were, in some cases, supported by international financial institutions and donor countries. Measures taken to combat the impact of the pandemic included border protection, strengthening in health infrastructure, a significant easing in monetary conditions, and a wide range of monetary and fiscal measures to support affected SMEs and households. Prudential policy has also played a role in the adjustment process, including through the regulatory support of measures taken by banks to provide SME and household borrowers with loan restructuring and debt servicing holidays. The combination of macroeconomic and other policy responses has assisted the PICs to mitigate the economic and social damage resulting from the pandemic. However, notwithstanding these arrangements, the PIC economies have inevitably sustained severe impacts as a result of the closure of borders and subdued economic activity across the region and in the economies to which the PICs export. The fiscal response initiatives taken by PIC governments have been necessary and beneficial, but have generally resulted in a worsening of fiscal deficits and public sector debt positions. The deterioration in fiscal position will require budget repair initiatives in the medium term, which might create headwinds for economic recovery in some cases.

Despite the economic impact of the pandemic, PIC financial systems have remained resilient to date. Banks' levels of impaired loans have not increased significantly through to September 2020 (the most recent period for which data are available). However, it is likely that loan impairment will increase – potentially significantly – in the last quarter of 2020 and through 2021, particularly once the temporary borrower support arrangements and government financial assistance measures are phased out. It will be important for the supervisory authorities in the region to maintain a close watch on banks' and non-bank lenders' asset quality and loan

[1] Timor-Leste is part of a different Country Management Unit in the World Bank classification. Timor-Leste has been included in the scope of this report, as it is a member of the Association of Financial Supervisors of Pacific Countries (AFSPC), which has acted as a platform for this analytical work.
[2] The Cook Islands are not formally participating in the World Bank study.

remediation processes over coming months in order to assess the full impact of the pandemic on asset quality and bank profits and capital.

PIC financial stability is supported by most of the banks having strong capital and liquidity positions as the pandemic unfolded. Bank capital ratios are generally very high by international norms and some benefit from strong foreign parentage. Bank liquidity positions were already high in many PICs before the pandemic developed, partly as a result of low levels of bank lending relative to deposits and a preference for banks to hold high levels of assets in the form of central bank deposits or government paper. Monetary policy and other measures taken during the pandemic have further strengthened bank liquidity positions.

Notwithstanding the strong starting position of many banks in the region, financial system pressures are likely to emerge over 2021 and beyond. This is partly as a result of the delayed recognition of loan impairment. Further factors likely to exert a negative influence on banks' profitability and capital positions over 2021 are the effects of cyclone activity in some countries, reduced net interest margins and subdued risk appetite. A further complicating factor is the withdrawal of some of the foreign banks, such as Westpac Banking Corporation (Westpac), from the region. This has been a trend over recent years and is expected to accelerate in 2021 with the further withdrawal of Westpac from some of the PICs. This creates a risk of reduced financial depth and competitiveness in the region, and potentially an increased risk of financial sector concentration risk and instability arising from the institutions that take over the business of the exiting banks.

The financial stability risks arising from Covid-19, weather events and changing ownership of major banks in the region suggest the need for particular vigilance by supervisory authorities.
In particular:

- **Supervisory authorities will need to intensify their off-site analysis and on-site assessments of banks and non-bank lenders**. Their focus should be on asset quality, the recognition of loan impairment, the adequacy of provisioning, and the loan impairment remediation process. More granular data monitoring and assessment by supervisory authorities will be an important part of this process, supported by peer group analysis.

- **Use of stress testing will be important in order to obtain a forward-looking assessment of bank and non-bank lender asset quality, profitability, liquidity and capital positions.** To the extent that concerns exist over particular banks' and non-bank lenders' asset quality and provisioning positions, supervisory authorities may need to undertake selected asset quality reviews in order to determine appropriate supervisory responses.

- **Supervisory authorities will need to renew their focus on bank and non-bank lender contingency plans for capital and liquidity.** It will be important to ensure that banks and non-bank lenders have robust arrangements in place to restore their capital and liquidity positions to acceptable levels in the event that the aftermath of the pandemic and other economic events leave them with inadequate levels of capital or liquidity. In the cases where banks and systemically significant non-bank lenders do not yet have recovery plans in place, supervisory authorities should work with the institutions to establish recovery plans that cater for severe-impact events and require the recovery plans to be regularly updated and tested.

- **Supervisory authorities are also advised to strengthen their capacity for early intervention and resolution.** In many of the PICs, early intervention frameworks are relatively under-developed, as are the legal powers and strategies for the resolution of non-viable banks and non-bank intermediaries. Although there appear to be no imminent threats to bank viability in the PICs at this stage, emerging stress over 2021 and beyond has the potential to weaken bank and non-bank lender capital and liquidity positions. Accordingly, it will be important for the supervisory authorities to have robust arrangements in place to detect early warnings of emerging stress and to respond proactively to implement remediation strategies when necessary. In the event that bank or non-bank lender stress cannot be rectified, the authorities will need to have the capacity – including legal powers, policies, plans and funding structures – to place non-viable financial institutions into resolution and implement resolution strategies that minimise adverse impacts on financial systems and economies. As part of this, initiatives are needed to put in place financial safety nets, including deposit insurance schemes and more structured emergency liquidity support and resolution funding arrangements.

- **PIC supervisory home and host authorities are advised to strengthen the cross-border cooperation and coordination arrangements to facilitate enhanced information-sharing on the response to the pandemic.** This includes enhanced information exchange on asset quality information, impaired loan remediation measures, stress testing, and asset quality reviews. A coordinated approach is also needed for any early intervention arrangements, activation of contingency and recovery plans, and resolution processes. Where feasible, home and host authorities should work towards a whole-of-group approach to bank recovery and resolution, but where each authority also maintains fallback options to protect national interests. In the case where foreign banks withdraw from PICs and their operations are acquired by other banks, it will be especially important for the host authorities to work with the home authorities to ensure that a smooth transition occurs and that host supervision is strengthened where necessary, such as where the change in ownership results in an increased risk profile of the host operations.

Section 1: Overview of the PIC economies and financial sectors

Size and structure of economies in the PICs

1. **The PICs included in this study represent a broad-cross section of jurisdictions in the western and southern Pacific region and a substantial majority of the population and economic activity in region.** The PICs are diverse in nature – economically, socially and culturally – but all have some common features. In particular, they are all, to varying degrees, countries with significantly under-developed economies heavily dependent on foreign trade in primary produce (mainly fish, fruit and timber, and in some cases mining and oil) and tourism. Most of the PICs also derive significant income from remittances of former residents and temporary migrants living in other countries (mainly from USA, Australia and New Zealand). The countries also have in common a significant dependency on foreign aid as part of their national income. Except for Papua New Guinea (PNG), all of the countries are small in population and in geographic area (but, together, cover a large ocean area in the Pacific). PNG has a population of around 8.9 million, Timor-Leste has around 1.3 million and Fiji has around 890,000, but most of the countries have populations of under 300,000.

2. **For the most part, the countries in this study have relatively low GDP per capita, reflecting the early stage of their economic development, lack of infrastructure and the diseconomies of distance and small size.** Most of the PICs have per capita GDP below US$7,000 (based on the most recent data available). The exceptions to this are the Cook Islands and Palau, with per capita GDP at much higher levels, reflecting their close economic relationships with New Zealand and the United States respectively. See Table 1 for summary data on macroeconomic and population data.

Table 1: Key macro data on Pacific Island Countries

	Population[3]	**GDP (USD million)[4]**	**GDP per capita (USD)[5]**
Group 1			
Fiji	895,000	5,407	6,043
PNG	8,950,000	24,809	2,884
Samoa	198,000	851	4,231
Solomon Is	686,000	1,598	2,494
Timor-Leste	1,320,000	1,620	1,252
Tonga	105,000	517	5,151
Vanuatu	307,000	933	3,186
Group 2			
Cook Islands	17,500	575	20,240
Federated States of Micronesia	115,000	414	4,045
Palau	18,000	280	16,064

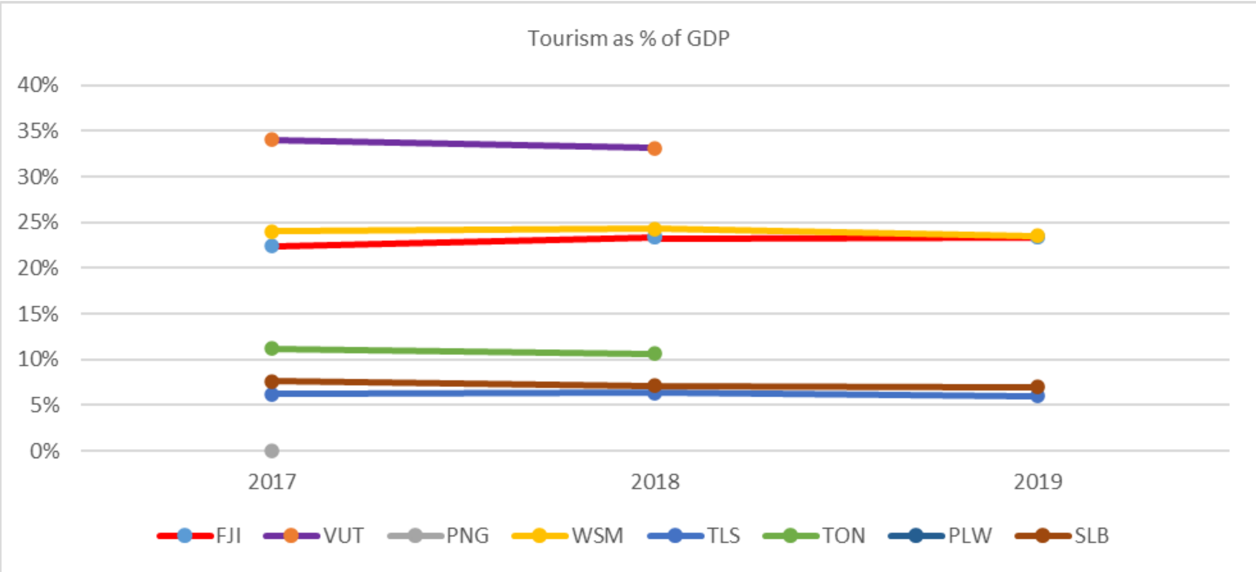
[3] Population estimates as at 2020 unless otherwise indicated. Source: World Development Indicators database, World Bank, December 2020

[4] GDP data sourced from IMF World Economic Outlook, October 2020, except for Cook Islands, where data are sourced from Ministry of Finance and Economic Management.

[5] GDP data sourced from The World Bank, as at 2019, except for Cook Islands, where data are sourced from United Nations.

3. **Most of the economic activity in the PICs is derived from exports of primary produce and tourism-related services**. In most cases, the exports of primary products (fish, fruit and timber), together with international tourism, make up the bulk of the production side of GDP. In PNG, output and exports are dominated by the extractive sector, comprising LNG production and mining. Tourism is especially significant for Vanuatu, Samoa and Fiji. (See Figure 1 below.) As noted later in this report, the high dependency on tourism has major implications for the economic impact of Covid-19 on a number of the PICs, given the closure of borders and the collapse of international tourism in many parts of the world. More generally, the reliance on primary exports also creates vulnerability for some of the PICs, given the impact of Covid-19 on the demand for and price of some commodity exports and the interruption to supply chains, including freight shipping.

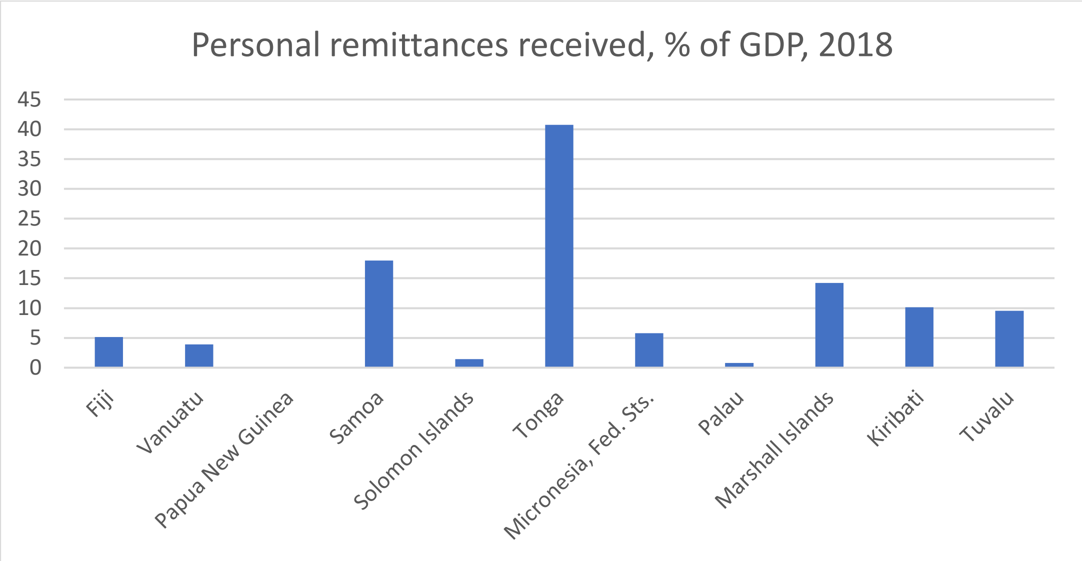
Figure 1: Tourism revenue as a percentage of GDP



Source: UN WTO (for tourism revenue) and World Bank (for GDP)
Note: Figures are annual data (ending 31 December) if not noted otherwise.
Abbreviations are: VUT = Vanuatu; PNG = Papua New Guinea; WSM = Samoa; TLS = Timor-Leste; TON = Tonga; PLW = Palau; SLB = Solomon Islands.

