|  |
| --- |
| **Confidential and Not for Distribution**logo 300dpi JPEG |
| **Papua New Guinea:****Technical Assistance-Financial Services Sector Development Strategy**[[1]](#footnote-2)**Technical Note on****Financial Sector Regulatory Architecture[[2]](#footnote-3)****Draft for Discussion****November 2015**  |

Contents

[Glossary 4](#_Toc437229559)

[Preface 5](#_Toc437229560)

[Executive summary 6](#_Toc437229561)

[Key recommendations – Summary 11](#_Toc437229562)

[I. Rationale for the report 13](#_Toc437229563)

[Introduction 13](#_Toc437229564)

[Review of the financial sector 13](#_Toc437229565)

[II. Economy 14](#_Toc437229566)

[III. Financial sector 16](#_Toc437229567)

[A. Overview 16](#_Toc437229568)

[B. Bank of Papua New Guinea 20](#_Toc437229569)

[C. Banking sector 20](#_Toc437229570)

[D. Superannuation sector 22](#_Toc437229571)

[E. Insurance sector 23](#_Toc437229572)

[Life insurance sector 23](#_Toc437229573)

[General insurance sector 23](#_Toc437229574)

[F. Finance companies 23](#_Toc437229575)

[G. Savings and Loan Societies (S&Ls) 24](#_Toc437229576)

[H. Microfinance 24](#_Toc437229577)

[I. Mobile banking 25](#_Toc437229578)

[J. Money changers and money remitters 25](#_Toc437229579)

[K. Credit bureau 25](#_Toc437229580)

[L. Development Bank 25](#_Toc437229581)

[M. National payment system development 26](#_Toc437229582)

[N. E-Money 26](#_Toc437229583)

[O. Financial inclusion & financial literacy 26](#_Toc437229584)

[P. Financial advisors 27](#_Toc437229585)

[Q. Complaint handling mechanism 27](#_Toc437229586)

[R. Capital market and financial securities 27](#_Toc437229587)

[Capital market for debt securities 27](#_Toc437229588)

[Capital market for equity securities–Port Moresby Stock Exchange Limited 28](#_Toc437229589)

[S. Other credit providers and money lenders 29](#_Toc437229590)

[T. Deposit insurance 29](#_Toc437229591)

[U. Contingency planning, crisis simulation exercise and crisis management 30](#_Toc437229592)

[V. Legal, regulatory and supervisory frameworks 30](#_Toc437229593)

[IV. Existing Financial Sector Regulatory and Supervisory Architecture 31](#_Toc437229594)

[A. Background 31](#_Toc437229595)

[B. Bank of Papua New Guinea 33](#_Toc437229596)

[C. PNG Insurance Commission 42](#_Toc437229597)

[D. PNG Securities Commission 44](#_Toc437229598)

[E. National Development Bank 45](#_Toc437229599)

[V. Analysis and Critique of Existing Situation 47](#_Toc437229600)

[A. Financial sector stability 47](#_Toc437229601)

[B. Payment system 47](#_Toc437229602)

[C. Coordination, cooperation and information sharing between agencies 48](#_Toc437229603)

[D. Quality of policy, legislation and regulatory frameworks 48](#_Toc437229604)

[*E.* Quality of supervisory frameworks and day-to-day supervision 49](#_Toc437229605)

[*F.* Capacity 49](#_Toc437229606)

[G. Resources 49](#_Toc437229607)

[H. Availability of and access to relevant, reliable and timely information 50](#_Toc437229608)

[I. Equity capital market regulation 50](#_Toc437229609)

[J. Financial sector safety net 51](#_Toc437229610)

[K. Legislative process 53](#_Toc437229611)

[VI. Proposed Changes to Financial Sector Regulatory Architecture 55](#_Toc437229612)

[A. Background 55](#_Toc437229613)

[B. Optimal financial sector regulatory architecture 56](#_Toc437229614)

[C. Preconditions for change to financial sector regulatory architecture 57](#_Toc437229615)

[D. PNG authorities’ needs and views 58](#_Toc437229616)

[E. Approach to the proposed changes to the financial sector regulatory architecture 59](#_Toc437229617)

[F. Key public policy objectives relating to the financial sector 59](#_Toc437229618)

[G. Considerations regarding integration of regulatory agencies 60](#_Toc437229619)

[H. Basis and criteria used as reference for development of change proposals 61](#_Toc437229620)

[I. Considerations regarding integration of regulatory authorities 62](#_Toc437229621)

[J. Enhancing the current arrangements 64](#_Toc437229622)

[K. Recommendations for change to the financial sector regulatory architecture 65](#_Toc437229623)

[L. Conditions necessary for the proposed prudential integrated regulatory authority 66](#_Toc437229627)

[M. Anticipated desirable corollary outcomes arising from the proposed changes 70](#_Toc437229628)

[N. Next steps in the review and change of financial sector regulatory architecture 70](#_Toc437229629)

[Appendix 1: Financial services regulatory architecture 71](#_Toc437229630)

[Appendix 2: Legal and legislative framework 74](#_Toc437229631)

[Background 74](#_Toc437229632)

[System of state 74](#_Toc437229633)

[Constitution 74](#_Toc437229634)

[Central bank 76](#_Toc437229635)

[Banks and financial institutions 78](#_Toc437229636)

[Superannuation funds 80](#_Toc437229637)

[Life insurance 81](#_Toc437229638)

[General insurance 82](#_Toc437229639)

[Payment system 83](#_Toc437229640)

[Consumer protection and competition 84](#_Toc437229641)

# Glossary

|  |  |
| --- | --- |
| AML | Anti-Money Laundering |
| BCBS | Basel Committee on Banking Supervision |
| BCP | Basel Core Principle for Effective Banking Supervision |
| BFIA | Banking and Financial Institutions Act 2000 |
| BPNG | Bank of Papua New Guinea (PNG) (–Central Bank of PNG) |
| BSP | Bank of South Pacific |
| CAR | Capital Adequacy Ratio |
| CBA | Central Banking Act 2000 |
| DOT | Department of Treasury |
| FATF | Financial Action Task Force |
| FIU | Financial Intelligence Unit |
| FSAP | Financial Sector Assessment Program |
| FSDS | Financial Sector Development Strategy |
| FSSA | IMF/WB 2011 PNG Financial System Stability Assessment |
| FSSR | Financial Services Sector Review |
| GIS | Government inscribed stock |
| IFSRSA | Integrated financial sector regulatory and supervisory authority |
| LNG | Liquefied natural gas |
| KATS | Kina Automated Transfer System |
| KFR | Kina Facility Rate |
| MOU | Memorandum of Understanding |
| NEC | National Executive Committee |
| NPL | Nonperforming Loan |
| NPS | National Payment System |
| PGK | Papua New Guinea Kina (National currency) |
| PNG | Papua New Guinea |
| PNGIC | Papua New Guinea Insurance Commission |
| PNGSC | Papua New Guinea Securities Commission |
| POMSoX | Port Moresby Stock Exchange |
| SME | Small and medium-sized enterprise |
| TA | Technical assistance |
| Treasury | Department of Treasury |
| WB | World Bank |
|  |  |

#

# Preface

At the request of the Papua New Guinea Department of Treasury (DOT) and the Bank of Papua New Guinea (BPNG), two World Bank missions visited Port Moresby, respectively during May 18-29 and November 4-13, 2015.The first World Bank mission comprised Ms. Wei Zhang (Task Team Leader) and Mr. Carel Oosthuizen (Consultant) and the second comprised Mr. Craig Thorburn, Technical Advisor, and Mr. Carel Oosthuizen (Consultant), to provide advice to the Papua New Guinea (PNG) authorities on the financial sector regulatory and supervisory architecture.

The first mission met with the DOT Secretary, the BPNG Governor, Deputy Governor, Assistant Governors and other senior staff of the BPNG; the Insurance Commissioner and staff from the PNGIC; the Securities Commissioner; representatives of the Independent Consumer & Competition Commission; the National Statistician; representatives from NGOs, including the Institute of National Affairs; and representatives from various private sector entities, including Bank of South Pacific, BSP Capital, Capital Insurance Group, Credit Corporation, Deloitte, Kina Group of Companies, KPMG, Nambawan Superannuation Fund, PacWealth, Petrusio Capital Partners, Port Moresby Stock Exchange, and QBE Insurance. Also, the mission met with the World Bank country manager, representatives of the Asia Development Bank and the IFC.

The second mission met with the BPNG Governor and Assistant Governor responsible for Financial Stability; DOT representatives, staff from the PNGIC, representatives from ANZ Bank, Kina Securities and POMSoX. Also, the mission met with the World Bank country manager, representative of the Asia Development Bank and of the IFC.

The mission expresses its gratitude to all counterparts for the cooperation extended to it, their time and attention, and their kind hospitality.

The report is structured as follows:

* Section I presents the rationale for the report.
* Section II provides a brief overview of the economy.
* Section III contains an overview of the financial sector.
* Section IV presents an overview of the existing financial regulatory architecture.
* Section V contains an analysis and critique of the financial sector regulatory architecture and framework.
* Section VI concludes with the proposed changes to the financial sector regulatory architecture.

# Executive summary

**The Papua New Guinea (PNG) authorities sought technical assistance (TA) in the areas of financial sector regulatory architecture.** The mission worked closely with the Department of Treasury (DOT), the Bank of Papua New Guinea (BPNG), the Papua New Guinea Insurance Commission (PNGIC), the Papua New Guinea Securities Commission (PNGSC), and representatives of the private sector, and subsequently generated recommendations.

**The DOT identified the need for a financial services sector review (FSSR) in order to develop a coordinated financial services development strategy (FSDS) that can guide the further development of the financial services sector in support of broader economic and development goals, to promote inclusive growth.** The FSDS will contain sequences of, and prioritized and time-bound, reforms, and an action plan for implementation. The FSDS will be aligned and consistent with the Government’s Vision 2050, the Development Strategic Plan 2010-2030, and the Medium Term Development Plan 2011-2015. The FSDS is expected to cover all elements of the financial sector.

**The overall objective of the FSDS is to facilitate and guide the evolution and maturation of the financial services sector, in support of broader economic and development objectives, and to establish a legal framework to support the strategy**. The FSDS will highlight any important financial sector reforms which currently are not being pursued and make clear how the required financial sector reforms are needed to support the overall economic growth and development strategy for PNG.

**This diagnostic technical report constitutes one further element of the FSSR, delving deeper into and focusing on financial sector regulatory and supervisory architecture issues, such as the question of an integrated regulatory approach that incorporates the regulation, licensing and supervision of the financial sector.** This report is one of a suite of four reports which constitute part of this comprehensive review of the financial services sector. The other reports focus on: (a) financial inclusion; (b) the bond market; and (c) the payment system.

**The DOT and the BPNG share concerns that the financial sector regulatory and supervisory structures and arrangements may not be yielding optimal outcomes and could be substantially improved.** [[3]](#footnote-4) Concerns center around an inability to take a holistic view of the financial sector; ineffective and inefficient regulation and supervision; inconsistent regulation and supervision; regulatory and supervisory gaps; silo-approaches; and sub-optimal coordination, cooperation and information sharing. It is recognized that there is no “silver bullet” or single best answer, and that a range of initiatives might be required to improve the situation.

**The DOT and the BPNG share the view that there is a need to establish a single prudential regulatory, licensing and supervisory authority.** It is envisaged that this would be achieved by incorporating the regulation, licensing and supervision of the entire financial sector under the BPNG to ensure effective coordination, and to ensure that consistent high level policies and supervision are applied across all sectors of the finance industry, to eliminate regulatory gaps and assure that there is a coordinated and consistent approach to the regulation and supervision of the entire financial sector.[[4]](#footnote-5)

**This report focuses on the regulatory objectives of financial sector stability, prudential safety and soundness of individual financial institutions, and conduct of business in the securities area.** A range of other regulatory objectives are also relevant to the financial sector and financial services, including competition, consumer protection, financial inclusion and integrity. Financial stability enables institutions and markets to work effectively and efficiently. Safe and sound institutions ensure the interests of key stakeholders, including depositors, policyholders and investors are safeguarded. Free and fair markets ensure that capital can be allocated effectively and efficiently. The financial institutions which are relevant include banks and other deposit-taking institutions, insurers, superannuation funds and securities businesses.

**The debate about regulatory architecture relates to the most appropriate structuring of the authorities in pursuit of the greatest effectiveness in achieving the regulatory goals.** In PNG, the prudential regulatory objectives (of financial sector stability and safety and soundness of individual financial institutions) are being pursued by the BPNG, the PNGIC and the PNGSC. **The question arises whether the current financial sector regulatory architecture best serves the needs of PNG.**

**Optimal financial sector regulatory architecture can enable financial services facilitate meaningful growth and development of the real economy.** No single model of financial sector regulatory architecture is perfect, or even the best under all circumstances. There is no international standard in this area. However, it is generally agreed that suboptimal financial sector regulatory architecture can inhibit the potential contribution of financial services to growth and development. The financial sector regulatory architecture must take local conditions into account. Optimal financial sector regulatory architecture does not guarantee optimal regulation and supervision, which are dependent on a range of other factors. **It is generally acknowledged that “structure must follow strategy.”** One way of looking at this is to ensure that the effective pursuit of regulatory objectives are given primacy over structure for the sake of structure.

**The mission concluded, based on consideration of a range of issues, to advise change to the financial sector regulatory architecture.** These issues include the role of the BPNG; the quality of policy, legislation and regulatory frameworks; the quality of supervisory frameworks and day-to-day supervision; considerations relating to cooperation, coordination and information exchange; dealing with conglomerates and regulatory arbitrage; synergies and cost savings; accountability; risks; and cost of change.

**Based on its review, the mission concludes that there is a case for integration of the financial sector regulatory architecture.** The mission recommends that

* As a first step, integrate general insurance regulation, licensing and supervision into the BPNG.
* As a second step
	+ Constitute the Bank Supervision Deparment and the Insurance (General and Life) and Superannuation Department as the BPNG’s microprudential[[5]](#footnote-6) regulation, licensing and supervision division/unit.
	+ Clearly separate and maintain apart the macroprudential surveillance and financial inclusion functions from the BPNG’s microprudential unit.
* As a third step, integrate the regulation, licensing and supervision of securities into the BPNG’s microprudential unit, as the Securities Department.
* As a fouth step, in the medium term, transfer the BPNG’s microprudential division/unit and Securities Department to a(n independent) subsidiary of the BPNG, which is to be consitituted as an integrated financial sector regulation licensing and supervision authority

**The mission generated also a range of other recommendations and supports recommendations made in the concomitant reports** focusing on: (a) financial inclusion; (b) the bond market; and (c) the payment system. The recommendations relate to the issues of financial sector stability; payment system; coordination, cooperation and information sharing among agencies; quality of policy, legislation and regulatory frameworks; quality of supervisory frameworks and day-to-day supervision; capacity; resources, availability of and access to relevant, reliable and timely information; conduct of business regulation; and also a number of recommendations relating to the financial sector safety net.

The mission would like to caution the key government stakeholders build full consensus on the actual implementation timeline and arrangement to ensure that the objectives of strengthening financial sector regulation can be achieved without interruption to the market and necessary resources are allocated to support the transition.

**Next steps**

This report constitutes the first step in effecting a change to the financial sector regulatory architecture, namely a thorough and comprehensive analysis of the status quo, and generation of well-founded recommendations for change.

Next, the recommendations for change must be studied by the relevant authorities and a consensus developed on decisions for change. All relevant agencies, including the DOT, the BPNG, the PNGIC and the PNGSC, must be involved in this process.

Once the necessary public policy consensus has been achieved, an overarching action plan must be developed for implementation of the consensus change decision/s.

The implementation of the public policy consensus must then be professionally project managed, with the joint DOT and BPNG Working Group being responsible for oversight of compliance with the plan and effectiveness of the outcomes.

The World Bank stands ready to support the authorities’ reform measures through further World Bank TA in the area of regulatory architecture, subject to the request from the authorities and availability of funding.

# Key recommendations – Summary

| **Recommendations** | **Time****frame [[6]](#footnote-7)** | **Responsible Institution(s)** |
| --- | --- | --- |
| **Recommendations relating to regulatory architecture** |  |  |
| Integrate general insurance regulation, licensing and supervision into the BPNG | ST | PNGIC & BPNG |
| Constitute the Bank Supervision Department and the Insurance (General and Life) and Superannuation Department as the BPNG’s microprudential division/unit | ST | BPNG |
| Integrate securities regulation, licensing and supervision into the BPNG | ST | PNGSC & BPNG |
| Transfer the BPNG’s microprudential division/unit and Securities Department to a(n independent) subsidiary of the BPNG, which is to be constituted as an integrated financial sector regulation, licensing and supervision authority | MT | BPNG |
|  |  |  |
| **Next steps** |  |  |
| PNG authorities to study this report and its recommendations, and develop a public policy position | ST | Authorities |
| PNG authorities to develop an overarching plan to implement its public policy position | ST | Authorities |
| PNG authorities professionally to project manage the implementation of its public policy position | MT | BPNG |
|  |  |  |
| **Recommendations relating to other topics** |  |  |
| Ensure that all registration and licensing of FIs are performed by micro-prudential authorities only | ST | BPNG |
| Review the overall financial inclusion policy framework and develop appropriate legislative and regulatory framework | MT | BPNG |
| Develop a general public policy framework, and regulatory and oversight frameworks, regarding investment advisors | ST | BPNG & Authorities |
| Establish an ombudsman / complaints handling function for the financial sector | MT | BPNG & DOT |
| Apply the 80:20 principle for resource allocation to micro-prudential regulation and supervision | MT | Prudential authorities |
| Give effect promptly to the outstanding recommendations from the 2007 ICCC review and the 2011 FSSR. | ST | PNGIC |
| Review financial sector stability and macro-prudential surveillance mandate for effectiveness | ST | BPNG & DOT |
| Payment system: See *PNG: Payment System Assessment Update,* by C Calozza and B Bossone, 2015 for relevant recommendations. | MT | BPNG |
| Improve coordination, cooperation and information sharing between authorities | MT | Authorities |
| Review and update financial sector policy, legislation and regulatory frameworks | MT | Authorities |
| Transition the supervision of general insurance to a risk-based approach. | MT | PNGIC |
| Place more focus on capacity development | ST-MT | Authorities |
| Place the BPNG’s micro-prudential function on a financially self-sustaining basis. | ST | BPNG |
| Review the availability and access to relevant, reliable and timely information. | ST | Authorities |
| Commission an investigation to develop, stimulate, deepen and broaden the equity capital market | MT | PNGSC &BPNG |
| Develop and promulgate consumer protection which is fully aligned with sound international standards and practice | MT | Authorities |
| Strengthen consumer protection through prudential standards for financial institutions | ST | Prudential authorities |
| Amend the ICCC Act 2000 to make it mandatory for prescribed transactions to be reported to the ICCC | ST | ICCC |
|  |  |  |
| Recommendations regarding legislation |  |  |
| Ensure appropriate consultation during the development of financial sector public policy, legislation and regulations  | MT | Authorities |
| Ensure that newly promulgated legislation promptly is placed in the public domain | MT | Authorities |
| Create, maintain and keep updated an official comprehensive central data base of financial sector legislation | MT | Authorities |
| Ensure that consolidated legal instruments are placed in the public domain | MT | Authorities |
|  |  |  |
| **Recommendations relating to financial sector safety net** |  |  |
| Undertake urgently contingency planning and crisis simulation exercises | ST | BPNG & DOT |
| Introduce promptly a standardized repurchase agreement and stimulate interbank market | ST | BPNG |
| Establish a standing LOLR facility. | MT | BPNG |
| Develop internal procedures for bank emergency liquidity arrangements  | ST | BPNG |
| Debt capital market: See *Review of the PNG Government Bond & Capital Market Development,* by RT Andreoli, 2015, for recommendations. | MT | DOT & BPNG |
| Review and update bank recovery and resolution framework | MT | BPNG & DOT |
| Develop a depositor protection framework and establish a formal deposit insurance scheme | LT | DOT & BPNG |

# Rationale for the report

### Introduction

1. **Papua New Guinea (PNG) has experienced sustained brisk economic growth during the past decade or more.** PNG is the largest country among the Pacific islands countries. The economic growth has been driven substantially by abundant natural resources.
2. **Development of the economy has been uneven and income is distributed highly unequally.** Average incomes have reached lower-middle income levels and demand for financial services is increasing, in line with growth in the real economy. More than 80 percent of the population live in rural areas, are dependent on the informal economy for their livelihoods, and typically lack financial access. Most informal economy participants (the bulk of whom are rural) have no access to financial transaction or savings services. Levels of financial exclusion in rural areas continue to be very high – estimated at between 95 percent and 100 percent in many rural communities**.**[[7]](#footnote-8)
3. **Formal financial institutions are involved almost exclusively in the formal economy.** Consistent with growth in the real economy, demand for financial services by government, corporates, institutional investors and households is increasing. Generally, only the urban population, which constitutes around 15 percent of the total population and which is concentrated in the few urban business centers, has ready access to formal financial services.