4. **Many PIC economies depend heavily on remittances received from abroad.** As noted later in this report, there is a risk of remittance income being disrupted due to the pandemic. As shown in Figure 2, below, six of the PICs for which data are available received personal remittances equivalent to 5% or more of their GDP in 2018, with Tonga and Samoa topping the list at 41% and 18% respectively. Remittances are an important buffer for expenses and investment, and they are at risk of disruption by the pandemic because the countries in which migrant workers reside face recession and rising unemployment and under-employment. However, anecdotal evidence from discussions with the PIC authorities suggests that remittance inflows from Australia and New Zealand in a number of PICs have been relatively stable since the beginning of the pandemic, although close monitoring of upcoming data is still warranted. On the contrary, the flows of remittances from the United States have been more severely impacted, due to the more severe consequences of the pandemic on the level of employment in the United States.

Figure 2: Dependence on remittances in PICs

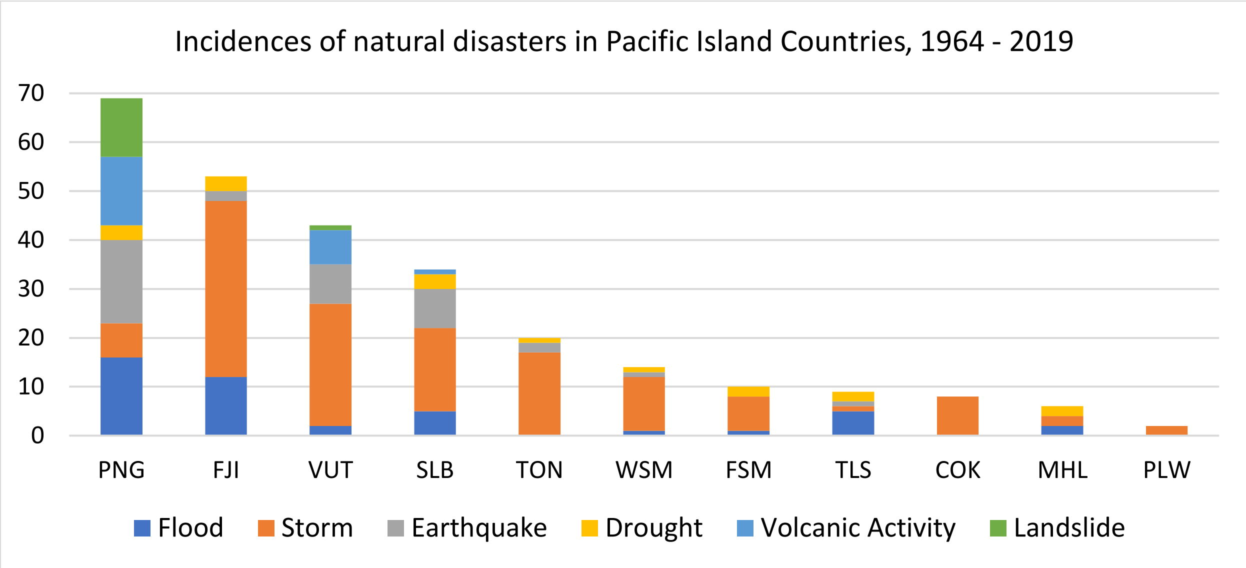


Source: World Development Indicators

5. **Most PICs are vulnerable to natural disasters which, if combined with the COVID pandemic, could lead to significant stress to the financial sector.** Figure 3, below, shows incidences of natural disasters for all PICs between 1964 and 2019. PICs experienced a total of 268 natural disasters during this period, and most PICs experienced 10 or more natural disasters in the past 55 years. PNG, Fiji, Vanuatu and Solomon Island account for most of the incidences of natural disasters. Tropical cyclones are the single most frequent type of disasters among PICs, followed by floods, earthquakes and volcanic activity. At the time this report was prepared, Cyclone Yasa had inflicted severe physical and economic damage to Fiji, compounding the economic stress Fiji is already under as a result of the pandemic. Vanuatu and Tonga have also been impacted by this cyclone.

6. **Climate change, natural disasters and related environmental issues can pose significant risks to the financial system stability of PICs.** Natural disasters and climate change risk events can have significant impacts on the repayment capacity of borrowers and damage underlying collateral, potentially affecting a bank's profitability and solvency. In the aftermath of storms and natural disasters, banks may be faced with severe disruptions to operations resulting from damage to infrastructure and branches. Moreover, depositors and other investors may withdraw funds from their banks, both to cover post-disaster expenses, as well as for fear of solvency problems with their banks, especially if they believe banks have substantial exposure to a vulnerable area. Insurers are also significantly exposed to climate change-related risks, including rising sea levels, greater vulnerability to storm surges and the prospect of more severe and more frequent tropical cyclones. These risks pose a threat to insurer profitability and capital, and have implications for the cost and availability of insurance cover. All of these risk factors need to be carefully monitored and managed by the financial institutions in question and by the supervisory authorities. This will be especially important in the next couple of years, given that any natural disasters that occur in the Covid environment will compound the economic impacts of the pandemic and exacerbate threats to the stability of financial systems.

Figure 3: Incidences of natural disasters in PICs, 1964-2019



Source: EM-DAT database

Financial systems in the PICs

7. **The PICs covered by this report have financial systems at varying stages of development.** In most cases, the financial systems are under-developed, with banks having by far the largest share of financial system assets. Banking products and services are relatively limited and traditional in scope, being largely confined to deposit-taking, unsecured personal loans, mortgage-based lending (subject to collateral availability and legal title issues), trade finance, and payments facilities. In many of the PICs a significant proportion of the population has no or limited access to bank accounts or payment services. Insurance companies operate in most of the countries, but have a very low share of financial system assets, as do the non-bank lenders, broking firms and other financial institutions. In most of the PICs a significant proportion of the population has no or only very limited insurance cover. Currently only Fiji and PNG have digital systems for the clearing and settlement of payments, while Samoa, Solomon Islands and Vanuatu intend to complete the implementation of modern payment systems infrastructure in the next 12-18 months. All the other countries currently use clearing and settlement mechanisms based on manual operations. Only two countries have a stock exchange (PNG and Fiji), but in both cases there are relatively few listed companies and trading volumes are low. At present none of the PICs has a Central Securities Depository. However, Fiji, PNG, Samoa, Solomon Islands and Vanuatu are intending to implement such systems within the upcoming months.

8. **A common characteristic in all of the PICs is the dominant position of foreign banks.** In many of the countries (such as Cook Islands, Fiji, PNG, Samoa, Solomon Islands and Tonga), the Australian banks (especially ANZ and to a lesser degree Westpac) have substantial shares of banking system assets and are systemically important banks. Bank South Pacific, domiciled in PNG, also has a systemic presence in some countries, including Fiji and Samoa. The Australian and PNG banks generally operate in host jurisdictions via branches, but in some cases operate through subsidiaries. BRED Bank (of the BPCE Group, based in France) has a significant presence in some of the PICs, as

do some Indian banks (particularly Bank of Baroda). Although the non-Australian and non-PNG banks are growing in importance, they do not generally have a systemic presence in the PICs and therefore do not pose a significant cross-border risk to financial system stability, although that could change in the years ahead. In some of the countries without their own central bank, such as Palau and the Federated States of Micronesia, US domiciled banks and other foreign banks (outside Australia) have a significant presence. Some domestically owned banks, including development banks, are also systemically significant in some countries, such as in PNG, Fiji and Tonga.

9. **The strong presence of foreign banks in the PICs is both a risk and a strength.** With cross-border banking, there is always the potential for a transmission of risk from the parent bank (or other parts of the parent group) to the subsidiary or branch in host countries. The risk is considerably greater where the foreign banks operate via branches, especially where they are not subject to de facto capital and local governance requirements. In the case of subsidiaries, the transmission of risk from the parent group to the subsidiary can be muted to some degree through local capital requirements and constraints on related party lending. There are also operational risks associated with foreign banks, including the risk of critical systems being unavailable to the local operation in a situation of operational or financial distress in the parent. This risk can be mitigated to some degree, but not completely. There is also a risk associated with the withdrawal from the PICs of large foreign banks, as has been occurring with the progressive withdrawal of Westpac from the region. This exposes PICs to a contraction in the availability of financial services, reduces competition and potentially gives rise to risks of instability in the future to the extent that the operations of these banks are acquired by banks with poorer standards of governance, risk management and capital strength.

10. **Against these risks, foreign banks undoubtedly also provide benefits to the PICs.** These benefits include strengthened competition, provision of deeper and more diverse financial services, and a deepening of credit channels. In the case of foreign banks with stronger parentage and high-quality home supervision, such as the banks from Australia and the United States, their presence in PICs helps to strengthen the resilience of PIC financial systems, given their ability to absorb localised credit losses with little impact on the strength of the parent banking group balance sheet. In some other cases, parent bank strength might not be as reliable, depending on the strength of corporate governance, capitalisation, risk management and quality of prudential supervision in the home country. As discussed later, these are significant issues for the stability of the financial systems across the PICs and have major implications for the nature of prudential regulation and supervision in the affected countries.

11. **Financial system development, as measured by monetisation of the economy and availability of private sector credit, is relatively low in most PICs.** As can be seen from Table 2, most of the countries in the region have low levels of bank lending relative to the size of their economy, consistent with the relatively early stage of development of their financial systems and, in some cases, a significant proportion of the population having no or only very limited access to financial services. In some countries in the

region, the difficulties in banks obtaining collateral due to land title difficulties[6] is also a factor in the constraint on bank lending.

Table 2: Domestic credit and monetisation of the economy

Country	Domestic bank credit as % of GDP	Monetisation of economy: M2 as a % of GDP
PICs with central banks		
Fiji	69.6	75.0
PNG	14.4	30.0[7]
Samoa	51.4	45.0
Solomon Is	22.2	50.0
Timor-Leste	15.5	50.0
Tonga	42.9	60.0
Vanuatu	59.2	80.0
PICs without central banks		
Cook Is	-	50.0
Federated States of Micronesia	19.8	55.0
Palau	-	100.0

Source: World Development Indicators database for domestic bank credit, World Bank, December 2020. Asian Development Bank for M2/M3 data.

12. A summary of the composition of PICs' financial systems, by type of financial institution, is provided in Table 3, below. Appendix 1 provides a brief description of the main features of the PICs' financial systems.

Table 3: Composition of financial system by institutional category

	Commercial banks	Insurance companies	Insurance brokers	Money transfer/fx dealers	Other financial institutions	Total
PICs with central banks						
Fiji	6	9	4	11	19[8]	49
PNG	4	5	4	10	50[9]	73
Samoa	4	6	4	13	4	31

[6] In some of the PICs, land is owned communally and not by individuals. This impedes the ability of banks and other lenders to take land as collateral for loans. In other cases, there are restrictions on the ability of foreigners to acquire land in some PICs, which further impedes collateralised lending.
[7] For PNG the data relates to M3.
[8] Fiji: Credit institutions (4), provided fund (1), stock exchange (1), stock brokers (3), and also includes unit trust providers and corporate advisers.
[9] PNG: Includes savings and loans societies (22), mobile network operator (1), superannuation funds (4), investment managers (5), fund administrators (3), stock exchange (1), stock brokers (2), other financial institutions (12).

Solomon Islands	4	4	6	13	13[10]	40
Timor-Leste	5	3		12	3[11]	23+
Tonga	4	-	-	11	-	15
Vanuatu	4	34			10[12]	48
PICs without central banks						
Cook Islands	4	5	9	3	12[13]	33
Federated States of Micronesia	2	-	-	-	-	2
Palau	5				3[14]	8+

Source: Asian Development Bank. This table excludes state-owned national development banks.