### Review of the financial sector[[8]](#footnote-9)

1. **In the light of the above, Department of Treasury (DOT) identified the need for a financial services sector review (FSSR).** The FSSR aims to develop a coordinated financial services development strategy (FSDS) that can guide further development of the financial services sector in support of broader economic and development goals, particularly to promote inclusive growth. The FSDS would contain sequences of prioritized and time-bound reforms, and an implementation action plan. The FSDS would be aligned and consistent with the Government’s Vision 2050, the Development Strategic Plan 2010-2030, and the Medium Term Development Plan 2011-2015. The FSDS is expected to cover all elements of the financial sector.
2. **The objective of the FSDS is to facilitate and guide the evolution and maturation of the financial services sector, supporting broader economic and development objectives, and establishing a legal framework for the strategy.** The FSDS will highlight any important financial sector reforms that are not currently being pursued and clarify how the required financial sector reforms which are needed to support the overall economic growth and development strategy for PNG will be implemented.
3. **The PNG government identified a number of challenges that are constraining financial services development in PNG.** In 2014, DOT commissioned a comprehensive review of the financial services sector, as preparation, and to lay the groundwork, for the development of the FSDS. The problems identified include weaknesses in the overall governance and oversight of the PNG financial services sector; a lack of depth in financial markets; insufficient competition; and impediments to access to finance and financial services in both the public and private sectors.
4. **This diagnostic technical report constitutes one further element of the FSSR, focused on financial architecture issues such as integrated regulatory approaches that incorporate regulation, licensing and supervision of the financial sector**. This report is one of a suite of four reports which constitute part of the comprehensive review of the financial services sector. The other reports focus on (a) financial inclusion, (b) the bond market, and (c) the payments system.
5. **The objective of this report is to review and make recommendations on an appropriate financial sector regulatory architecture that would promote and facilitate financial sector stability, safe and sound individual institutions, sound conduct of business and competition/efficiency.** Financial architecture issues are examined, including economies of scope and scale; an integrated regulatory approach and an integrated regulatory authority; coordination, cooperation and information exchange among authorities; and overlaps, gaps and regulatory arbitrage in relation to the regulatory and supervisory frameworks.

# Economy

1. **PNG has a small open economy with a concentrated financial sector.** The key links to the global economy are through trade of goods, services and resources. PNG has limited exposure to the global wholesale funding markets and little use is made of sophisticated financial instruments.
2. **During the past 15 years, the economy has made significant progress, moving from a low income economy to a lower middle-income economy.** In the period 2005 to 2014, the GDP growth rate averaged more than 6 percent. After a one-off substantial hike, attributable to the commissioning of the LNG project, GDP growth is anticipated to moderate, while the fall in resource prices will cause further downward pressure. The BPNG benchmark interest rate is at 6.25 percent (at 31 December 2014) and inflation is at 6.6 percent (for the 12 months to 31 December 2014).
3. **Key vulnerabilities and risks to the economy arise, among others, from the following factors:**
	1. being a small open economy;
	2. limited financial inclusion;
	3. limited or lack of competition;
	4. limited sectoral diversification;
	5. substantial exposure to commodity prices;
	6. high exposure to exchange rate risk;
	7. a highly concentrated banking system with three of the four banks being systemically important;
	8. high concentration in the banks’ loan portfolios;
	9. high reliance on bank funding of the national budget;
	10. high concentration in the superannuation funds’ portfolios;
	11. high operational risk;
	12. severe capacity challenges;
	13. negligible secondary capital market, both in the case of debt and equity;
	14. weak systemic liquidity tools and management;
	15. limited contingency planning;
	16. a challenging security situation;
	17. fiscal discipline challenges;
	18. high cost to do business;
	19. weak governance; and
	20. high levels of corruption.

# Financial sector

## Overview

1. **The financial sector largely is insulated from international financial markets.** The financial sector has limited exposure to international capital markets and little use is made of derivatives and other sophisticated financial instruments.
2. **The bank-dominated financial sector has four banks holding the bulk of financial sector assets.** The next largest component of the financial sector is the superannuation industry, which constitutes the bulk of longer-term-oriented institutional investors. There are short-term insurers and a nascent life insurance industry. Non-bank deposit-taking institutions include finance companies, savings and loan societies and microfinance entities. The non-bank deposit-taking institution sector is small in size. The capital market, both debt and equity, mostly is a primary market, with little secondary market activity. Port Moresby Stock Exchange essentially is moribund. At the apex of the financial sector is the Bank of Papua New Guinea (BPNG).
3. **The 2011 Financial System Stability Assessment (FSSA) identified a number of vulnerabilities.** Indicators pointed to a generally well-capitalized and highly profitable financial sector overall. Vulnerabilities included a highly concentrated financial sector, limited access to finance, limited secondary markets and lack of competition. Improving access to financial services was noted as a key developmental challenge. Developing a liquid secondary market for government bonds would be an important initiative to reduce the external debt and mitigate potential liquidity risks faced by banks. More certainty and clarity on standardized repurchase arrangements with the BPNG would also be an advantage, along with greater clarity on BPNG’s role and responsibilities.
4. **Subsequent follow-up technical assistance, based on the 2011 FSSA recommendations, was provided to strengthen prudential regulations, financial infrastructure and financial inclusion.** The BPNG’s work program over the past five years included efforts to improve financial infrastructure, prudential regulation and advance financial inclusion, with particular efforts around building financial literacy and access to financial services, especially among less advantaged groups of the population,. The BPNG has also been at the forefront of efforts to improve the country’s legal and regulatory framework to comply with international standards for AML/CFT.
5. **The financial sector largely is focused on serving the formal sector, with little outreach to the vast bulk of the population.** Less than 15 percent of the population interface directly with formal financial services.
6. **Financial inclusion and financial literacy are key development challenges.** There is a lack of access to financial services by people in the informal sector and rural communities, and the level of financial and technical capacity is low.
7. **PNG is served by a significant range and number of financial institutions.** There are commercial banks, finance companies, microfinance institutions, savings and loans societies, superannuation funds, superannuation fund investment managers, superannuation fund administrators, life insurance companies, general insurance companies and one development bank. (See Table 1 below)

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Table 1. Papua New Guinea: Financial System Structure**

|  |  |  |  |
| --- | --- | --- | --- |
| **Numbers of institutions** | **2005** | **2010** | **2014** |
| Commercial banks | 4 | 4 | 4 |
| Finance companies | 8 | 8 | 9 |
| Microfinance institutions | 2 | 2 | 5 |
| Savings and loans societies | 21 | 22 | 22 |
| Superannuation funds | NA | NA | 4 |
| Superannuation fund investment managers | NA | NA | 3 |
| Superannuation fund administrators | NA | NA | 3 |
| Insurance companies - Life | 5 | 5 | 5 |
| Life insurance brokers | 4 | 4 | 4 |
| Insurance companies – Non-life | 12 | 14 | 14 |
| Development banks | 1 | 1 | 1 |
| Foreign exchange dealers | 2 | 2 | 2 |
| Mobile network operator | 1 | 1 | 1 |

 |

Source: BPNG Annual Report and *Terms of Reference – Financial Services Sector Review,* Joint Communique of PNG DOT and BPNG, 2015; NA: Not available

1. **Total financial sector assets amounted to PGK38.5 billion (US$14.8 billion) (31 December 2014) (94.4 percent of GDP).** The high ratio of financial sector assets to GDP may be misleading as an indicator of PNG’s level of development.[[9]](#footnote-10) The total assets of non-bank deposit-taking institutions are PGK2.0 billion (US$781 million) (31 December 2014). (See Table 2 below)
2. **Commercial banks hold the largest amount of total assets, at K25.1 billion.** Superannuation funds represent the other significant component of the financial sector, holding K9.4 billion in total assets. (See Table 2 below)

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Table 2. Papua New Guinea: Financial System Structure**

|  |  |  |  |
| --- | --- | --- | --- |
| **Assets by type of institution (in PGK’ million)** | **2005** | **2010** | **2014** |
| Commercial banks | 5,676 | 18,328 | 25,116 |
| Finance companies | 186 | 865 | 912 |
| Savings and loans societies | 335 | 757 | 941 |
| Microfinance institutions | 16 | 113 | 174 |
| Insurance companies - Life | 111 | 356 | 473 |
| Insurance companies – Non-life | 648 | NA | 963 |
| Development banks | 47 | 248 | 550 |
| Superannuation funds | 2.391 | 6,011 | 9,382 |
| **Total** |  |  | 38,512 |

 |

Source: BPNG Quarterly Economic Bulletin NA: Not available

1. **Commercial banks dominate the financial sector, holding 65.2 percent of total financial sector assets. Superannuation funds hold 24.4 percent of total financial sector assets.** Together, commercial banks and superannuation funds hold 89.6 percent of total financial sector assets. (See Table 3 below)

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Table 3. Papua New Guinea: Financial System Structure**

|  |  |  |  |
| --- | --- | --- | --- |
| **Proportion of total financial sector assets (%)** | **2005** | **2010** | **2014** |
| Commercial banks | 60 | 69 | 65.2 |
| Finance companies | 2 | 3 | 2.4 |
| Savings and loans societies | 4 | 3 | 2.4 |
| Microfinance institutions | 0 | 0 | 0.5 |
| Insurance companies - Life | 1 | 1 | 1.2 |
| Insurance companies – Non-life | NA | NA | 2.5 |
| Development banks | 0 | 0 | 1.4 |
| Superannuation funds | 25 | 23 | 24.4 |

 |

Source: BPNG Quarterly Bulletin NA: Not available

1. **The ratio of financial sector assets to GDP recently has been hovering around 100 percent.** The ratio of the equity market (POMSoX) capitalization to GDP consistently has been well in excess of 100 percent, although this is distorted by dual listings.[[10]](#footnote-11) Unfortunately, the equity market turnover has been negligible. (See Table 4, below.)

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Table 4. Papua New Guinea: GDP and stock exchange**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **2006** | **2009** | **2014** |
| GDP (PGK ’million) | 15,195 | 21,784 | 40,800 |
| Financial sector assets to GDP (%) | 63 | 109 | 94.3 |
| **Port Moresby Stock Exchange (POMSoX)** |  |  |  |
| * Market capitalization (K ’million)
 | 23,258 | 47,083 | 53,303 |
| * Number of listed entities
 | 15 | 20 | 18 |
| * Turnover to market capitalization (%)
 | 0.10% | 0.11% | 0.36% |
| * Market capitalization to GDP (%)
 | 153% | 216% | 131% |
| * Licensed stockbrokers
 | 2 | 2 | 2 |

 |

Source: BPNG and Kina Securities NA: Not Available

## Bank of Papua New Guinea

1. **The BPNG is the central bank of Papua New Guinea.** The BPNG’s mandate primarily is monetary policy. In addition, its mandate includes the payments system and financial stability, which in turn includes financial sector supervision. The BPNG acts independently from government.