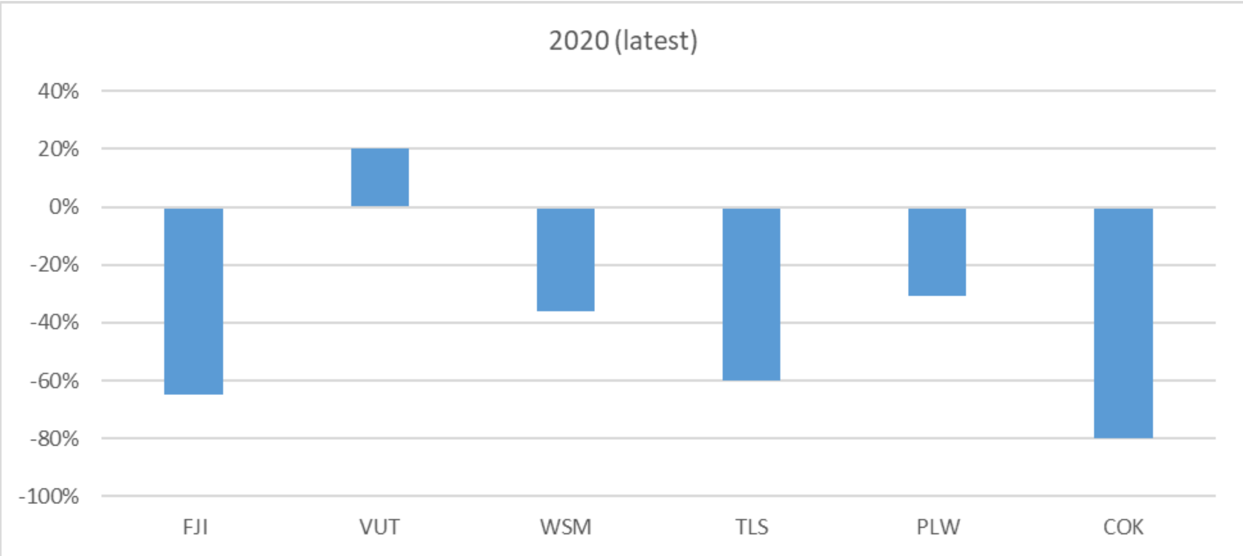
[10] Solomon Islands: Includes provident fund (1), credit institution (1), and other financial institutions.
[11] Timor Leste: Includes microfinance institutions and other deposit-takers.
[12] Vanuatu: Includes international banks (7) and a pension fund (1).
[13] Cook Islands: Includes offshore financial sector with 3 international banks, superannuation fund (1) and trustee companies (8).
[14] Palau: Includes pension funds (2), development bank (1), plus micro-lending institutions and credit unions (unquantified number).

Section 2 – Impact of Covid-19 on PIC financial systems

Economic impact

13. **Across the PICs, as for much of the world, economic output is estimated to have declined sharply over calendar year 2020 and a gradual 2021 as a result of the impact of the pandemic.** Countries whose economic activity is reliant to a substantial degree on international tourism have been affected more severely than others. In most cases, economic output is forecast to partially recover in 2021. However, the strength and sustainability of economic recovery is expected to vary considerably across countries, including within the PICs, and will depend to a significant degree on the effectiveness of measures taken to combat the pandemic, including how quickly the new vaccines can be distributed.

Figure 4: Percentage change in international tourist arrivals in selected PICs



Source: UN WTO
Note: Figures are June data for Fiji, Timor Leste; July for Vanuatu, Samoa, and Palau; and September for Cook Islands. In each case the percentage changes are 2020 year-to-date relative to same period 2019.
Abbreviations are: VUT = Vanuatu; WSM = Samoa; TLS = Timor-Leste; PLW = Palau; and COK = Cook Islands.

14. **Reflecting the contraction in export revenue, particularly from tourism (Figure 4), current account position of many PICs is estimated to have deteriorated sharply in 2020.** For most PICs the pressure on current account deficits is expected to continue in 2021. This is especially the case for PICs with a strong dependence on tourism, such as Fiji, Samoa, Vanuatu, Tonga and the Cook Islands. Adverse impacts on commodity exports are also expected to contribute to a weakening in current account positions, as is

a possible weakening in remittances due to higher unemployment and under-employment, and reduced household incomes, in Australia and New Zealand.

15. **Discussions with the authorities indicate that, in most cases, inwards remittances from Australia and New Zealand held up surprisingly well over 2020.** This might partly reflect the extent of government support measures taken in Australia and New Zealand, including employment support and various programs to support mortgagors and small businesses. The effect of these measures has likely had the benefit of muting the adverse impact on incomes of those PIC citizens who work in Australia and New Zealand, enabling them to continue to transfer remittances to their home countries. However, given that income support measures are phasing out or have already phased out in Australia and New Zealand (and in many other countries), and that an increase in unemployment and under-employment is forecast for these countries, a weakened remittance inflows in PICs may be possible in 2021.

Implications for financial stability

16. **The economic impact of the pandemic in the PICs have potentially major implications for their financial stability.** Banks and non-bank lenders are likely to sustain a deterioration in asset quality as a result of credit exposures to SMEs and households affected by the economic contraction associated with the pandemic. This is especially the case for banks with significant exposures to the tourist sector, regional airlines and retail sector. As discussed later in this report, the eventual impact on bank revenue and capital has yet to work itself out; much will depend on the extent and duration of the pandemic's economic impact, and the effectiveness and sustainability of government and central bank policy responses. The impact on banks' asset quality and loan provisioning will become apparent once the temporary government support and debt servicing concessions expire.

17. **A weakening in bank and non-bank lender profits and capital appears unavoidable as a result of narrowing interest margins, reduced appetite for lending, increased holdings of (low return) liquid assets, and increasing loan losses.** Against these risks, the starting point for banks' capital positions is generally strong, with most banks in the PICs having relatively high capital ratios. Moreover, the risks to financial stability and depositors will be mitigated to a substantial degree by the dominant presence of strong parent banks from jurisdictions with sound governance, risk management and supervisory frameworks, especially Australia and, in the case of some of the smaller PICs, US and French banks. There is a risk, though, that these banks will seek to reduce operating costs as part of their remediation strategies in ways that could, in the medium term, see growing pressure on some banks, such as ANZ and Westpac, to further cut back or sell of their PIC operations. Westpac is already on this path, having sold off some of its business in the region and with plans announced to further exit the region in 2021. This creates a medium to longer term risk for financial stability and efficiency for the PICs.

18. **A greater risk for the banking systems in the PICs arises from the potential impact of the pandemic on domestically-owned banks, including some development banks with commercial operations.** This is especially a risk for PNG, Fiji, Samoa, Solomon Islands and Tonga, given the extent to which domestic banks and non-bank lenders have

a major share of total banking system assets. Fiji, Samoa and Tonga, among others, are also at some risk to the extent that foreign parent banks of subsidiaries and branches in their jurisdictions come under capital pressure. Cross-border contagion risk is therefore an important issue to be factored into financial system impact.

19. **The financial stability impact is also influenced by the quality of supervisory arrangements and financial safety nets in the PICs.** In most countries in the region, prudential supervision is at a relatively early stage of maturity and is under-resourced, with significant areas of non-compliance with the BCBS Core Principles[15]. Prudential supervision tends to be mainly compliance-based rather than risk-based, with relatively limited off-site monitoring. On-site examinations are undertaken in most of the countries, but tend to be hampered by too few staff with the experience and depth of knowledge required to do the job effectively, particularly as regards in-depth asset quality reviews and risk management assessments. There is relatively little development of early warning indicators and stress testing in some of the PICs, which reduces the ability of supervisory authorities to detect emerging stress at an early stage. This recognises that there is limited capacity to undertake stress testing due to insufficient staff with the necessary skills, knowledge and experience. Moreover, there is a lack of integration in the linkage between stress testing and the calibration of prudential regulation and supervision. Much work remains to be done in these areas. However, in some of the PICs considerable progress has been made in building capacity in surveillance, stress testing and on-site supervision. This is encouraging and will help to strengthen the supervisory authorities in those PICs to respond effectively to the Covid impact on the financial system.

20. **In the countries with little or no regulatory presence, the risks to the financial system are even greater, given the lack of capacity to detect and respond to emerging risks and maintain constant overview of the banks and insurers.** In effect, these countries are relying substantially on foreign supervision of the banks and insurers, leaving them exposed in cases where foreign supervision is not of a high quality and does not extend to coverage of the operations in the PICs. In the case of the small domestic financial institutions, such as credit unions, finance companies and microfinance institutions, a deficiency in supervision and regulation creates a significant vulnerability in periods of stress and reduces the capacity for appropriate responses.

21. **The extent of cross-border systemic banks in PICs increases the risk of contagion between home and host countries.** This risk is low in the case of banks whose parent entities are domiciled in countries with strong supervisory frameworks, such as Australia and the United States. However, the risk of cross-border contagion is considerably greater where the parent banks are domiciled in countries with relatively under-developed supervision and corporate governance and/or where the host operations in PICs represent a substantial proportion of the bank global balance sheet. These risks place a premium on the need for effective cooperation and coordination between home and host authorities, including for the detection of risk, early intervention, supervision, recovery planning and resolution. This is an area where considerable strengthening of arrangements would be beneficial, particularly in the case of banks that are domiciled in PICs and other countries with limited supervisory capacity and where the banks in

[15] See, for example, various IMF/World Bank FSAP and FSSR reports for PICs, together with a range of TA reports provided to the PIC authorities. In many of these reports, the findings reached included that the banking supervision arrangements were generally not sufficient to meet financial stability objectives and materially not compliant with the Basel Core Principles.

question have operations that are systemically important in home and/or host countries in the region.

22. **There is also a vulnerability in all PICs in terms of recovery and resolution capacity, and in financial safety nets.** The PICs generally do not yet have robust recovery planning frameworks in place. Various TA and FSAP missions have identified significant deficiencies in supervisory arrangements for early intervention and remediation in some of the PICs. A number of the countries have only relatively limited capacity for the early detection of risks and a structured approach to remediation required for situations of emerging stress in banks. The general absence of bank recovery plans compounds the problem. That said, progress is being made in some of the PICs to strengthen early intervention frameworks and to develop recovery planning requirements for banks.

23. **Resolution frameworks in all of the PICs are below the level expected by international standards.** Most of the regulators have some legal powers for intervention and resolution, but these are under-developed and lack many of the features expected of a robust resolution regime (e.g. as per the FSB Key Attributes). There is also generally a significant lack of resolution policy development. TA and FSAP reports have identified major gaps in some of the PICs' resolution frameworks, including a lack of generic resolution guidance and preparation, no comprehensive resolution toolkits, and no bank-specific resolution plans.

24. **Financial safety nets are also largely non-existent in the PICs.** No country in the region has a formalised deposit insurance framework, although some (e.g. FSM and Palau) derive the benefit of US deposit insurance arrangements. There is no structured source of systemic resolution funding. In effect, the resolution arrangements, such that they are, would largely depend on ad hoc public bail-outs, with attendant moral hazard and fiscal risks. As has been conveyed in various TA, FSSR and FSAP reports, there is a need for the PICs to develop financial safety nets to reduce the risk of poorly structured fiscal support. Desirable initiatives include the establishment of pre-funded deposit insurance schemes and systemic resolution funding mechanisms that, while it may be initially publicly funded, would include a capacity for ex post levies on banks to recover net outlays.

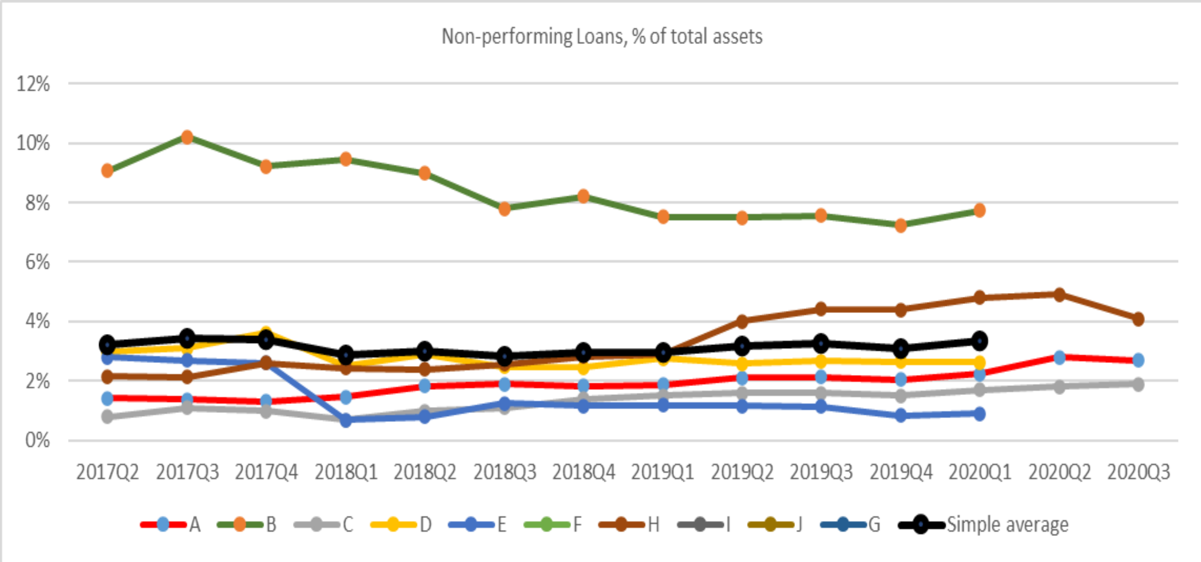
25. **The emergency liquidity arrangements of central banks in the region are also generally in need of further development.** In most respects, the legal powers for ELA are present in central bank statutes, but there is often a lack of policy development in this area, with little preparation of indicative loan agreements, terms sheets for lending, recovery mechanisms, collateral arrangements and disclosure arrangements. This creates a risk of ad hoc central bank funding in periods of bank stress, including a risk that central banks could become the source for solvency support. Further work is needed in these areas to strengthen the capacity for ELA and to mitigate the risks associated with it, including through a strengthening of liquidity requirements in banks. To that end, some of the central banks in the region have recently made significant progress in strengthening ELA policies and operational pre-positioning, which will assist in facilitating ELA readiness should liquidity problems emerge.