## Banking sector

1. **The banking system is constituted of four banks which hold assets of PGK25.1 billion (US$9.7 billion) (31 December 2014), equivalent to 65.2% of the total financial system assets, and equivalent to 61.6 percent of GDP.** Two of the banks are locally controlled and two are foreign controlled. Total loans amounted to PGK10.2 billion (US$3.9 billion) (31 December 2014), equivalent to 40.6 percent of total banking sector assets, and 25 percent of GDP, which points to a low level of credit intermediation. Total securities other than shares amount to PGK7.9 billion (US$3.0 billion) (31 December 2014), equivalent to 31.4 percent of total banking sector assets.
2. **The three largest banks hold well in excess of 95 percent of total banking sector assets.** Bank of South Pacific (BSP) dominates the market and makes up around half of the banking sector, thereby constituting a systemically important bank. BSP has an extensive range of cross-border interests located in the South Pacific. The PNG state owns 18 percent of the issued shares in BSP, while the balance is held mostly by local institutional investors. The two Australian-controlled banks, ANZ Bank and Westpac Bank, constitute the vast bulk of the balance of the banking sector, resulting in them also being considered systemically important banks. These latter two banks are focused on corporate and expatriate business.
3. **The BSP group consists of the Bank of South Pacific Limited as the holding company and a range of subsidiaries.** The BSP group has interests in two foreign jurisdictions, namely the Solomon Islands and Fiji. The BSP group is involved in banking, insurance and securities business (share-broking, funds management and corporate advisory). The principal business of the group is the provision of commercial banking and finance services. BSP is listed on the Port Moresby Stock Exchange (POMSoX).
4. **Based on reported indicators[[11]](#footnote-12), the banking sector is financially sound, which constitutes a strong support for a sustaining and facilitating macroeconomic environment.** The average regulatory capital adequacy ratio of the banks is 34.5 percent (31 December 2014) (against a regulatory minimum capital adequacy ratio of 12 percent). Asset quality appears satisfactory with an average NPL ratio of 1.4 percent (31 December 2014). The ratio of liquid assets to total assets of 51.5 percent (31 December 2014) (against a liquid asset requirement of 25 percent) suggests a liquid sector. Return on assets is an attractive 2.0 percent (year to 31 December 2014) and return on equity is 26.2 percent (year to 30 June 2014).
5. **Banks’ liquidity position may not be all it seems on the surface.** Around 95 percent of deposits have a term of three months or less (31 December 2014). Institutional and corporate deposits, which can, in some circumstances, result in lumpy withdrawals, predominate. BSP is the main recipient of government deposits and trust funds. The banks’ liquid assets include substantial holdings of short-term DOT or BPNG bills, for which there is no substantive secondary market. As there is no active interbank market, no repo facility with the BPNG bank nor a BPNG discount window, the natural inclination of a prudent bank would be to maintain high liquidity buffers.
6. **Banks hold significant surplus capital.** This is a reflection of the idiosyncratic nature of the banking sector, with banks holding large portfolios of government bonds (with a zero risk weighting) which form a substantial proportion of the banks’ assets, the high rate of credit growth historically and the lumpiness of corporate loans (with individual large exposures being limited to 25 percent of capital). Securities, the bulk of which is government bonds and BPNG securities constitutes 31.4 percent (31 December 2014) of total assets. Total lending to total bank assets is modest, at around 40.6 percent (31 December 2014). The bulk of the balance of banks’ assets are in the form of cash, currency and deposits.
7. **Areas of concern include liquidity and concentration risk.** Though the banks appear to be liquid, there is extremely limited liquidity in the secondary capital market. Bank’s credit portfolios are concentrated in the resource, commercial and financial sectors.
8. **All the banks are in compliance with the regulatory requirements.**

## Superannuation sector

1. **The superannuation sector is the second largest component of the financial sector, with PGK9.4 billion (US$3.6 billion) (31 December 2014) in assets, equivalent to 24.4 percent of total financial sector assets.** The superannuation industry has the largest non-bank financial institutions and holds more than 70 percent of total non-bank financial assets. The superannuation industry comprises 4 authorized superannuation funds, 5 licensed investment managers and 2 licensed fund administrators. (The PNG state’s unfunded superannuation liability of more than K2 billion (US$0.6 billion) is not included in the above figures.)[[12]](#footnote-13)
2. **Two superannuation funds, Nasfund and Nambawan Fund, dominate the superannuation sector.** Respectively, they have PGK3.7 billion (US$1.4 billion) (31 December 2014) and PGK4.7 billion (US$1.8 billion) (31 December 2014) in assets under management. Their aggregated assets under management constitutes 90.4 percent (31 December 2014) of the total of the superannuation sector’s assets under management.
3. **The superannuation sector has been challenged by a range of serious and fundamental issues.** These include governance, compliance with prescriptions relating to employer contributions requirements, contagion risk and asset concentration risk with limited investment options, and the rapid dissipation of benefits following lump sum payout upon retirement.[[13]](#footnote-14)

## Insurance sector

### Life insurance sector

1. **The life insurance sector has total assets of PGK473 million (US$182 million) (31 December 2014), equivalent to 1.2 percent of total financial sector assets, held by four life insurance companies, which are served by four life insurance brokers.** The life insurance sector is small and has been stagnant for most of the last 15 years. In a recent change in sector direction, the latest life insurer to be licensed has rolled out a business model based on using mobile phones as its marketing and delivery channel. Already, it has over 130,000 policy holders.
2. **As part of its financial inclusion initiative, the BPNG is examining how to leverage the social and economic benefits of life insurance.** One idea is to facilitate improved penetration of life insurance by introducing mandatory group life coverage to all members of superannuation funds (on an opt-out basis). By increasing the proportion of the population which has life insurance cover, social benefits will ensue, the life insurance sector will be strengthened and capital formation will be boosted.Though such an initiative might have some merit, it is clear that much more needs to be done beyond adding insurance to already served clients. Expanding insurance penetration remains a challenge in PNG, especially in view of challenges in the areas of product development and customization, service delivery, financial consumer protection and affordability.

### General insurance sector

1. **Total assets amounted to PGK 963.3 million (US$ 371 million) (31 December 2014), equivalent to 2.5 percent of total financial sector assets** The general insurance industry comprises of 14 general insurance companies, 1 reinsurer, 6 insurance brokers and 1 reinsurance broker. The latest premium income figures available for general insurance sector relate to 2011.

## Finance companies

1. **Finance companies provide asset-based finance to individuals and businesses.** Several finance companies in PNG also provide specific purpose non-chattel-based personal loans (for example, loans for school fees) and are (apparently) potentially expanding to compete with microfinance institutions to provide finance to SMEs.[[14]](#footnote-15)
2. **Finance company lending is being supported through the establishment of an improved chattel security regime.** The Personal Property Security Act was passed into law in December 2011. However, this act will only become effective following the implementation of the Personal Property Securities Online Registry, which will reduce transaction costs, increase transparency of security interests and increase creditors’ capacity to enforce rights in the event of default. Implementation of the registry is scheduled for 2015.[[15]](#footnote-16)
3. **The number and scale of finance companies are increasing as the formal economy expands.** Commercial asset financing experienced significant growth during the construction of the LNG pipeline. However, with the completion of the LNG pipeline, asset financing has slowed and debt recovery action, repossessions and levels of loan delinquency have increased. [[16]](#footnote-17)
4. **There are 9 licensed finance companies which have PGK912 million (31 December 2014) in total assets, equivalent to 2.4 percent (31 December 2014) of total financial sector assets.**

## Savings and Loan Societies (S&Ls)

1. **S&Ls cater to groupings of people who have a common bond.** A S&L is authorized to accept deposits and give out loans only to its members. Each member has an equal say in the election of directors to the board of the society as well as in the distribution of profits. S&Ls have been present in PNG since 1962.[[17]](#footnote-18) S&Ls are mainly limited to professions (eg. Teachers Savings & Loan Society), employers (e.g. Air Niugini Savings & Loan Society) or regions (e.g. East New Britain Savings & Loan Society).
2. **The S&L sector consists of 22 S&L societies, and the Federation of Savings and Loan Societies.** TheS&L sector has total assets of PGK941 million (31 December 2014), equivalent to 2.4 percent (31 December 2014) of total financial sector assets.

## Microfinance

1. **Regulated microfinance is still developing in PNG.** Effectively, microfinance commenced in 2004 with the establishment of Way Microbank, the antecedent of Nationwide Microbank (MiBank), which is the only microfinance institution with nationwide representation.[[18]](#footnote-19) Currently, there are five regulated microfinance institutions.
2. **Microfinance has PGK156 million (31 December 2014) in total assets, equivalent to 0.5 percent (31 December 2014) of the total financial sector banks.**

## Mobile banking

1. **Commercial banks are offering mobile banking services in partnership with mobile network operators.** Digicel PNG has an electronic wallet application which allows deposits, withdrawals and transfers of money. The potential for delivering financial services through mobile banking is considered sizable. Products and technical solutions are under development.

## Money changers and money remitters

1. **There are 7 money changers and 1 money remitter.** The largest provider of domestic remittance services is Post PNG which has 40 postal outlets across PNG and handles 400,000-500,000 remittance transactions per annum.[[19]](#footnote-20)
2. **The high cost of remittance of money between Australia and PNG is a cause for concern.** Remittances are a significant source of foreign earnings and important source of income for a noticeable proportion of the population. The corridor between Australia and PNG is recognized as having one of the highest cost structures globally for the remittance of money. This has a significant impact on the lower-income portion of the population.

## Credit bureau

1. **The principal business of the one credit bureau is to make credit-relevant information available to its members, which it does through the internet.** The Credit & Data Bureau Limited was established in 2008 by a number of financial institutions and collects information from its members and also from public records. The bureau has close to 100 subscribers and its database holds information on close to 200,000 consumers and 18,000 companies.

## Development Bank

1. **The National Development Bank (NDB) is a domestic development finance institution which focuses primarily on the agriculture sector and the microfinance market.** NDB is a state-owned institution which was previously known as the former Rural Development Bank. After the Rural Development Bank had become insolvent for a third time since its establishment in 1967, the PNG government had replaced the board, recapitalized the bank and charged the board with the responsibility of setting the institution on a sustainable footing.
2. **People’s Micro Bank, a subsidiary of NDB, recently reported that it had more than 50,000 customers and deposits of PNK50 million.** In 2010, NDB established NDB Microbank, to enable NDB to mobilize savings and offer other retail banking products and services.
3. **A recent media report states that the NDB has received PNG government endorsement to “move to a full commercial license.”** NDB had lodged an application for a banking license with the BPNG in 2011.

## National payment system development

1. **A safer and more efficient payments system has been established through the implementation of a real time gross settlement system (RTGS) early in 2015.** Checks and direct credit payments can now be settled directly between banks through the Kina Automated Transfer System (KATS). Retail payments systems are under development.

## E-Money

1. **E-Money (the use of computer networks or digital stored value systems to store and transmit money) is increasingly being used and is bound to increase further as the benefits of cashless banking are appreciated.** The BPNG is planning to develop a National Switch (NS) that will enable interoperability between all users of electronic cards and mobile phones for transacting. The national Switch will connect all ATMs, EFTPOS devices and mobile phone payment devices and will facilitate market entry of new providers. The NS will then connect to the KATS for automated settlements. This will provide avenues for more innovative systems.