Loan impairment

26. **Banks and non-bank providers of credit in the PICs are likely to sustain higher levels of impaired loans and provisioning expenses as a result of the economic impact of the pandemic.** The extent of loan impairment and loan loss provisioning has yet to be fully identified, given the temporary support measures in place, such as suspensions of debt servicing, and the usual lags involved in loan impairment following an economic shock. In that regard, as noted later in this paper, some PICs have undertaken an array of measures to support businesses and individuals affected by the pandemic, such as providing government-funded loans, public guarantee schemes, and temporary payment moratoria. In some cases, banks are working with affected borrowers to restructure loans for firms and individuals heavily impacted by the crisis. These initiatives are important and will play a key role in transitioning the PIC economies back to a stable footing. However, some of the initiatives also have the effect of delaying the recognition of loan losses. Once the temporary support measures are phased out and full recognition of loan impairment takes place, it is very likely that the true level of loan impairment will become apparent during 2021. The level of loan impairment will be a key factor to monitor in the next 12 months, particularly once temporary support measures and debt servicing suspension programs come to an end.

27. **The information available on loan impairment is somewhat dated, with the most recent data generally being for the June or September quarters 2020, and some being as far back as the March quarter.** The data available show a wide range of levels of loan impairment (relative to total loans and to total assets) across the PICs. Loan impairment was relatively stable for most of the PICs over the latter part of 2019 and into 2020, with most PICs having impaired loans below 4% of total assets, and just one country demonstrating particularly high levels of impaired assets. It could be expected that the percentage of impaired loans relative to total assets will rise significantly over the second half of 2020 and into 2021, reflecting the weakening in economic activity, rise in unemployment and underemployment, and possible decline in asset prices. Discussions with supervisory authorities suggest that, in many cases, banks appear to be well provisioned against impaired assets, with some banks having specific and general provisions in excess of the level of impaired assets. See Figure 5 below for data on impaired loans as a percentage of total bank assets. Countries have been anonymised due to the non-public nature of the data on impaired assets.

Figure 5: Non-performing loans relative to total assets

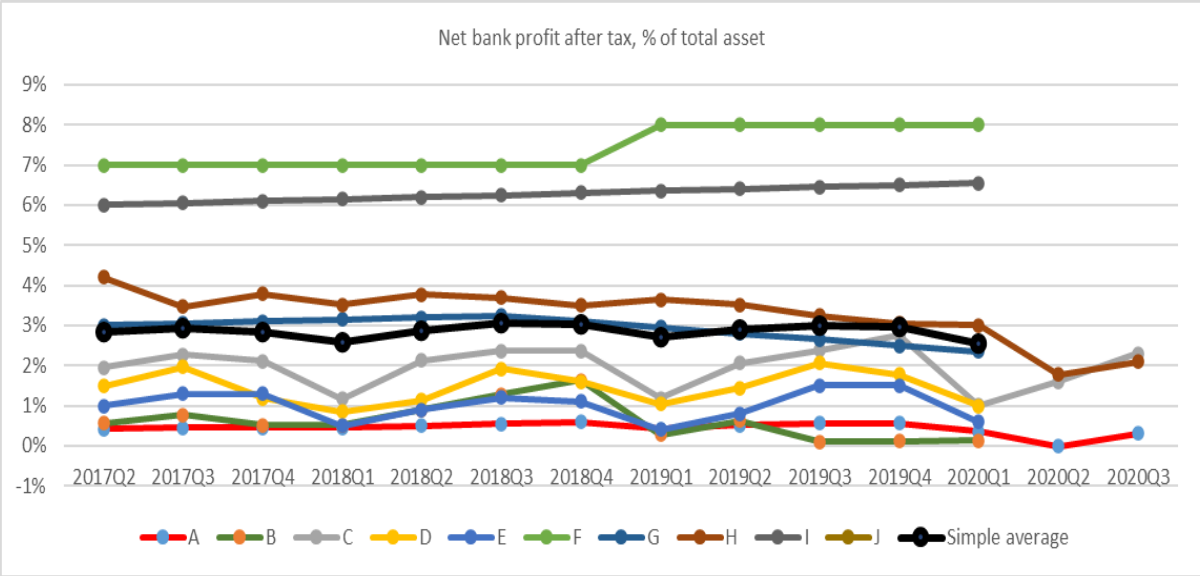


Source: PIC supervisory authorities and IMF FSI. Countries have been anonymised due to the non-public nature of the data on impaired assets. However, letter representations of countries are consistent across the charts , i.e. country A is always the same country in all figures.

Bank profitability

28. **Loan loss provisioning, coupled with a likely compression in net interest margins, will adversely impact on banks' net profits over the latter half of 2020 and into 2021.** The data currently available (generally only through to the first or second quarters of 2020) do not yet reveal any significant downturn in bank profitability across most of the PICs' banking systems, but this will be a key indicator to monitor over the next 12 months. As can be seen in Figure 6, below, average bank profitability (measured as NPAT as a percentage of total assets) varies widely across the PICs, and has been fairly stable for most PICs in recent years. However, as the figure reveals, bank profitability is generally relatively low in the case of most PICs (below 2% of total assets). Significant loan losses and a narrowing in net interest margins creates a risk that some banks and non-bank lenders may incur net losses over the next 1 to 2 years, thereby posing a threat to banks' capital positions. This might be exacerbated if banks hold larger than normal proportions of their assets in central bank deposits or in government bonds, rather than lending, thereby further eroding interest income. It remains to be seen how significant the reduction in bank profitability or the occurrence of losses will be, and what risk they might pose to bank capital positions. Countries have been anonymised in the figures below due to the non-public nature of some of the data.

Figure 6: Profitability of banks in PICs



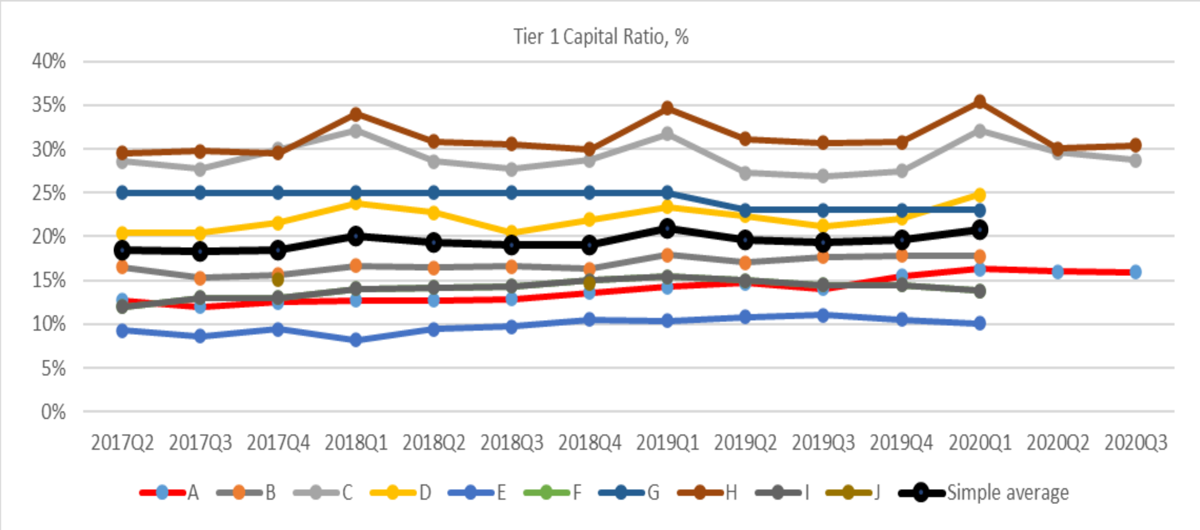
Source: PIC supervisory authorities and IMF FSI. Countries have been anonymised due to the non-public nature of the data on profitability . However, letter representations of countries are consistent across different figures, i.e. country A is always the same country in all figures.

Bank capital ratios

29. **The data currently available show a mixed picture for average bank capital ratios across the PICs.** For most of the PICs, average bank capital ratios were in a relatively strong position as at March/June 2020, with all PICs having average bank tier 1 capital ratios of at least 10% relative to risk-weighted assets, and most having tier 1 capital ratios over 15%. Some PICs have very strong average bank capital ratios, partly reflecting a low level of lending relative to total assets and high levels of holdings of liquid, low-risk assets. The high levels of capitalisation provide a considerable source of strength for the PICs, both in terms of future loss absorption and the capacity of banks to resume lending activity once economic conditions stabilise. See Figures 7 and 8, below. Countries are anonymised due to the non-public nature of some of the data.

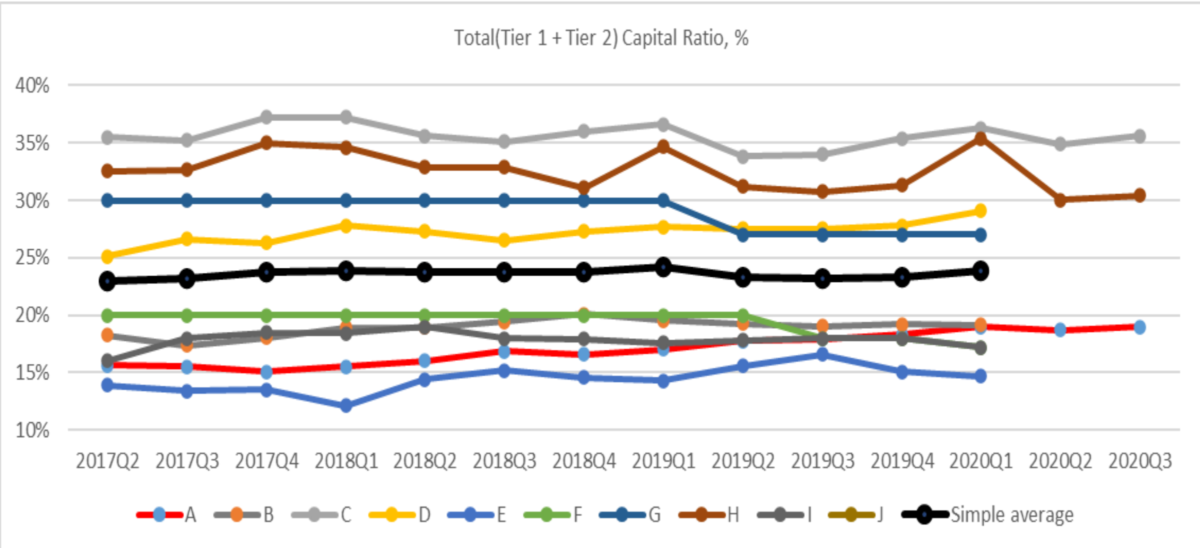
30. **It is likely that bank capital ratios will come under pressure once the impact of loan losses and the reduction in net interest margins fully manifest.** In cases where banks are strongly provisioned against potential loan losses – as appears to be the case in some of the PICs –the impact of deteriorating asset quality on bank capital ratios is likely to be muted. However, for those banks and non-banks with a lower level of provisioning and significant exposures to the tourist and retail sectors, there is likely to be pressure on capital positions, albeit in most cases from a relatively high base. This will be a key issue for supervisory attention through 2021 and might require renewed attention to banks' capital contingency plans, recovery plans (if they have them) and, where relevant, parent bank support.

Figure 7: Average bank tier 1 capital ratios in each PIC



Source: PIC supervisory authorities and IMF FSI. Countries have been anonymised due to the non-public nature of the data on capital ratios. However, letter representations of countries are consistent across different figures, i.e. country A is always the same country in all figures.

Figure 8: Average bank total capital ratios in each PIC



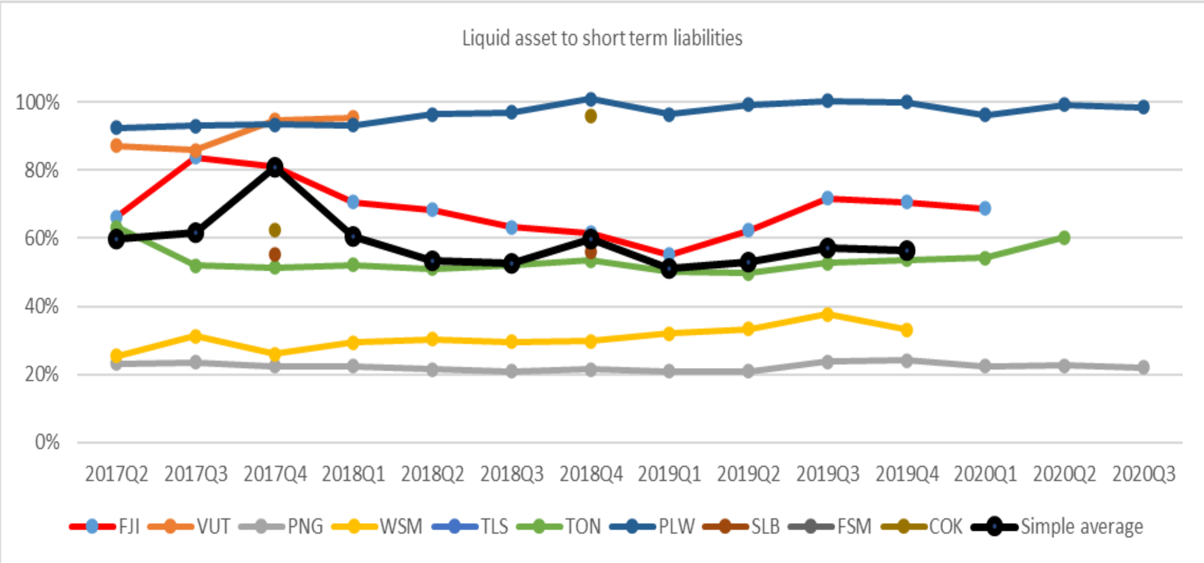
Source: PIC supervisory authorities and IMF FSI. Countries have been anonymised due to the non-public nature of the data on total capital. However, letter representations of countries are consistent across different figures, i.e. country A is always the same country in all figures.

Bank liquidity

31. **Up-to-date liquidity data has been difficult to obtain for several PICs in the current round of reporting.** However, based on the limited data available for recent periods, it appears that average bank liquidity (measured as liquid assets to total assets, and liquid assets to short-term liabilities) has increased significantly in those PICs for which relatively recent data are available. Discussions with the authorities confirm this, with

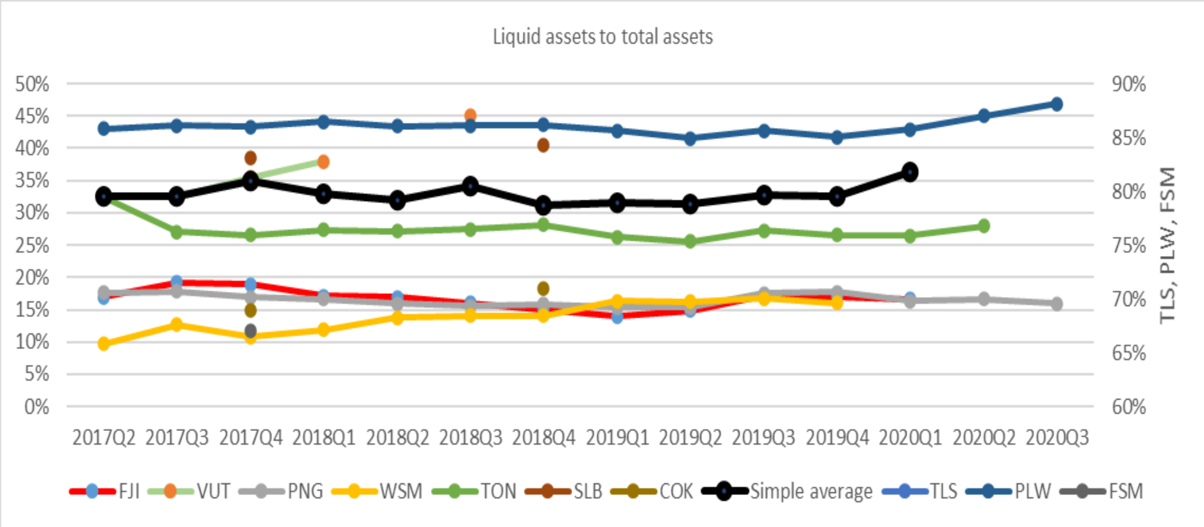
banks generally holding larger-than-normal levels of deposits in the central bank or holdings of liquid assets in other forms, such as government securities. In part, this reflects banks' cautious risk appetite settings in a period of considerable uncertainty, with many banks preferring to hold large liquid balances than to expand their lending. See Figures 9 and 10 below.

Figure 9: Liquid assets to short-term liabilities for banks in selected PICs



Source: IMF FSI
Abbreviations for countries are: VUT = Vanuatu; PNG = Papua New Guinea; WSM = Samoa; TLS = Timor-Leste; TON = Tonga; PLW = Palau; SLB = Solomon Islands; FSM = Federated States of Micronesia; COK = Cook Islands.

Figure 10: Liquid assets to total assets for banks in selected PICs



Source: IMF FSI
Abbreviations for countries are: VUT = Vanuatu; PNG = Papua New Guinea; WSM = Samoa; TLS = Timor-Leste; TON = Tonga; PLW = Palau; SLB = Solomon Islands; FSM = Federated States of Micronesia; COK = Cook Islands.

Operational resilience in banks and supervisory authorities

32. **The closure of borders by PICs has potential implications for operational risk management by banks and supervisory authorities, together with other financial entities.** In particular, the closure of borders, the requirement for quarantine and the limited availability of flights create a risk that essential supplies for banks and other financial institutions, such as IT equipment and parts for ATMs and other banking equipment, may be hindered. Similarly, it may be difficult for PICs to fly in skilled personnel, such as IT experts and bank equipment service staff. Therefore, some operational risks may be exacerbated by the effect of the pandemic.

33. **Discussions with the authorities in the PICs have not identified any major operational risk events because of the pandemic situation.** There has been a minor incidence of ATM malfunction where repair work could not be undertaken due to the inability to fly in technical specialists. Further monitoring of this will be important, especially if foreign travel for IT and other specialists is delayed for many months into 2021, pending the distribution of vaccines.

34. **The World Bank will continue to monitor economic and financial indicators for all the PICs participating in this study.** It will be especially important to monitor the development in impaired loans, given the potential for these to increase significantly in 2021 once the various support programs have been removed.

Section 3: Policy responses to COVID-19

35. **As with many countries globally, the PICs have taken a number of border control, health, macroeconomic and prudential policy initiatives to reduce the economic impact of the pandemic.** PICs closed their borders quickly once the threat of the pandemic became apparent, with strict quarantine requirements applying for residents returning, and full border closure typically applying to non-residents. For the most part, as at February 2021, borders remain closed for most PICs and are unlikely to re-open until vaccines become available and are in widespread use – with borders potentially remaining closed to varying degrees through much of 2021. However, selective corridors of travel have begun to open up, such as between New Zealand and the Cook Islands, with the prospect of this widening progressively into 2021 if infection levels remain very low in the region and depending on the availability of vaccines.

36. **Prudential policy has been used to some extent to assist in the response to the Covid-19 situation.** Supervisory authorities in the region, like those in many countries globally, have taken an accommodative stance to loan impairment. Banks have been given leeway – sometimes with associated fiscal support measures – in the recognition of loan impairment and have been encouraged to offer flexibility to borrowers in stress. Measures taken have included deferment of principal repayments and interest payments on loans, both for the household sector and SME sector, and restructuring of the terms of loans to ease debt servicing obligations. Supervisory authorities also have tended to take a more accommodative stance in the recognition of loan impairment, enabling banks to not treat loans as being impaired solely because of Covid-19 loan repayment deferment arrangements. The capital framework has also provided a means by which prudential policy can assist in the adjustment to the Covid situation, by enabling banks to transition to lower capital ratios while still being comfortably in compliance with capital requirements. Those countries which apply countercyclical capital buffers can use those buffers to enable a relaxation of capital requirements in the face of emerging loan losses and subdued profits.

37. **Appendix 2 contains details of PICs' policy responses to Covid-19**.

Section 4 – Conclusions and possible areas for further focus

38. **To date, banking systems in the PICs have remained stable despite the severe impacts of the pandemic on economic activity.** To some degree, this reflects the extent of monetary and fiscal policy support measures that some PIC authorities have put in place, particularly measures to support incomes of households and SMEs, and debt servicing relief packages. Financial stability has been further supported by the generally sound starting position of most of the PICs' financial systems. Most banks in the PICs are well capitalised, with many having particularly strong capital positions. Several of the key systemic banks in the region have the added advantage of being owned by strongly capitalised parent banks that are domiciled in countries with robust prudential supervision, governance and risk management arrangements. Liquidity is also generally strong, with banks in the PICs holding substantial buffers of high-quality liquid assets and deposits in central banks. Impaired asset positions have not deteriorated significantly to date and impaired assets are generally well covered by specific and general provisioning. All of these factors represent a good starting point for financial systems in the region.

39. **However, as fiscal support measures are progressively wound back and debt servicing relief arrangements come to an end, it is likely that increasing levels of loan impairment will become more apparent.** This is especially the case for those PICs which are heavily dependent on international tourism and those whose economies have been adversely impacted by weather events. Increased loan impairment will result in provisioning expenses, as well as reduced income from loan portfolios. This, coupled with reduced net interest margins and possibly a reduced appetite for lending, are likely to have adverse impacts on bank profitability and capital positions for at least the next two years. It is therefore essential that the supervisory authorities in the region undertake, in a proactive manner, the initiatives needed to address these financial stability risks.

40. **Strengthening of supervisory surveillance of the banks and non-bank lenders will be especially important.** The focal areas for surveillance will be asset quality and the measures taken by banks to identify the loans that are unlikely to return to performing status once the temporary support measures have been phased out. It will be important for the supervisory authorities to monitor the level of asset impairment and the remediation policies banks and non-bank lenders are applying to transition loans that are under temporary support arrangements back to normal status or into a formally recognised category of loan impairment.

41. **Surveillance will need to be supported by strengthened off-site monitoring and on-site assessment processes.** Off-site monitoring will likely involve the collection of more granular information on banks' and non-bank lenders' loan portfolios, with identification of loans that are under different forms of support measures (such as loan restructuring, interest payment suspension, loan repayment deferral, elongated loan terms, etc). It will also require information on banks' and non-bank lenders' assessment of the ability of borrowers to resume normal loan servicing capacity. On-site assessment capacity may need to be strengthened to enable supervisors to conduct selected reviews of loans under stress to assess the level of impairment and the adequacy of specific provisions against loan impairment. The off-site and on-site surveillance processes would benefit from peer group analysis, whereby supervisors have the capacity to compare banks and non-bank

lenders by reference to a range of indicators of loan performance, remediation measures and provisioning.

42. **Banks with strong parent banks and a well-developed risk management infrastructure and culture are likely to be better placed to manage the loan remediation process than banks without those arrangements.** In such cases, supervisory authorities need to monitor the processes applied by such banks and seek to ensure that the banks are implementing appropriate remediation strategies for loans that are unlikely to return to normal performing status. For banks and non-bank lenders without strong parentage and/or with relatively little experience in the remediation of impaired loans, supervisors will need to monitor their loan remediation processes carefully to ensure that non-performing loans are identified at an early stage, are appropriately provided for in terms of loan loss provisioning, and are placed into a remediation process that seeks to either transition the borrower back to performing status or to terminate the loan and implement an impaired loan recovery process.

43. **Supervisory authorities should consider providing additional guidance to banks and non-bank lenders on asset classification and provisioning, building on the guidance from international standards.** The authorities should refrain from relaxing the regulatory definition of non-performing exposures, with a view to ensuring that banks and non-bank lenders undertake accurate and complete assessments of loan impairment and that provisioning for loan losses is realistic. The easing of the regulatory definition of non-performing loans, even on a temporary basis, should be avoided, to reduce moral hazard risks and maintain accuracy and transparency of loan quality. It is therefore important for supervisors to ensure appropriate disclosure of: (i) materiality of loan restructuring; (ii) the performance of the loan portfolio; (iii) any adjustments made to policies to assess borrowers' creditworthiness; and (iv) the impact of these adjustments. When needed, supervisors should provide additional guidance to ensure that the policies applied to deal with the crisis and their impact are disclosed.

44. **Stress testing will be an important tool going forward.** For the authorities that already have stress testing frameworks in place, it will be important to review these to consider the most appropriate scenarios to assess the potential vulnerability of the banking system and non-bank lenders as they transition from the current Covid-19 situation to the post-Covid-19 environment. Scenarios should seek to evaluate the implications for banks' loan quality, lending growth prospects, net interest margins, profitability and liquidity in a forward-looking scenario that incorporates plausible features of the post-Covid-19 economic environment. For the authorities that have not yet undertaken stress testing as part of the surveillance and risk evaluation supervisory process, it will be important to build capacity in this area, with an initial focus on evaluating the risks to the banks and non-bank lenders to the post-Covid-19 economic environment. Stress testing will be especially useful in the assessment of bank and non-bank lender vulnerability for scenarios in which the return to pre-Covid-19 levels of economic activity takes longer than currently expected. Stress testing will also be an important tool in evaluating the economic and financial implications of climate change and increased risks associated with more frequent and severe tropical cyclone activity.

45. **For the period ahead, when additional surveillance of banks and non-bank lenders will be critical, supervisors may need additional information beyond the normal data they maintain**. Consideration should therefore be given to collecting more wide-

ranging and granular data from banks and non-bank lenders designed to ensure that supervisors are well placed to assess asset quality, provisioning, loan remediation and other key risk areas. The types of data needed might include:

- more granular data on credit exposures, with a particular focus on impaired and restructured loans, loans subject to temporary support arrangements, large exposures, connected exposures, and exposures to entities and sectors that are under stress as a result of the pandemic;

- more granular data on collateral used for lending, including valuation of collateral, particularly for those entities which have been significantly affected by the pandemic;

- data on liquidity positions, including holdings of high-quality liquid assets, asset and liability maturity mismatch positions, cashflow from loan portfolios, and deposit withdrawals; and

- data on interest rate risk positions on the banking book and trading book, and on net open foreign exchange positions.

46. **Supervisory authorities need to ensure that early intervention arrangements are in place for dealing with any situations of emerging bank/non-bank lender stress.** This should include ensuring that the authorities monitor a comprehensive set of early warning indicators covering all key banking risks and that there is a framework for escalating supervisory measures in response to deteriorating financial conditions for individual financial institutions. Existing early intervention frameworks should be reviewed to ensure that they remain pertinent to the current circumstances and modified where necessary. For the authorities that do not yet have early intervention arrangements in place, such as pre-defined early warning indicators, triggers for early intervention and an escalating set of supervisory responses, initiatives should be taken to put arrangements in place, even if just of an ad hoc nature. In the longer term, more structured, permanent early intervention frameworks should be established if they do not currently exist.