## Financial inclusion & financial literacy[[20]](#footnote-21)

1. **PNG has a strong need for financial inclusion and financial literacy**. Financial exclusion still exceeds 80 percent of the population. There are substantial opportunities and challenges to improve the quality, equity, usability and access to financial services. The National Financial Inclusion Policy is contained in the National Informal Economy Policy 2011-2015. The National Financial Inclusion and Financial Literacy Strategy 2014-2015 (the Strategy) was developed to serve as PNG’s roadmap towards achieving greater access to financial services, while also improving the financial capability of citizens. The seven key objectives of the Strategy are based upon PNG’s commitments to the Maya Declaration on Financial Inclusion, made at the Alliance for Financial Inclusion’s global policy forum in 2013.
2. **Six industry working groups were formed to implement the Strategy**. The working groups are structured on the themes of government coordination, consumer protection, financial literacy and financial education, inclusive insurance, data measurement and monitoring, and electronic/branchless banking. Implementation of the Strategy is coordinated by the Centre for Excellence in Financial Inclusion (CEFI), in close consultation with the BPNG and the working groups. Beyond the working groups, CEFI collaborates with the CIMC Financial Inclusion Sub-Committee, the Microfinance Expansion Projection, the Pacific Financial Inclusion Project, IFC, AusAid, ADB and other stakeholders that are working together to achieve financial inclusion in PNG.

## Financial advisors

1. **There are two types of financial advisors.** Financial advisors servicing the superannuation sector, who are required to be licensed by the BPNG, and other financial advisors. There are concerns about the behavior of some unlicensed financial advisors and the lack of control and oversight of this sector.

## Complaint handling mechanism

1. **The absence of effective complaint handling mechanisms undermines public confidence on the financial sector.** Also, this constitutes a lost opportunity to gather important information and promote financial inclusion.
2. **The PNG Ombudsman Commission is focused on the public sector only.**
3. **Recommendation:** Consideration must be given to the establishment of an ombudsman / complaints handling authority function for the financial sector.

## Capital market and financial securities

### Capital market for debt securities

1. **The DOT and the BPNG are the only significant primary issuers of debt securities to the market, while the secondary market in debt securities shows negligible activity.** Buyers of these debt securities, being the banks and superannuation funds, mostly hold them to maturity and thus there is no meaningful secondary debt capital market.[[21]](#footnote-22) Consequently, banks are the only substantive source of debt capital and liquidity to the economy.
2. **An active primary and secondary debt capital market serving both the public and private sectors would bring substantial benefits.** An active capital market, inter alia, would promote market integrity, efficiency and effectiveness; enable price discovery; and facilitate investment, investment management, financial management and risk management, especially liquidity risk management.
3. **The only issuer of long term debt is the Government of Papua New Guinea (GoPNG) through the issuance of government inscribed stock (GIS).** GIS has an issue maturity in the range of 3 years to 17 years. The BPNG conducts a monthly auction and maintains a registry of GIS purchasers.[[22]](#footnote-23)
4. **Bond trading activities of bond dealers and clients are by a negotiated process, on an over-the-counter (OTC) basis, rather than exchange traded, which is order driven.** In countries where government securities are listed on the stock exchange, the trading activities are still chiefly OTC. The bond market in PNG should develop as an OTC market regardless of where a trading platform is housed. It is not uncommon in markets where trades are executed in the OTC market and the trade reporting to the exchange are merely pass-through. Central bank open market activities utilize predominately T-bills, central bank bills, and repurchase agreements executed in the OTC market, for purposes of efficiency and timeliness. Government securities are not listed on the stock exchange nor is there any initiative to this effect by the DOT.[[23]](#footnote-24)

### Capital market for equity securities–Port Moresby Stock Exchange Limited

1. **POMSoX operates under two pieces of legislation. POMSoX was established and registered as a company under the Companies Act 1997.** Thereafter, POMSoX was granted a license to operate a stock market under the Securities Market Act 1997.The Securities Act 1997 provides the regulatory framework for the equities capital market, including the offering of securities to the public.
2. **The ownership situation of and regulatory arrangements regarding POMSoX may be leading to suboptimal outcomes.** The key shareholders in POMSoX are also the only authorized stock brokers on POMSoX, namely BSP Capital and Kina Securities. This ownership structure may be contributing to the moribund nature of the capital market in equities. Other credible financial intermediaries, such as the other commercial banks have not shown any interest in becoming involved in POMSoX.
3. **Consequently, there is no independent oversight and regulation of POMSoX.** This raises question marks regarding the transparency, objectivity and fairness of the market. Market conduct regulation must be bolstered, in the interest of building confidence in the market and investor protection.
4. **The securities market includes listed equity securities (regulated by POMSoX), government bonds and BPNG securities.** There are 18 entities listed on the POMSoX, of which 11 relate to natural resources. The POMSoX market capitalization was PGK53.3 billion (US$20.5 billion) (31 December 2014). The POMSoX market turnover was PGK191 million (US$74 million) (31 December 2014), equal to 0.36 percent of POMSoX market capitalization. The 7 listed PNG companies contribute 16% to the total POMSoX market capitalization.
5. **Market turnover is negligible. POMSoX has an automated Trading System called the Port Moresby Stock Exchange Electronic Trading System (PETS).** PETS is an order driven system with relatively few narrow bid-to-offer quotes. Investors must go through one of the two licensed brokers for securities transactions, settlement is T+3, and clears and settles are done manually.[[24]](#footnote-25)
6. **Notwithstanding an aggregate market capitalization which exceeds GDP, very little trading takes place on the stock exchange.** The bulk of the market capitalization is made up of companies which are cross-listed in Australia.Due to the thin market in equities, counterparts indicated that it is difficult to trade in substantial volumes and that high volumes often would result in a significant impact on the price of a share. POMSoX’s trading system appears to be dated and in need of upgrading.
7. **An equities capital market must cater for the need for equity capital of the country.** To this end, it is necessary to develop, by deepening and broadening, the equities capital market. POMSoX has an internet website through which it makes limited information available to the general public. POMSoX does not publish an annual report.

## Other credit providers and money lenders

1. **Other credit providers and money lenders is a problematic component of the financial sector which requires a solution.** There are a large number of other credit providers and money lenders and they are not effectively regulated and supervised. Predatory practices exploit the more vulnerable members of the society, interest rates charged too often are usurious, and in many cases intimidation is used as a loan recovery practice. Consumer protection must be bolstered.
2. **Recommendation:**
	1. Develop and promulgate consumer protection legislation which is fully aligned with sound international standards.
	2. Strengthen consumer protection by issuing prudential standards to financial institutions.

## Deposit insurance

1. **There is no (explicit) deposit insurance in PNG.** In the absence of deposit insurance, the question arises how the authorities will deal with the interests of depositors in the event of a bank failing. As things stand, the door remains open to the authorities to treat every case on its own merits. In the case of insurance policyholders and superannuation customers the situation is similar, and corresponding considerations apply.

## Contingency planning, crisis simulation exercise and crisis management

1. **There is no formal financial sector contingency planning, crisis simulation exercise and crisis management framework.** No crisis simulation exercise has been undertaken.Also, there is no secondary market for government securities and there is an absence of an effective mechanism for providing central bank liquidity.

## Legal, regulatory and supervisory frameworks

1. **The 2011 FSSA noted that more progress was needed on updating the regulatory and supervisory frameworks of the banking and insurance sectors.** The FSAP noted there remained a need to introduce a full set of prudential standards, starting with risk management, market and liquidity risk, to further standardize financial statement reporting, and expand and use more effectively the range of supervisory tools. A more risk-focused approach was also needed and the BPNG should conduct its own assessment of risks to financial stability and use this to form the basis of the supervision strategy. All supervisory functions at the BPNG needed more stable funding, more staff and a more flexible pay system, and, for both the BPNG and the PNGIC, the use of funds should be transparent to ensure accountability. There was a need for greater coordination between the BPNG and the PNGIC. The oversight powers of the BPNG were not categorically stated and the oversight and regulatory powers of the PNGSC were inadequate. As none of these recommendations have been satisfactorily implemented, all of these recommendations appear to require further work.

# Existing Financial Sector Regulatory and Supervisory Architecture[[25]](#footnote-26)

## Background

1. **The financial sector regulatory and supervisory architecture consists of a number of regulators and supervisors.** They include the BPNG, the Independent Consumer and Competition Commission, the PNGIC, POMSoX, and the PNGSC.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Table 1.3 Papua New Guinea: Financial System Structure**

|  |  |  |
| --- | --- | --- |
| **Financial institution** | **Regulatory and supervisory authority** | **Governing legislation** |
| Commercial banks | BPNG | Banking and Financial Institutions Act |
| Finance companies | BPNG | Banking and Financial Institutions Act |
| Microfinance institutions  | BPNG | Banking and Financial Institutions Act |
| Savings and loans societies | BPNG | Savings and Loan Society (Amendment) Act 1995 |
| Superannuation funds | BPNG | Superannuation (General Provision) Act 2000 |
| Superannuation funds investment managers | BPNG | Superannuation (General Provision) Act 2000 |
| Superannuation fund administrator | BPNG | Superannuation (General Provision) Act 2000 |
| Money changers and money remitters | BPNG | Central Bank Act 2000 (Regulations relating to Foreign Exchange and Gold) |
| Insurance companies - Life | BPNG | Life Insurance Act 2000 |
| Insurance companies – General insurance | PNGIC | Insurance Act 1995 |
| Equity market | POMSoX | Securities Act 1997[[26]](#footnote-27) |
| Securities market conduct | PNGSC | Securities Act 1997 |
| Stock brokers | POMSoX | Securities Act 1997 |
| Consumer protection | Independent Consumer Commission | Independent Consumer and Competition Commission Act 2002 |
| Competition | Independent Competition Commission | Independent Consumer and Competition Commission Act 2002 |
| AML / CFT | BPNG | Proceeds of Crime Act, 2005 |
| National Payment System | BPNG | National Payment System Act 2013 |
| National Development Bank |  | National Development Bank Act 2007 |

 |

1. **The DOT and the BPNG share concerns that the financial sector regulatory and supervisory structures and arrangements may not be yielding optimal outcomes and could be substantially improved.** [[27]](#footnote-28)Concerns center around an inability to take a holistic view of the financial sector; ineffective and inefficient regulation and supervision; inconsistent regulation and supervision; regulatory and supervisory gaps; silo-approaches; and sub-optimal coordination, cooperation and information sharing. There is recognition that there is no “silver bullet” single best answer, and that a range of initiatives may be required to improve the situation.
2. **The DOT and the BPNG share the view that there is a need to establish an integrated prudential regulatory, licensing and supervisory authority.** The DOT and the BPNG envisage that this would be achieved by incorporating the prudential regulation, licensing and supervision of the entire financial sector under the BPNG, in one form or other, to ensure effective coordination and consistently high level policies and supervision are applied across all sectors of the finance industry, to eliminate regulatory gaps and ensure that there is a coordinated and consistent approach to the regulation and supervision of the entire financial sector.[[28]](#footnote-29) Similarly, given the lack of active secondary markets in debt and equity, a similar case can be made for bringing the PNGSC under the overall microprudential regulations in BPNG.