47. **As part of the early intervention arrangements, supervisory authorities need to ensure that banks and non-bank lenders have contingency plans and recovery plans in place to deal with emerging stress.** Contingency plans should be a standard requirement for all banks and significant non-bank lenders, including for capital and liquidity, as well as business continuity plans. The plans should be integrated into financial institutions' risk management frameworks and designed to enable the financial institution to restore capital and liquidity back to pre-defined restoration levels, and to maintain continuity of all essential banking functions and support systems. There should be a requirement for banks and non-bank lenders to undertake regular testing of these contingency plans, and for the supervisory authorities to oversee this testing process. Where banks and significant non-bank lenders do not yet have recovery plans in place, supervisory authorities should take the necessary steps to ensure that recovery plans are established and are integrated into financial institution risk management frameworks. Recovery plans should be designed to address relatively severe scenarios of financial impact to capital and liquidity, and should incorporate a comprehensive set of triggers and recovery actions, as well as appropriate governance arrangements. They should be subject to regular testing by financial institutions and be overseen by the supervisory authorities.

48. **Where appropriate, domestic coordination of relevant agencies may need to be strengthened in the response to the pandemic.** This is especially the case between supervisory authorities and finance ministries, with particular focus on coordinating the exit from pandemic government support to households and SMEs, the withdrawal of loan guarantees and the progressive transition back to normal monetary and fiscal policy settings. The supervisory authorities need to ensure that they are well informed of government initiatives that may have implications for the financial system. Equally, the supervisory authorities/central banks need to ensure that the finance ministry and other government advisers are well informed of any financial stability issues that may be impacted by post-Covid normalisation policy transitions. Coordination will also be needed between supervision authorities and finance ministries to the extent that any bank or non-bank lender financial distress situation arises, including an agreed approach to any recovery and resolution procedures and, potentially, resolution funding.

49. **Cross-border cooperation and coordination will be an important element in the response to the pandemic.** This is especially the case for the PICs whose systemically important banks include banks which are subsidiaries or branches of foreign banks (which is the case for many PICs) and those with banks that have extensive foreign operations (as with PNG, for example). Cross-border cooperation and coordination need to cover a number of elements to ensure an appropriate response to the pandemic, including:

- Regular information-sharing between home and host supervisory authorities on the asset quality and provisioning position of the parent bank and host subsidiaries/branches.

- Regular information exchange on the remediation measures being taken by the parent bank and its host operations to address impaired assets.

- Regular information exchange, and coordination as appropriate, between supervisors in terms of the supervisory responses to the Covid situation, particularly matters relating to intensified surveillance, on-site asset quality reviews, stress testing, and supervisory initiatives relating to impaired loan remediation.

- To the extent that early intervention is needed, including invoking contingency plans or recovery plans, this should ideally be done on a coordinated basis between the home and host authorities, with a view to ensuring a whole-of-group response to the situation. In that regard, if the host operations of a bank require parent support – e.g. liquidity support, capital support or functionality support – these matters should be promptly identified by the host supervisory authority and a coordination plan established with the home authority.

50. **In a worst-case scenario, the pandemic and/or other trigger events, such as severe weather impacts, could lead to a serious financial distress situation in PIC economies, such as a severe liquidity crisis or the failure of a bank or non-bank lender.** It is important that the authorities are well prepared for such events, including through the maintenance of crisis management protocols, bank resolution policies and procedures, emergency liquidity assistance frameworks, and formalised or de facto deposit insurance systems to protect small depositors. Most of the PICs are relatively

under-developed in these areas. Legislation for bank crisis management is generally quite dated and falls short of international principles and good practices. The policies and procedures for dealing with bank distress and failure are generally under-developed and not subject to regular testing. With few exceptions, there are no financial safety nets in the PICs, including deposit insurance. There is no established framework for resolution funding in most cases. These deficiencies create a risk of ill-prepared responses to financial crises, with the potential for single bank distress events to trigger inter-bank contagion and for the authorities' responses to involve potentially expensive fiscal funding, with attendant moral hazard risks. It is therefore important that the authorities invest the resources and time needed to develop appropriate frameworks for responding quickly, effectively and efficiently to financial distress events in ways that maintain financial system stability, while also minimising moral hazard and fiscal risks. Much of the work needed in this area falls to the supervisory authorities/central banks and finance ministries in close coordination. It will also require a considerable degree of cross-border coordination, given the substantial degree of cross-border banking activity in the region.

51. **A strong legal and institutional framework for insolvency and debtor/creditor rights is critical to support the speed and efficiency of banks' recovery and the resolution of distress to minimize economic damage and financial market disruption.** Corporate insolvency is also a critical tool to enable the deleveraging of firms presenting unsustainable debt levels and to allocate losses among the relevant stakeholders. However, these frameworks exhibit deficiencies in many developing economies, both in terms of design and implementation, and can thus amplify shocks and financial distress. Moreover, corporate insolvency institutions may weaken during the crisis due to disruptions to basic operations of courts and insolvency agencies. Without intervention, even ordinarily effective frameworks may lead to a significant increase in insolvencies which could trigger fire-sales. Accordingly, it is important that the PIC authorities review their insolvency regimes, with a view to ensuring that the frameworks in place are adequate to cater for the potentially significant increase in personal and corporate insolvencies that could arise in the aftermath of the pandemic or as a result of adverse weather events. See Appendix 4 for data on corporate insolvency frameworks in PICs.

Appendix 1

Overview of financial systems in selected PICs

Country	Brief description of composition of financial system
Cook Islands	The Financial Supervisory Commission serves as the primary regulator of the finance sector. The Financial Services Development Authority, established in 2009, works to promote the industry and progress its long-term development. The Cook Islands economy is moderately monetised, with M2 (relatively broad monetary aggregate) being around 50% of GDP. The Cook Islands financial system comprises a domestic and an offshore sector. The domestic sector includes four domestic commercial banks, three of which have international bank licenses. It also has a national superannuation fund, a domestic insurance company, several insurance intermediaries, and money-changing and remittance businesses. Aside from the three licensed international banks, the offshore finance sector also includes trustee companies specializing in asset protection, and several insurers. Three of the four banks in the Cook Islands are foreign-owned with licenses to conduct both domestic and international (offshore) banking: ANZ Banking Group; Bank of South Pacific (BSP); and Capital Security Bank. The Bank of the Cook Islands is a state-owned enterprise. ANZ Banking Group holds the largest share of the domestic market with 45%, followed by BSP at 40% and Bank of Cook Islands at 15%. Although the Capital Security Bank is a private offshore bank offering private banking products, it also provides domestic banking services, catering mostly to international clients.
Fiji	The Reserve Bank of Fiji (RBF) is the central monetary authority and primary regulator of financial institutions in the country. Fiji’s economy is relatively well monetised compared to many of the PICs, with M2 representing over 75% of GDP. Six commercial banks, one locally owned and five foreign-incorporated, operate in Fiji. The finance sector also features insurance companies, credit institutions, foreign exchange dealers, and the Fiji Development Bank. It has one provident fund that provides pension services to its members.

	Most banks in Fiji are foreign-owned. ANZ Banking Group, Bank of Baroda, Bank of South Pacific, Bred Bank, and Westpac are foreign banks operating in Fiji, while Home Finance Company is locally owned. The Fiji National Provident Fund (FNPF) is Fiji's largest financial institution, accounting for 32.8% of the finance sector's total assets in 2018. Fiji has a small capital market, which includes an equity market, a unit trust market, and a bond market. The bond market, which is mostly composed of government debt instruments, accounts for 58.7% of Fiji's capital market, followed by the equity market at 36.3% and the unit trust market at 4.8%.
Federated States of Micronesia	The FSM Banking Board serves as the regulator of the country's banking system. The FSM economy is moderately monetised, with M2 representing around 55% of GDP. However, given the limited lending activity by banks, together with the difficulties over obtaining collateral over land (a common problem in many PICs), private sector credit is low relative to GDP, at a little over 20%. The FSM's finance sector is not fully regulated. It comprises two commercial banks: one local bank, the Bank of the Federated States of Micronesia (which is owned jointly by the state and private sector shareholders); and a foreign-owned bank, the Bank of Guam. The financial system includes a number of very small deposit-taking credit unions that are not subject to supervisory oversight. The Government of the FSM is taking steps to include credit unions under the supervision of the FSM Banking Board.
Palau	The Financial Institutions Commission supervises the commercial banks. However, insurance providers, micro-lending facilities, pension funds, and credit unions with assets of less than $500,000 are exempt from regulatory oversight. Palau is one of those most monetised economies in the region, with M2 being around 100% of GDP. However, bank lending is low relative to the size of the economy, in part due to the inherent difficulties in banks obtaining collateral due to restrictions on land titles. Private sector credit represents only around 12% of GDP. Palau's financial system is reasonably diverse. Of the five commercial banks operating in the country, three (the Bank of Guam, the Bank of Hawaii, and BankPacific) are foreign-owned and insured by the United States Federal Deposit

	Insurance Corporation (FDIC), while the remaining two (the Asia Pacific Commercial Bank and the Palau Construction Bank) are domestic banks. The FDIC-insured banks provide a full range of banking services, while those not insured by the FDIC are limited to operating savings accounts only. The country also has its own development bank, the National Development Bank of Palau (NDBP), as well as access to the services of the regional development bank, the Pacific Islands Development Bank. The Social Security Administration Retirement Fund and the Civil Service Pension Fund manage pensions in Palau.
Papua New Guinea	The Bank of Papua New Guinea is the primary prudential regulator for most financial institutions in PNG. PNG’s financial system is relatively underdeveloped and limited in scope relative to the economy. Broad money supply (M3) represents a relatively low level relative to GDP at around 30%. Private sector credit is also low, representing only around 20% of GDP. PNG’s finance sector not only includes the usual institutions, such as commercial banks and microfinance companies, but includes superannuation funds, life insurance companies, and a stock exchange. Despite the diversity of institutions, PNG’s financial sector remains underdeveloped, with many residents not having bank accounts or insurance. Commercial banks remain the dominant group in PNG’s finance sector. The four commercial banks operating in PNG (two of which, Bank South Pacific (BSP) and Kina Bank, are locally domiciled) account for around two thirds of total banking system assets. The two foreign-owned banks licensed to operate in PNG are the ANZ Banking Group (as ANZ PNG) and Westpac Bank (as Westpac PNG). Among the four commercial banks, BSP accounts for half the banking system’s assets, with ANZ PNG and Westpac PNG sharing the bulk of the remainder. BSP dominates domestic and regional banking as the largest bank with the widest network of branches and the broadest customer base. Westpac Group has announced the sale of its Western Pacific business, Westpac PNG Bank Limited and Westpac Fiji, to Kina Bank, subject to obtaining local regulatory consent and approval from the shareholders of Kina Bank. The sale is expected to occur in the latter half of 2021.

	The four authorized superannuation funds (Nasfund, Nambawan Super, Defense Force Retirement Benefit Fund, and Aon Master Trust) make up the second largest group in PNG's finance sector, accounting for around 25% of total financial system assets. Microfinance institutions provide an alternative source of financial services, particularly those without bank accounts. With commercial banks focusing more on urban-based transactions, microfinance firms have a growing role in the rural economy. These institutions are largely used for savings, since deposits greatly exceed loans, indicating the important role of the microfinance sector in providing liquidity to PNG's financial system.
Samoa	The Central Bank of Samoa is the country's monetary authority and primary regulator of financial institutions. Samoa's economy has a moderate level of monetisation, with M2 representing around 45% of GDP. Private sector credit is around 80% of GDP. Samoa's financial system comprises 30 licensed financial institutions. The banking industry is composed of two locally-owned and two foreign-owned licensed commercial banks. The insurance industry is made up of six insurance companies and four brokers. The non-bank financial institutions include the Samoa National Provident Fund, the Samoa Housing Corporation, the Development Bank of Samoa, and the Unit Trust of Samoa. Foreign-owned commercial banks and public financial institutions dominate Samoa's finance sector. The country's four commercial banks provide almost 60% of credit to the economy, while the Samoa National Provident Fund and the Development Bank of Samoa account for approximately 30% of credit. ANZ Bank Samoa holds 45% of Samoa's total banking assets. Meanwhile, Bank South Pacific, which is headquartered in PNG, holds around 20% of total assets. The two locally owned banks, Samoa Commercial Bank and the National Bank of Samoa, control around 18% and 16% of the market, respectively.
Solomon Islands	The Central Bank of Solomon Islands is the financial sector regulatory authority. Solomon Islands' economy is moderately monetised, with M2 being around 50% of GDP. However, bank and other institutional lending is relatively low, with private sector credit being only around 25% of GDP. As with some other PICs, this reflects a combination of factors, including a relatively low level of financial inclusion, difficulties in banks obtaining

	collateral due to land title issues, and limited risk appetite by banks. The financial system is dominated by four commercial banks - ANZ Banking Group, Bank South Pacific (BSP), Pan Oceanic Bank (POB), and BRED Bank - and the Solomon Islands National Provident Fund (SINPF). Commercial banks account for around 60% of total assets of the financial sector. Solomon Islands' only domestically incorporated bank, POB, opened in 2014. There are four licensed insurance companies, four insurance brokers, and two insurance agents. A small credit union subsector, two credit companies (Credit Corporation and BSP Finance), one microfinance institution, and a small savings-club subsector supplements the commercial banks.
Timor-Leste	Banco Central de Timor-Leste (BCTL) is the monetary authority and regulator of most financial institutions. Timor-Leste's economy is moderately monetised, with M2 being around 50% of GDP. Bank lending is low, with private sector credit being only around 15% of GDP, reflecting the lack of financial inclusion, land title issues and constrained bank risk appetite. Timor-Leste has five commercial banks, four of which are branches of foreign-owned banks. The financial system also includes insurance companies, microfinance institutions, money transfer operators, financial cooperatives, and credit unions. Timor-Leste's non-bank finance sector is undeveloped, and lacks diversity in financial products and providers. The four international banks operating in Timor-Leste are ANZ Banking Group, PT Bank Mandiri, BNU Timor-Grupo Caixa Geral de Depositos, and PT Bank Rakyat Indonesia. The branches of these banks primarily serve international organizations and their staff, and businesses and nationals from their respective home countries. The only local bank, Banco Nacional de Comercio de Timor-Leste, is owned by the government. Although Banco Nacional de Comercio de Timor-Leste is a relatively small bank compared to its foreign-owned counterparts, it has a large and predominantly local customer base, making it strategically important in Timor-Leste's pursuit of a more inclusive finance sector. It also has the widest outreach and branch network in the country.

	Insurance companies in Timor-Leste have a small consumer base. While insurance providers have expanded their product range in recent years, only a small number of people from Timor-Leste are insured and/or have access to some form of insurance product.
Tonga	The National Reserve Bank of Tonga (NRBT) is the country's central bank and is responsible for the licensing, regulation, and supervision of financial institutions. Tonga's economy is relatively well monetised compared to most PICs, with M2 representing around 60% of GDP. Bank lending is constrained by limited risk appetite and other factors, with private sector credit being around 40% of GDP. There are four commercial banks licensed to operate in Tonga. Two of the four banks are branches of international banks (ANZ Banking Group and Bank of South Pacific), while the other two are domestically owned and incorporated (MBF Bank and the Tonga Development Bank). Tonga has four licensed and seven registered money transfer dealers.
Vanuatu	The Reserve Bank of Vanuatu serves as the primary monetary authority and regulator of financial institutions in Vanuatu. Vanuatu's economy is one of the most monetised in the region, with M2 representing over 80% of GDP. Private sector credit is also relatively strong compared to many PICs, being around 65% of GDP. There are 11 banks licensed to operate in Vanuatu. One commercial bank (the National Bank of Vanuatu) is owned by Vanuatu nationals, while three banks (ANZ Banking Group, BRED Bank, and Bank of South Pacific Vanuatu) are subsidiaries of foreign-owned banks. The remaining seven banks provide international banking services. The country also has 34 insurance companies and intermediaries as well as a pension fund.

Source: Asian Development Bank

Appendix 2

Summary of policy responses to Covid-19 in selected PICs

Country	Policy responses to Covid-19
Federated States of Micronesia	**Border and health restrictions.** The authorities in FSM declared a public health emergency effective from 31 January 2020. The national and state governments introduced travel restrictions, including restricting residents from traveling aboard and banning or requiring 14-day self-quarantine in a COVID-19-free area prior to entry into the FSM. On 30 November 2020, the national government has relaxed outward travel restrictions, allowing residents to travel abroad. **Fiscal responses.** To address the emergency caused by COVID-19, the national government has prepared a US$20 million (5 percent of GDP) COVID-19 Response Framework, in order to develop quarantine and isolation facilities across the nation, provide mandatory infection control training for all first responders, and increase testing capacity and ventilators for each island state in the FSM. On 3 April 2020, the government announced the Pandemic Unemployment Assistance Program of US$36 million (9 percent of GDP) for the period of nine months, supported by the U.S. Department of Labor. On 22 April 2020, the government approved the economic stimulus package of US$15 million (3.8 percent of GDP). The package includes measures to support affected businesses, including wage subsidies, debt relief, as well as social security tax and other tax rebates. **Monetary policy responses.** Given that the FSM uses the USD and has no central bank, it has no independent monetary policy and relies on monetary policy settings established by the US Federal Reserve.
Fiji	**Border and health restrictions.** The authorities reacted to the first confirmed case (on 19 March 2020) with a broad set of measures, including massive screenings of the population, the closure of the international airport, restrictions on domestic travel and public gatherings, closures of schools and certain types of businesses (e.g. cinemas, gyms, etc.), a nationwide curfew and lockdowns of affected areas halted the spread of cases in the country. The repatriation of Fijian citizens since July led to a temporary resurgence of border cases that were quarantined in government-designated facilities and the last active COVID-19 patient was diagnosed and quarantined on 30 October 2020.

	The authorities started relaxing containment and mitigation measures at the national level on 26 April 2020. Phase 2 of Fiji's COVID-safe Economic Recovery Plan, announced on 21 June 2020, leads to the gradual easing of some restrictions (e.g. national curfew, limitations on public gatherings) and the reopening of schools and certain recreational facilities under strict conditions. The reopening of the economy under Phase 2 has been tied to the launch of CareFIJI, a contact-tracing mobile application. On 15 October 2020, the tourism ministry launched Care Fiji commitment program to promote tourism and to increase awareness among the visitors about pandemic related safety measures. It also removed mandatory 14 days quarantine requirements for visitors from COVID contained countries. **Fiscal responses.** The authorities announced two major fiscal stimulus packages in response to the COVID-19 pandemic, one on 26 March 2020 and one on 17 July 2020. The first package entailed up to FJ$1 billion (8.7 percent of GDP) in supplemental expenditures on public health, lump sum payments through the Fiji National Provident Fund (FNPF), tax and tariff reductions, and loan repayment holidays (up to F$ 400 million of the total envelope) aim at protecting public health, supporting the economy and ensuring food security. The second fiscal package was announced as part of the FY2020-21 budget for the fiscal year beginning in August. The stimulus mainly consists of sizeable tax and tariff cuts. Fiscal and import excise duties on over 1,600 items are reduced or eliminated. Similarly, the budget includes cuts to the service turnover tax, environmental tax and departure tax. The budget also entails a total of F$100 million for unemployment assistance and a subsidy to Fiji Airways of F$60 million to incentivize first 150,000 tourists in new fiscal year. The government also introduced several additional allocations amounting F$50.9 million for the development of sugar sector. More recently, the government expanded its unemployment assistance, guaranteed the debt of Fiji Airways and announced a concessional loans initiative for MSMEs impacted by COVID-19, approving loans of in the amount of F$ 23.5 million (as of 12 Oct 2020). The government's initiatives aim to improve the investment ratio which has fallen to 12.8 percent against an average of 20 percent in the last three years. The authorities also announced a new hiring subsidy program under which the government will pay the minimum wage of F$ 2.68 per hour and the remainder will be paid by the employers. **Monetary policy responses.** The Reserve Bank of Fiji reduced the overnight policy rate to 0.25 percent from 0.5 percent on 18 March 2020 to counter the economic impact of COVID-19. The RBF also: (i) expanded the SME Credit Guarantee Scheme to

	assist small entities, (ii) raised its Import Substitution and Export Finance Facility by FJ$100 million to provide credit to exporters, large scale commercial agricultural farmers, public transportation and renewable energy businesses at concessional rates, (iii) raised its Natural Disaster and Rehabilitation Facility to FJ$60 million (renaming it the Disaster Rehabilitation and Containment Facility) to provide concessional loans to commercial banks for them to on-lend to businesses affected by COVID-19, and (iv) purchased FJ$280 million of Government bonds in the first half of 2020 to help finance the Government deficit.
Palau	**Border and health responses.** The authorities adopted early prevention and containment measures. These include temporary bans on domestic and international air and sea travel, screening at ports of entry, school closures, and restrictions on public events. On 31 July 2020 the government announced the re-establishment of essential air services, allowing a minimum number of flights for emergencies, repatriation, medical referral, and worker recruitment. Regular commercial air travel remains temporary suspended. All travellers including essential workers and Palauan residents are subject to quarantine regulations and are required to show proof of a negative COVID test result for the 72 hours prior to arrival in Palau. Passengers from low risk areas (Taiwan) are required to observe a 7-day mandatory quarantine in a designated government facility. Passengers from high risk areas are placed under mandatory quarantine for 14 days. **Fiscal policy responses.** The government initiated actions that appropriately support the health sector and hard-hit individuals and businesses. The parliament appropriated an additional $916,808 (0.3 percent of GDP) to the Hospital Trust Fund to help with prevention and preparation for COVID-19. The government also announced measures totalling $20 million (8 percent of GDP) to mitigate economic and social hardship through targeted support to affected businesses and individuals. These included a new unemployment benefit scheme, temporary subsidies for utility bills, a new temporary job creation scheme for public works, and a lending scheme for the private sector. **Monetary and financial responses.** The National Development Bank of Palau announced plans to provide financial relief to affected business and households, including interest only payments, term extension, loan consolidation, and temporary payment deferral. Some private banks have introduced loan deferral and forbearance programs for three months.
Papua New Guinea	**Border and health responses.** Since early February 2020, the PNG government took stringent measures to mitigate a domestic outbreak of COVID-19. Initially, these included a ban on travellers from Asian countries, reduced international flights,

	mandatory health declaration forms for incoming travellers and enhanced screening at designated ports of entries. On 24 March 2020 the authorities announced a State of Emergency (SoE), restricting internal bus and air travel, closure of bars, and work-from-home requirements. Following the lapse of the SoE in June, there has been a renewed outbreak of COVID-19, mainly centered on the National Capital District (NCD), but with a growing number of cases in other regions. The Government announced that domestic travel will only be allowed for essential services and a lockdown of 14 days has been implemented in the NCD. On 5 October 2020, international travel restrictions were eased (allowing additional routes), but domestic requirements to enforce social distancing and hygiene were tightened. On 2 April 2020, the PNG parliament voted to shut down the country and extended the SoE, for a further two months, until 16 June 2020 which enables a return to normal operations. However, businesses are to implement 'new normal' work arrangements which includes physical distancing and use of face masks. The PNG parliament also passed the Public Health Emergency Bill 2020 which seeks to provide a practical and effective legislative mechanism for the implementation of all necessary measures to detect, prevent the entry of, and eradication of pandemic, outbreak or serious public health threat. **IMF disbursement.** On 9 June 2020, the IMF Executive Board approved the disbursement of US$363.6 million in emergency financing under the Rapid Credit Facility (RCF) to help PNG address urgent balance of payments needs created by COVID-19. **Fiscal policy responses.** On 2 April 2020, the PNG government announced a K5.6 billion economic stimulus package in the parliament, consisting of direct budget support/fiscal stimulus of K600m, donor-funded project/grants of K135m, off-budget support of K1,100m, and below-the-line financing of K3.8b. The government announced a K600 million credit line to support businesses and individuals in coordination with the banks and financial institutions, and K500 million support from superannuation savings to employees affected by the economic slowdown. Support for businesses includes K200 million in guarantees for loans to SMEs. Moreover, the government allocated K645 million more to support health, security and economic sector. **Monetary policy and macro-financial policy responses.** The Bank of Papua New Guinea (BPNG) reduced the Kina Facility Rate (KFR) – the main policy rate - by 200 basis points to 3 percent from 5 percent and has asked the commercial banks to

	reduce their respective Indicative Lending Rates. BPNG also reduced the Cash Reserve Requirement to 7 percent from 10 percent to provide additional liquidity to the commercial banks. In addition, BPNG announced a program to repurchase government securities in the secondary market to provide liquidity to the private sector. To encourage interbank activity, BPNG increased the margin on central bank borrowing by 25 basis point to 100 basis points of both sides of KFR. All financial institutions agreed to provide relief of 3 months on loan repayments and interest payments to customers who have lost their jobs on a case-by-case basis. To cover for the 3-month loan repayment holiday for borrowers severely affected by the COVID crisis, BPNG suspended loan-loss provisioning for affected loans during this period. A total of K806 million is expected to be paid out the members from their superannuation savings. The amendments to Superannuation Act will allow its members to withdraw up to 20 percent of their contribution or a maximum of K10,000.
Timor-Leste	**Border and health responses.** The Democratic Republic of Timor-Leste extended the state of emergency until 2 January 2021. It covers the entire national territory and entails restrictions on the entry of people by land, sea or air to prevent the spread of the virus. Citizens are required to maintain social distance, wear a face mask in places of collective use, and wash their hands when entering public buildings. **Fiscal policy responses.** On 20 April 2020 the government approved a stimulus package (US$150 million, about 10.5 percent of GDP) to manage economic and financial risks from the COVID-19 including: (i) cash transfers with a monthly basic income to over 214,000 households, worth US$100 per month per household, lasting for 3 months; wage subsidies (60 percent of the wage cost) for formal sector employees (for 30,000 workers); (ii) the purchase of three months emergency supply of rice; (iii) maintaining transportation channels for movement of essential goods and medical/emergency goods; (iv) waiving for three months (for low-income households) the payment of electricity (up to US$15 per month), water bills, property rental payments owned by the government and social security contributions;(v) provide stipends to over 4,200 Timorese students studying overseas; and (vi) deferral of tax payments for two months. On 23 September 2020, the government decided to distribute cash transfers for basic staple foods to eligible households, worth US$25 per month per household, lasting for two months (November and December 2020). **Monetary policy and financial responses.** On 29 April 2020 the authorities extended access to the Credit Guarantee System to micro-enterprises, increasing the type of economic activities eligible for the program. On 11 May 2020, the authorities