## Bank of Papua New Guinea

#### Introduction

1. **The BPNG is a creature of statute and is regulated by the Central Banking Act 2000.** The Central Banking Act 2000 provides that it is an objective of the BPNG to formulate financial regulation and prudential standards to ensure stability of the financial system in PNG. It also specifies that it is a function of the BPNG to regulate banking, credit and other financial services as empowered by the act.
2. **The BPNG is a typical central bank vested with the typical range of central banking responsibilities.** These include the formulation and implementation of monetary policy (the maintenance of price stability, both domestic and of the exchange rate). The BPNG is responsible for both the operation of, and oversight over, the payment system. The BPNG is banker to the government. The BPNG is banker to the government and holding certain bank accounts of the public sector. The BPNG is responsible for the management of the national foreign exchange reserves. Also, the BPNG is the Department of Treasury’s agent relating to the government’s debt. In this capacity, the BPNG has the following roles: issuer, underwriter, registrar, paying agent, market maker, as well as overseeing this market**.**
3. **In addition, the BPNG has a range of other non-traditional responsibilities.** These include capital controls, AML/CFT and operating the Financial Intelligence Center, financial inclusion and playing an important role in the sovereign wealth fund.
4. **The BPNG is responsible for financial stability, which is constituted of both macro-prudential and micro-prudential responsibilities in relation to the financial system.** The BPNG is responsible for financial system stability by means of macro-prudential surveillance. Furthermore, the BPNG is responsible for the regulation, licensing and supervision of a range of entities offering financial services. These include banks, other financial institutions, savings and loan societies, microfinance institutions, superannuation funds, life insurance companies, savings and loan societies, mobile banking, money changers and money remitters, and the payment system.
5. **The BPNG has the following mission and vision:**
	1. “The Bank of Papua New Guinea’s mission is to serve the people of Papua New Guinea by conducting effective monetary policy and maintaining a sound financial system. We will act at all times to promote macro-economic stability, provide a first class payments system and help foster economic growth of our country.”
	2. “Vision: A contemporary central bank and regulator excelling in performing out core functions and making a distinct and valuable contribution to the economic well-being of Papua New Guinea.”

#### Financial stability and macro-prudential surveillance in general

1. **The BPNG is responsible for financial system stability and to this end must perform macro-prudential surveillance.** The Central Bank Act 2000 states that the objectives of the Central Bank include “to formulate financial regulation and prudential standards to ensure stability of the financial system in PNG.”
2. **The importance of the BPNG’s financial sector stability mandate can be gauged, among others, from the following:** The total assets of the PNG financial system (at PGK38.5 billion) almost equate to the size of the PNG GDP (at PGK40.8 billion), which is a useful pointer to the significance of the financial system to the economic well-being and development of the country.
3. **The BPNG recognizes the imperative of macro-prudential surveillance and the supervision of systemically important financial institutions (SIFIs).** The BPNG recently restructured the Financial System Stability Group which is dedicated towards addressing these issues, with the aim of improving its focus and capacity.[[29]](#footnote-30) The BPNG’s financial stability responsibilities cover the entire financial sector. To date, the BPNG has not yet published a financial stability report.
4. **In supervising the financial system, the BPNG aims:**[[30]](#footnote-31)
	1. To protect the interests of depositors and creditors of authorized deposit-taking institutions (ADIs), policyholders of licensed life insurance companies (LICs), and members of authorized superannuation funds (ASFs), by setting, promoting, monitoring and enforcing high standards of integrity and financial soundness of the institutions it regulates;
	2. To promote stability and soundness of authorized financial institutions (AFIs), including ADIs, LICs and ASFs, and effective markets through setting and issuing of prudential standards and enforcing high standards and taking action where such standards are inadequately being complied with;
	3. To maintain confidence in the financial system by promoting consumers’ and AFIs’ confidence in its strength and integrity; and by ensuring that the failure of individual AFIs do not undermine the overall stability and soundness of the financial system.

#### Micro-prudential regulation in relation to the payment system

1. **The BPNG is tasked with the responsibility of regulating and overseeing the payment system.** The Central Banking Act 2000 specifies “to promote an efficient national and international payment system” as one of the four objectives of the BPNG.
2. **The National Payment System was established and is regulated through the National Payment System Act 2013.** The payment system is recognized as part of the core financial infrastructure that underpins the economy as a whole. The National Payment System Act 2013 tasks the BPNG with statutory responsibility for the national payment system, by requiring the BPNG to
	1. exercise regulatory and oversight powers over the national payment system as a whole and any component thereof; and
	2. ensure that users of payment services and instruments are treated fairly and transparently.

#### Micro-prudential regulation in relation to participants in the financial sector

1. **The BPNG is responsible also for micro-prudential regulation and supervision of certain financial institutions.** The Central Bank Act 2000 specifies that it is a function of the BPNG to regulate banking, credit and other financial services as empowered by the act. The Banks and Financial Institutions Act 2000 (BFIA) confers upon the BPNG certain functions and powers to regulate authorized institutions. In terms of section 5 of BFIA, “The principal function of the Central Bank under this Act shall be to promote the general stability and effective working of the financial system in Papua New Guinea.” The BPNG is required to supervise the institutions authorized by it in the exercise of its powers under the Act.
2. **The BPNG has arranged the supervision of the financial system on an institutional basis.** All authorized deposit-taking institutions are supervised by the Banking Supervision Department. All authorized superannuation funds and life insurers are supervised by the Superannuation & Life Insurance Supervision Department.
3. **The support functions are organized into a third department.** The Financial System Development Department is responsible for researching, issuing and reviewing prudential standards and guidelines, licensing, developing and refining the supervision practices of the BPNG, compliance enforcement, and development functions, including financial inclusion and financial literacy advocacy, and anti-money laundering/combating of terrorism financing systems development.[[31]](#footnote-32)

#### Micro-prudential regulation of banks and other licensed financial institutions

1. **The BPNG is charged with the responsibility of supervising banks and other licensed financial institutions, collectively referred to as authorized institutions.** The legal, regulatory and supervisory frameworks are based on and contain key elements of the pronouncements of the Basel Committee on Banking Supervision (BCBS). The banking system is regulated in terms of BFIA.[[32]](#footnote-33) The BFIA is supplemented by prudential standards which regulate, amongst other things, capital requirements, asset classification and provisioning, large and related party exposures.
2. **Authorized deposit-taking institutions include banks, finance companies, micro-banks and savings and loan societies.** Bank and licensed financial institutions are licensed under the BFIA to conduct “banking business.” The BFIA defines banking business as the “business of taking money on deposit and using that money to lend to others or to finance any other activity of the business, wholly or to a material extent, out of the capital or interest on money received by way of deposit.”
3. **Only a bank may carry on the business of**
	1. Accepting money on deposit that is repayable on demand by cheque drawn by the depositor on the borrower; or
	2. Paying and collecting cheques drawn by or paid in by depositors; or
	3. Such other financial activities prescribed by regulations.[[33]](#footnote-34)
4. **The BPNG develops prudential standards for the banking industry.** During 2014, the BPNG developed standards on risks, including credit risk, operational risk and market risk. In addition, it developed standards on capital and corporate governance.
5. **The BPNG’s supervision activities include conducting on-site prudential reviews of and prudential consultations with licensed financial institutions.**

#### Micro-prudential regulation of superannuation funds

1. **The BPNG is responsible for the micro-prudential regulation of superannuation Funds.** The BPNG regulates, licenses and supervises superannuation funds in accordance with the Superannuation (General Provision) Act 2000, which was recently amended[[34]](#footnote-35), and a range of prudential standards covering aspects such as financial disclosure, bad and doubtful debts, etcetera. The purposes of the act primarily is to protect the interests of members of all superannuation funds and to provide for the prudent management of each superannuation fund.
2. **The BPNG recently issued one new and two revised prudential standards for superannuation funds.** The Corporate Governance Prudential Standard and the undertaking of detailed assets reviews have resulted in a significant improvement in the quality of governance and the awareness and control over investments by the authorized superannuation funds.[[35]](#footnote-36) The BPNG issued prudential standards on risk management and investments, and plans to revise all existing prudential standards over the next two years.
3. **The Superannuation and Life Insurance Supervision Department within the BPNG has primary responsibility for the supervision and the sound prudential management enforcement of the authorized superannuation funds (ASFs).** ASFs include trustees, investment managers and fund administrators.
4. **The policy agenda has some important outstanding issues.** The DOT and the BPNG are examining the possibility of introducing a mandatory pension requirement where benefits are paid as income streams, to counteract the rapid dissipation of benefits following retirement.[[36]](#footnote-37)
5. **The BPNG has been active in discharging its responsibilities.** Recently, the BPNG performed detailed asset reviews to improve the industry’s appreciation of the importance of the quality of and control over investments. An Employer Contribution Enforcement Unit was established to address the challenge of ensuring compliance by employers with their obligations to make superannuation contributions.[[37]](#footnote-38) Three times a year, BPNG holds meetings with all key stakeholders in the superannuation industry, the directors, CEOs, investment managers, fund administrators and the external auditors. There appears to be active and productive interaction between the BPNG and the superannuation industry as a whole.