	introduced a moratorium on the fulfilment of capital and interest obligations arising from credit agreements, which delayed maturity by three months and reduced debtors' interest payment obligation to 40% of the original amount with the remaining 60% financed by the government.
Samoa	**Border and health responses.** The government declared a State of Emergency on 20 March 2020 and instructed the public to avoid mass gatherings (of five or more people), and unnecessary travel. The amended State of Emergency Orders was signed into law on 26 March 2020, which gives police officers the legal authority to enforce the Emergency Orders to the full extent of the law. Samoa implemented travel restrictions to protect citizens of the country on 24 January 2020, being among the first countries in the world to do so and has gradually tightened the rules. The government issued the amendments of the Emergency Orders on 13 May 2020 and 20 May 2020, to gradually lift lockdown restrictions. Currently most businesses are under normal operations. Social distancing measures still apply for dining at restaurants, and public and village gatherings are permitted only on limited occasions. Social gatherings in public places remain closed until further notice. On 19 November 2020 the government extended the State of Emergency Orders with amendments, including inbound travel restrictions. Repatriation flights from New Zealand and Australia arrived on 18 September 2020, 6 October 2020 and 30 October 2020 to bring home the citizens, workers under the seasonal employment programs, and scholarship students in the region. Additional repatriation flights for returning citizens from Europe, and the US were scheduled from 27 November 2020 to 11 December 2020. All passengers were required to show proof of a negative COVID-19 test result within the 72 hours before arrival and to be quarantined for 14 days upon arrival into Samoa at a designated location. **IMF disbursement.** On 24 April 2020 the IMF Executive Board approved the disbursement of US$22 million in emergency financing under the Rapid Credit Facility (RCF) to help Samoa address urgent balance of payments needs created by COVID-19. **Fiscal policy responses.** The government put together the first phase of the fiscal and economic response package, amounting to 66.3 million Samoan tala (about 3 percent of GDP). The package, approved by parliament on 7 April 2020, is centred around the mission of "Support the private sector so they can feed the nation," and includes: (i) expenditure to cover the immediate medical response; (ii) assistance to the private sector; and (iii) assistance to individuals and households. The

	government stepped up its efforts to increase the level of preparedness and prevention. Temporary quarantine facilities were established in key areas. The support for the private sector includes: a temporary exemption on import duties on most commonly bought food items for households; duty concessions to be applied to an expanded list of agricultural and fishing materials; a grace period of three months to be applied for all loan payments; and a six-month moratorium on pension contributions for the hospitality sector. Support for citizens includes: establishment of the Emergency Price Control Board to keep wholesale and retail prices in check and bring them down, if necessary; provision of financial assistance to members of the National Provident Fund in the form of a refund of their loan payments for March 2020; and a temporary reduction of utility bills (both electricity and water) for six months through to September 2020. On 30 June 2020 Parliament approved the FY2021 budget, including the second phase of the fiscal and economic response package that amounts to 83.1 million Samoan tala (about 3.8 percent of GDP). It provided a dividend payout by Samoa National Provident Fund, a benefit of 50 tala per citizen for a national ID registration, a special one-off pension payment, unemployment benefit, financial support for utility bills, and paid training for the hospitality sector. The health sector continues to be a priority sector for the government in light of the COVID19 pandemic, and the package finances construction and upgrade of rural hospitals. The government will continue to assist remote education services. **Monetary policy and financial responses.** The Central Bank of Samoa (CBS) continues to maintain an accommodative monetary policy. The CBS encourages commercial banks to reduce interest rates, and/or associated bank fees and charges. The CBS intends to maintain ample liquidity in the banking system to support businesses and stands ready to activate its lending facilities for the financial institutions. The fiscal and economic response package included provision of a three-month grace period to be applied for all loan payments. To compensate part of the losses in interest income, local commercial banks will receive payments from the government.
Tonga	**Border and health responses.** The Government of Tonga introduced restrictive containment measures starting in January 2020. In March 2020, it declared a state of National Emergency and toughened measures for incoming travellers (including international cruise ships and yachts passengers) before prohibiting all passengers flights into the country. Other preventive measures included a national lockdown, a national curfew, the closure of non-essential businesses and public

	facilities, movement restrictions and the prohibition of public gatherings. The authorities started easing restrictions on 12 April 2020 by lifting the national lockdown, and domestic restrictions were further eased on June 11, for example by further reducing curfew hours and removing the prohibition on contact sports. **Fiscal policy responses.** The Government of Tonga announced an Economic and Social Stimulus Package of 60 million Tongan pa'anga (5.3 percent of GDP) for FY2020 on 2 April 2020. This package was intended to provide short-term assistance to all affected sectors in response to the COVID-19 pandemic. Over a third of the funds were to be directed to the health sector, while the rest were to support the other sectors, including tourism, transport, agriculture, education and security. In addition, the Government of Tonga announced a 3-month moratorium on Government Development Loans & TC Gita Recovery Loan Fund, deferral of retirement contributions and hardship allowances for laid-off employees (up to 3 months), needs-based financial assistance, tax and duty relief during the pandemic, and assistance with the payment of utility bills by public enterprises. The FY2021 budget, approved by Parliament on June 22, envisages a deficit of 37.4 million Tongan pa'anga (some 3½ percent of GDP) for FY2021. Spending on health has been identified as one of the top priorities for the government, accounting for 21 percent of the total budget of 589.6 million Tongan pa'anga. **Monetary policy and financial responses.** On 19 March 2020 the National Reserve Bank of Tonga (NRBT) Board approved the provision of liquidity support to the banking system. It also committed to easing exchange control requirements if needed. It placed monetary policy, which was accommodative given low inflation and slow economic recovery, on hold. The NRBT started meeting weekly with banks to ensure there is clear communication, enhanced preparedness and best practices. It is supporting banks in their effort to mitigate the negative impact of the COVID-19 virus on the economy as well as provide essential financial services to households and businesses. Commercial banks are assisting their customers affected by the COVID-19 virus on a case by case basis and depending on individual customers' circumstances by: (i) reducing or suspending the principal loan repayments to interest only loan repayments; (ii) restructuring loans to businesses that have reduced business hours, in affected sectors such as tourism and related industries like transportation and to individuals who have been laid off; (iii) extending the terms of loans to reduce repayments; (iv) reducing loan interest rates on a case by case basis; and (v) providing access to short-term funding, if

	required. The NRBT is also building awareness and expectations through press releases. At end-August, the NRBT announced that its monetary and financial sector policy stance will continue unchanged, given the weak economy. The exchange rate remains pegged against a basket of currencies (within a ±5 percent monthly adjustment limit). No new exchange restrictions have been announced.
Vanuatu	**Border and health responses.** A national State of Emergency (SOE) was declared on 26 March 2020 for a two-week period. The SOE was extended for a 30-day period on 11 April 2020 as a prevention and containment measure for COVID-19 and in response to Tropical Cyclone (TC) Harold which impacted Vanuatu in April 2020. After further renewals, it was due to expire on 31 December 2020. The government: closed all ports of entry for international flights and cruise ships; suspended all domestic flights and ferries; temporarily suspended departures for seasonal worker programs to Australia and New Zealand (with optional repatriation of workers already abroad); closed all schools; established curfews for businesses and transport (excludes essential medical and communication services); banned gatherings of more than 5 people (suspended temporarily as of 5 April 2020 to allow for group sheltering caused by TC Harold and its aftermath) and been encouraging social distancing. Tourism, which contributes 24.6 percent of Vanuatu's GDP, has effectively ceased. Domestic flights and ferries resumed on 11 April 2020, also in response to the aftermath of TC Harold. From 12 May 2020 international flights and vessels carrying international relief supplies or cargo were permitted to enter, provided they comply with Vanuatu's COVID-19 prevention and containment measures. All public schools reopened on 18 May 2020. The government drafted a plan to address the reopening and recovery of the tourism sector which involves how to get visitors back to Vanuatu and under what conditions. From 3 June 2020 the government began repatriation of its citizens and residents stranded abroad after strengthening in-country COVID-19 screening, testing and containment measures. Repatriation and return of vessels registered locally or internationally as Vanuatu vessels outside Vanuatu waters were suspended from 11 to 31 July 2020. The second phase of government's repatriation plan resumed in August and was expected to continue until December 2020. As part of the second phase, the seaport and wharf in Port Vila has now received ships returning to Vanuatu and the mandatory quarantine process has been carried out offshore. The government confirmed on September 18 that targeted testing in quarantine for COVID-19 is being conducted as an additional precaution for those entering Vanuatu from areas classified as high risk. After confirming its first COVID-19 border case in

	November, people returning on repatriation flights from medium and high risk COVID-19 countries must have a negative COVID-19 test 72 hours before boarding. The government announced on 16 July 2020 that it wants to create a travel bubble – the Tamtam travel bubble – although it may not do so until 2021. On 3 September 2020 Vanuatu began a trial Seasonal Workers Program with Australia, called the Mango Pilot project, providing employment for 162 ni-Vanuatu (as mango pickers) in Northern Territory. **Fiscal policy responses.** The government, using its existing budget envelope and with help from Australia, China, New Zealand, UNICEF, WHO, other NGOs/CSOs and some local businesses, is: expanding health facilities, restocking personal protective equipment and supplies, and further training healthcare workers, especially in Port Vila; and spending on community education and awareness. The Vanuatu National Provident Fund (VNPF) provided Hardship Loans, an interest-free withdrawal from a member's account for 6 months of up to 100,000 vatu, after which the member either choses a repayment plan with interest or permanently withdraws the funds with a penalty. When the loan facility closed on 1 May 2020, the VNPF had paid out about 1.5 billion vatu (US$12.5 million). On 31 March 2020 a first-stage fiscal package worth 4.4 billion vatu (roughly 4.5 percent of GDP) was announced. It includes: deferred and cancelled taxes, license fees and charges for businesses in 2020 (796 million vatu); backdating to start of 2020 some reductions resulting from forthcoming business license reforms; the Employment Stabilization Payment (ESP) (reimbursing employers 30,000 vatu per employee per month for four months, plus an additional 12 percent to the employer, for a total of 2.5 billion vatu); SMEs (turnover of less than 200 million vatu) will also receive the value of their business license fees (roughly 400 million vatu); Commodity Support Grant will be provided to producers of copra, kava, cocoa and coffee (300 million vatu); Shipping Support Grant to facilitate farmers' access to major market centres such as Port Vila and Luganville (100 million vatu); secondary school tuition fees are suspended for 2020 (42,000 vatu per student for a total of 510 million vatu, paid directly to schools). The package is financed by the government's cash reserves, reprioritization of expenditures, some debt, and development partner assistance. The government closed the reception for new ESP applications on 15 September 2020. **Monetary policy and financial responses.** On 27 March 2020 the Reserve Bank of Vanuatu (RBV) cut its policy rate from 2.9 percent to 2.25 percent. In its press release on 31 March 2020, it also noted that it undertook other measures at its meetings on 27

	and 30 March 2020, that along with its policy rate cut, were consistent with its twin policy objectives to maintain inflation within a target range of 0-4 percent and official foreign exchange reserves above a minimum threshold of 4 months of import cover. Other RBV measures included: a reduction of commercial banks' Capital Adequacy Ratio (CAR) from 12.0 per cent to 10.0 per cent; and the reactivation of the Bank's Imports Substitution and Export Finance Facility (ISEFF) and the Disaster Reconstruction Credit Facility (DRCF).

Sourced from the International Monetary Fund document '*Policy Responses to Covid-19: Policy Tracker*'.
https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19#P

Appendix 3

Corporate insolvency frameworks in PICs

On average, insolvency frameworks in PICs are weaker compared to the rest of the world. Table 4 displays, for seven PICs, a measure of the strength of corporate insolvency frameworks (lower = better, more efficient) based on three subcomponents: legal framework, process efficiency and quality of the judiciary. For the seven PICs in this sample, the quality of their corporate insolvency frameworks are weaker than the average around the world, as their average percentile rank are above 50. Micronesia, Samoa and Tonga appear to exhibit weakness in at least one of the three dimensions of insolvency frameworks considered here. The interaction between corporate sector stress, insolvency framework and bankruptcies should be closely monitored in the PICs as the pandemic-related economic downturn continues.

Table 4: Quality of Corporate Insolvency Frameworks in PICs (percentile rank among all countries, lower=better)

	Corporate Insolvency, average percentile rank	Subcomponent 1: Legal Framework, average percentile rank	Subcomponent 2: Process efficiency, average percentile rank	Subcomponent 3: Quality of Civ. and Com. Judiciary, average percentile rank
Fiji	**0.52**	0.80	0.16	0.59
Micronesia, Fed. Sts.	**0.70**	0.27	0.90	0.92
Papua New Guinea	**0.61**	0.80	0.63	0.41
Samoa	**0.75**	0.67	0.75	0.82
Solomon Islands	**0.57**	0.74	0.64	0.34
Tonga	**0.73**	0.74	0.54	0.92
Vanuatu	**0.54**	0.65	0.27	0.71

Source: Doing Business and WB FCI staff calculations. Data as of 2018. High = more vulnerable.