#### Micro-prudential regulation of life insurers

1. **The BPNG regulates, licenses and supervises the life insurance sector in terms of the Life Insurance Act 2000.** Life insurance is the business of issuing life policies; undertaking liability under life policies; and any business that relates to the foregoing. The purposes of the act include to protect the interests of policy holders and to make provision for the prudent management of insurers.
2. **The Superannuation and Life Insurance Supervision Department of the BPNG has primary responsibility for the supervision and the sound prudential management enforcement of life insurance companies (LICs).** LICs include life insurance companies and life insurance brokers.
3. **The BPNG has issued various prudential standards on life insurance.** In 2012, BPNG introduced a prudential standard on corporate governance for life insurance companies. The standard requiring amongst others a majority of independent directors, conflict of interest policy and an audit committee. The BPNG is scheduled to release a risk management prudential standard for life insurance before the end of 2015. BPNG is also in the process of reviewing all of the current prudential standards to reflect better practice with regard to liquidity and risk-based capital.
4. **The dispute between the BPNG and the PNGIC, which has dragged on for years, regarding the definition of a life insurance policy under the Life Insurance Act 2000 remains unresolved.**

#### Micro-prudential regulation of savings and loan societies (S&Ls)

1. **The current legislation is considered to be a constraint to the operation and growth of S&Ls.** The BPNG regulates licenses and supervises savings and loan societies in terms of the Savings and Loan Society (Amendment) Act 1995. Under the act, the members own the society by virtue of their membership. The objects of S&Ls include to receive savings and make loans to their members; to promote thrift amongst their members; and to educate their members in financial responsibility.
2. **The S&L legislation was recently reviewed, and a draft bill presented to the Minister for Treasury for obtaining National Executive Council approval and subsequent tabling in Parliament.** The proposed legislation envisages the separation of the registration and supervision of S&Ls, with registration being the responsibility of the Investment Promotion Authority, while the BPNG will continue to be responsible for supervision. This proposal raises serious challenges to the ability of the authorities to maintain the integrity of prudential regulation and supervision of S&Ls. S&Ls will be required to maintain a minimum initial capital requirement of PGK100,000. S&Ls will be able to access the payment system and consequently be in a position to offer credit and debit cards. The proposed legislation appear to be designed to stabilize the current situation and enable a smaller number of stronger sustainable S&Ls t develop.[[38]](#footnote-39) These proposed changes raise some fundamental questions relating to prudential regulation and supervision. For example, what fit and proper requirements would apply to S&Ls and who will be responsible for enforcing these?
3. **Recommendation:** Ensure that all registration and licensing of financial institutions be performed only by micro-prudential regulatory, licensing and supervisory authorities, as fit and proper testing is indispensable to safe and sound financial institutions.
4. **The BPNG is challenged by the supervisory responsibilities relating to finance companies, savings and loans societies and microfinance, as evidenced by the fact that the resources allocated hereto equates that which is allocated to bank supervision.** The total assets of finance companies, savings and loan societies and microfinance are less than 6 percent relative to the total assets of the financial sector.[[39]](#footnote-40)

#### Micro-prudential regulation of microfinance

1. **In the absence of a customized regulatory and supervisory framework, the BPNG is regulating and supervising microfinance in terms of the BFIA.** The minimum capital requirement for regulated microfinance institutions is PGK1.5 million. [[40]](#footnote-41)
2. **Recommendation:** Review the overall financial inclusion policy framework and develop an appropriate legislative and regulatory framework which can support a safe and sound microfinance industry effectively.

#### Micro-prudential regulation of mobile banking

1. **The regulatory framework for mobile banking is in development.** The one mobile network operator offering mobile banking is operating in terms of an exemption under section 8 of the BFIA. A draft regulation which makes provision for licensing of mobile banking is awaiting promulgation, whereupon it is intended to enable licensing of mobile banking under section 10 of BFIA.[[41]](#footnote-42)

#### Micro-prudential regulation of money changers and money remitters

1. **The BPNG regulates and licenses money changers and money remitters.** The relevant legislation is section 80 of the Central Bank Act 2000 (See also the Regulations relating to Foreign Exchange and Gold).

#### Micro-prudential regulation of e-money

1. **Currently, there is no customized legal framework regulating e-money.** The BPNG uses the Banks and Financial Institutions Act 2000 to regulate entities which are not authorized institutions.

#### Micro-prudential regulation of government securities

1. **The BPNG acts as regulator and supervisor of the PNG government securities primary and secondary markets, as well as repurchase agreement transactions.** Currently, there is no code of conduct, nor does any other criteria exist to control market participant’s activities in government securities market. Given that there is no secondary market activity, supervision is limited to primary market bidding and participation by registered and non-registered bidders. However, once a secondary market develops, there will be a greater participation from the non-financial sector.[[42]](#footnote-43) The PNGSC regulates securities other than government securities.

#### Micro-prudential regulation of AML/CFT

1. **PNG is on the Financial Action Task Force (FATF) list of countries which are considered to have strategic AML deficiencies**.[[43]](#footnote-44) In the latest FATF statement, dated 26 June 2015, it is noted that PNG made a high-level political commitment to work with the FATF and Asia Pacific Group (APG) to address its strategic AML/CFT deficiencies. However, the FATF has determined that certain strategic AML/CFT deficiencies remain. PNG should continue to work on implementing its action plan, including by: (1) adequately criminalizing money laundering and terrorist financing; (2) establishing and implementing an adequate legal framework for identifying, tracing and freezing terrorist assets; (4) establishing a fully operational and effectively functioning financial intelligence unit; (5) establishing suspicious transaction reporting requirements; (6) implementing an adequate AML/CFT supervisory and oversight program for financial sectors; and (7) establishing and implementing effective controls for cross-border currency transaction.[[44]](#footnote-45)
2. **The BPNG was mandated with the responsibility for establishing and operating a Financial Intelligence Unit.** In the light of the BPNG’s role of supervision of the bulk of the financial sector, and its capacity and credibility advantage, the BPNG is well-positioned to discharge this mandate more effectively. The Deputy Governor is responsible for the project to develop, maintain and regularly review the effectiveness of AML/CFT. Austrac is providing technical assistance on AML/CFT to the BPNG The key activities of the project are to:
	1. Ensure that AML/CFT policies and procedures and legislative framework is established and applied.
	2. Ensure that breaches of the AML/CFT are pursued through to conclusion.
	3. Ensure the undertaking of effective enforcement actions on breaches of AML/CFT related issues are pursued through to conclusion in consultation with the relevant authorities.
	4. Ensure that there is appropriate liaison within the BPNG and with other key stakeholders regarding AML/CFT policy and implementation.
	5. Access and make recommendations with regard to AML/CFT
	6. Conduct and enforce compliance with AML/CFT
	7. Develop policies consistent with Financial Action Task Force pronouncements and international sound practices[[45]](#footnote-46)
3. **The AML/CFT Act 2015 recently was passed by Parliament.** It is now a matter for the BPNG to move forward on implementing and supervising the new act. Since June 2015, Papua New Guinea has taken steps towards improving its AML/CFT regime, including by obtaining Parliamentary approval of a Criminal Code Amendment, passing the AML/CFT law, establishing a legal framework to require the freezing of terrorist assets and a cross-border declaration system. FATF is reviewing the laws.

**Regulation of financial advisors**

1. **Certain financial advisors are not licensed.** Only investment managers to superannuation funds are required to be licensed by the BPNG. Instances exist where persons, who were declared under the Superannuation Act to be not fit or proper, are offering financial advice to the general public, government and other key sectors of the financial sector. The gap in the regulatory framework relating to financial advisors needs attention.
2. **Recommendation:** A general public policy framework, regulatory framework and oversight framework must be developed in relation to investment advisors. This framework must impose fit and proper requirements, ethical standards, and an accountability and enforcement framework.

## PNG Insurance Commission[[46]](#footnote-47)

1. **The PNGIC is a creature of statute, implicitly constituted by article 5 of the Insurance Act 1995.** The Insurance Act 1995 raises a number of fundamental issues and questions, including the following:
	1. This actdoes not contain an explicit (public policy) objective. Accordingly, the purpose of the Insurance Act 1995 can only be derived by deduction, a process which leaves one uncertain as to the public policy objective of this act.
	2. In the exercise of his powers and functions the PNGIC must operate within any framework of policy laid down from time to time in policy guidelines issued by the Head of State. Seemingly, no such policy guidelines exist.
	3. Article 75, titled *Regulations,* provides that the Head of State may make regulations prescribing all matters that by this act are required or permitted to be prescribed. The mission was not provided with such regulations. Seemingly, no such regulations were issued.[[47]](#footnote-48)
	4. The only reference to the terms regulation and supervision contained in the Insurance Act 1995 is in Article 37, titled *Exemption*, which does not give any guidance on the meaning, for the purposes of this act, to be attributed to these terms. According it is not clear what the regulatory and supervisory objectives of the PNGIC are or ought to be.
	5. The PNGIC must present to the Minister, for presentation to the Parliament, annually by 31 March, an annual report. The most recent annual report of the PNGIC relates to 2011. (The mission was informed that the PNGIC reports to the DOT.)
	6. It is not clear from this act to which Minister the PNGIC is required to report, apart from two instances (out of 40 references in total) where the reference is to the “Minister responsible for financial affairs.”
2. **The Independent Consumer & Competition Commission (ICCC) in 2007 conducted an independent review of the general insurance industry (2007 ICCC review). The ICCC made the following key findings:**
	1. The Insurance Act 1995 lacks clarity and is not adequately supported by regulations providing detailed guidance to the regulator.
3. **The 2007 ICCC review made the following key recommendations:**
	1. A comprehensive examination of the existing industry legislation be undertaken in order to establish an effective legislative, regulatory and governance framework for the general insurance industry in PNG.
	2. The regulation of the general insurance industry be brought under the auspices of the Bank of PNG.
	3. The redrafting of the legislative, regulatory and governance frameworks be undertaken as soon as possible and recommends that this process is commenced in early 2008.
4. **The 2011 FSSR recommended, among others, the following:**
	1. Develop guidance on governance, risk management and internal controls.
	2. Implement the International Association of Insurance Supervisors’ principles, as appropriate to the PNG setting.
5. **A number of the 2007 ICCC and 2011 FSSR recommendations, including the abovementioned recommendations, appear not to have been acted upon and remain relevant.**
6. **Recommendation:** Give effect promptly to the outstanding recommendations from the 2007 ICCC review and the 2011 FSSR.

#### Micro-prudential regulation of general insurers

1. **The PNGIC is responsible for the micro-prudential regulation of general insurers.** To this end, the PNGIC regulates licenses and attends to various administrative issues pertaining to the general insurance sector. The PNGIC reports to the DOT. A policy review of the Insurance Act 1995 was recently completed, though implementation remains outstanding.
2. **There is a need for more regular structured coordination between the BPNG and the PNGIC.** Rarely is there contact between the BPNG and the PNGIC, and years may elapse between such contacts.

## PNG Securities Commission

#### Conduct of business regulation of securities business

1. **The PNG Securities Commission (PNGSC) was established by the Securities Act 1997.** Currently, the PNGSC is a division within the Investment Promotion Authority. The PNGSC reports to the Minister of Trade, Commerce and Industry. The PNGSC administers the Securities Act 1997, the Takeovers Code 1998, and certain provisions of the Companies Act 1997 relating to prospectuses and the offering of shares to the public. Though the Securities Act 1997 vests regulatory powers in relation to a limited range of topics in the PNGSC, the PNGSC is not empowered to specify operating requirements and guidelines for securities brokers, nor is it empowered to license and oversee registrars and depositories, nor does the PNGSC have oversight powers over settlement systems.[[48]](#footnote-49) The PNGSC regulates securities other than government securities. The PNGSC does not maintain an internet website, nor does it publish any information. The PNGSC does not publish an annual report. PNGSC does not interact with POMSoX or with securities brokers. Interlocutors expressed concern about the effectiveness and capacity of the PNGSC.
2. **The PNGSC has a limited role, as per the Securities Act 1997.** The role of the PNGSC is more of an administrative role, with limited conduct of business related powers and prescriptions. The Securities Act 1997 does not contain an objective clause. Though the fundamental objective of the act can be deduced, it still leaves one with some uncertainty. The act provides that the NPGSC shall have all such powers as are reasonably necessary of expedient to enable it to carry out its functions and duties. The PNGSC exercises no regulatory or supervisory function over the POMSoX, The PNGSC does not appear to have the power to suspend or retract a stock exchange license, even as a measure of regulatory enforcement or penalty for breach of requirements or abuse. The PNGSC has no powers to direct or sanction brokers, or regulate licensing or disclosure requirements.
3. **New draft legislation has been developed to overhaul the framework pertaining to securities business.** These include the Securities Commission Bill 2015, the Capital Markets Bill 2015, and the Central Depository Bill 2015.[[49]](#footnote-50)
4. **The Securities Commission Bill 2015 envisages the establishment of the PNGSC as an independent agency.** The Securities Commission Bill 2015 specifies clear objectives for the PNGSC, including to ensure the orderly administration of the capital markets; to ensure the sound conduct of business in the capital markets and over-the-counter centers; to elaborate policies which are directed at ensuring the fairness, efficiency and transparency of securities and derivatives markets. The Securities Commission Bill 2015 specifies that the PNGSC shall have such functions as are necessary most effectively to further its objectives, including to license, regulate and monitor and supervise the conduct of business activities in the securities and derivatives market, and to set rules and guidelines governing the conduct of business in the securities and derivatives market, and the over-the-counter activities. The Securities Commission Bill 2015 specifies that the chairman of the PNGSC shall inform the Minister on capital markets, its policies and other economic matters, but it does not identify which Minister.

#### Port Moresby Stock Exchange (POMSoX)

1. **POMSoX operates under two pieces of legislation.** POMSoX was established and registered as a company under the Companies Act 1997. Thereafter, POMSoX was granted a license to operate a stock market under the Securities Market Act 1997.
2. **The PNGSC licensed POMSoX.** The PNGSC does not have any role in the regulation and oversight of POMSoX. POMSoX is constituted as a self-regulatory organization in relation to stock broking firms and is authorized to set rules and standards for its members, conduct inspections, and empowered to enforce such standards and rules. Two stockbrokers, BSP Capital and Kina Securities, equally own the total issued share capital of POMSoX. A necessary implication of this state of affairs is that there is no independent effective oversight of the stock brokers or of POMSoX. The Securities Commission Bill 2015 should be wide enough in ambit to address this issue.

## National Development Bank

1. **The NDB is a created of statute, constituted by article 4 of the National Development Bank Act 2007 (NDB Act 2007).** The NDB is specifically empowered by the NDB Act 2007 to apply for a license from the BPNG under the Banks and Financial Institutions Act 2000. The functions of the NDB are
	1. To mobilize savings and provide credit and other banking and financial services to the people of PNG; and
	2. To carry out such other functions as are given to it under this Act or any other law; and
	3. Generally to do such supplementary, incidental, or consequential acts and things as are necessary to convenient for the NDB to carry out its functions.
2. **The NDB is not a department within the public sector, nor is it a public body.** Consequently, it is not subject to the Public Services (Management) Act 1995 or the Salaries and Conditions Monitoring Committee Act 1998.
3. **The NDB must prepare an annual report which is to be furnished to the Minister with ministerial responsibility over the NDB.** The Minister must table it in Parliament as soon as possible after he receives it.

# Analysis and Critique of Existing Situation

## Financial sector stability

1. **Overall, the financial sector appears stable.** The banking sector makes up the bulk of the financial sector and its financial soundness indicators point to a safe and sound banking system. Banks report high capital and liquidity ratios, strong asset quality and attractive profitability ratios. More than half of the assets are in the form of government securities and cash, while loan to deposit ratios are less than 50 percent.
2. **However, there are serious concerns relating to the banking system**. Key concerns include the fact that three banks which are systemically important constitute well in excess of 95 percent of the banking sector; and, the banks’ credit risk exposures are concentrated on a limited number of counterparties in a limited number of sectors, such as the resources, commercial and financial sectors. In addition the banks’ exposure to the PNG state is of concern. Though banks appear to be liquid, there is extremely limited liquidity in the secondary capital market and the BPNG does not appear to have the required systemic liquidity management tools in place.
3. **The adequacy of macro-prudential surveillance is of concern.** Though the BPNG has restructured the Financial System Stability Group, there still appears to be important gaps and shortcomings relating to the monitoring and assessment of financial sector stability. For example, there does not appear to be a financial stability committee which is chaired by the responsible Minister and at which the DOT and the BPNG are represented and which has the mandate for financial stability. Also; there have not been any publications by the Financial System Stability Group on financial stability.
4. **Recommendation:** The DOT and the BPNG urgently must commission a review of financial sector stability and macro-prudential surveillance mandate with a view to developing a sound policy, action plan and appropriate structures to discharge it effectively.

## Payment system

1. **Oversight of the NPS must be bolstered. Though the BPNG has** been granted full legal authority and powers over domestic payment systems, the BPNG has not yet entrenched an oversight function within its internal structure. While the principle has been correctly affirmed within the BPNG that the oversight function will have to be separated from operation, the BPNG has not yet taken action to create the oversight unit, to define the job descriptions for its staff, and to hire the human resources to staff the unit. Delaying these decisions exposes the BPNG, as well as the NPS, to situations where oversight action might be necessary and yet the BPNG would not be able to deliver the required response. More generally, as a national payment system develops in its many dimensions, it requires central bank preparedness to govern its development. Currently, while the NPS in PNG is evolving rapidly, the BPNG is not yet adequately prepared to fulfill its governing, directing and oversight responsibilities.[[50]](#footnote-51) (See *PNG: Payment System Assessment Update,* by C Calozza and B Bossone, 2015 for relevant recommendations.)

## Coordination, cooperation and information sharing between agencies

1. **There appears to be a serious lack of coordination, lack of cooperation and lack of information sharing between the various agencies.** There is no formal coordination arrangements between the DOT and the BPNG for handling systemic risk issues. Nor are there any formal arrangements between the BPNG and the PNGIC. There is considerable scope for enhancing cooperation, coordination and information sharing between the BPNG and the PNGIC.
2. **Coordination, cooperation and information exchange between regulators is essential and demanded by international standards.** Moreover, both the BPNG and PNGIC have financial stability responsibilities, which also require active cooperation, coordination and information exchange. The financial sector under the jurisdiction of the PNGIC may not at present pose major systemic risks, but it remains important to monitor it. The mission found that the BPNG and PNGIC do not cooperate adequately or properly coordinate their regulatory functions.
3. **Recommendation:**
	1. Memoranda of understanding (MOUs) must be entered into between the various domestic agencies which encapsulate their coordination, cooperation and information sharing arrangements bilaterally and multilaterally. These MOUs must also deal with contingency planning, crisis simulation exercise and crisis management. The same applies to relevant and material foreign counterparts. In the event that the responsibility for registration of S&Ls in future were to be vested in the Investment Promotion Authority (IPA), it would be necessary for there to be proper coordination, cooperation and information sharing between the BPNG and the IPA.
	2. Appropriate structures and procedures must be put in place to ensure effective coordination, cooperation and information sharing takes place.

## Quality of policy, legislation and regulatory frameworks

1. **Financial sector policy, legislation and regulation mostly date from around 15 to 20 years ago.** International standards and sound practices, which had been developed and refined during the interim period, were adopted only to a limited extent and inconsistently. Consequently, there are important gaps in the legislation and regulatory frameworks. For example, in relation to banking, there are no detailed prescriptions on governance, risk management, liquidity risk, operational risk, interest rate risk and market risk. This financial services sector review, of which this report is part, mostly is not focused on this issue.
2. **Recommendation:** A comprehensive review must be undertaken by all micro-prudential authorities to update the financial sector policy, legislative frameworks and regulatory frameworks covering all parts of the financial sector.

## Quality of supervisory frameworks and day-to-day supervision

1. **The BPNG appears to be challenged in its allocation of resources to the supervision of, respectively, banks/banking and other financial institutions (other authorized institutions, savings and loan societies and microfinance institutions).**
2. **Recommendation:** The BPNG must apply the 80:20 principle in relation to its micro-prudential regulation and supervision mandate, by focusing 80 percent of its resources on those institutions which hold 80 percent of the systemic risk potential.
3. **While the BPNG is in the process of transitioning its prudential safety and soundness supervision of individual institutions to a risk-based approach, the PNGIC applies a compliance-based approach.** Internationally, it is universally accepted that a risk-based approach is the preferred approach.
4. **Recommendation:** Transition the supervision of general insurance to a risk-based approach.

## Capacity

1. **PNG has an acute capacity challenge in financial sector regulation.** PNG is a small country and financial sector oversight is in the early stages of development. One of the most difficult challenges to overcome is that of capacity. Inability to challenge effectively those being regulated, licensed and supervised implies that no economic value is being added – in fact, economic value is being destroyed. Furthermore, constraints in capacity would inhibit the valuable contributions made through development of public policy frameworks, regulatory frameworks and supervisory frameworks, and enforcement.
2. **Recommendation:** More focus is required on sustainable capacity development, including through the coordination of the efforts of the various authorities.

## Resources

1. **The resources available to the BPNG’s regulatory activities are dependent on the resources available to the BPNG.** In the past, when the BPNG’s profitability was under pressure, it had an impact on the resourcing of the BPNG’s micro-prudential supervisory activities. In the event that such functions are not financially self-sustaining, from time-to-time the independence and capacity of such functions become impaired and compromised. In contrast, the PNGIC is in a relatively more secure position, being funded by a dedicated levy.
2. **Recommendation:** The BPNG’s micro-prudential regulation and supervision function must be placed on a financially self-sustaining, transparent and clearly earmarked basis.

## Availability of and access to relevant, reliable and timely information

1. **There appears to be somewhat of a dearth of information, and whatever information is available becomes available only after an inordinate time delay.** The latest annual report of the PNGIC relates to 2011. The BPNG’s annual report for the year 2014 was published in November 2015, some four months after the statutorily prescribed date of 30 June. The PNGIC does not have a website. The PNGSC has a very limited presence on the internet.
2. **There is no central portal where all information related to the financial sector is available.** Financial information on all the licensed participants in the financial sector is not available at a central site. There is no central point where a complete set of all the legislation, regulations and other statutory instruments, including guidance notes, relating to all the licensed participants is available. Such legislation, regulations and other statutory instruments as are available are not in a consolidated updated form, which makes the task of establishing the current prescriptions challenging. This makes the task of license holders and license applicants to comply with the law unnecessarily challenging.
3. **The concepts of accountability, market discipline, transparency and disclosure, which are indispensable to a modern financial system, are given effect by relevant, reliable and timely information being placed in the public domain.** The lack of information on the general insurance sector means that it is not possible to know what the sector’s performance has been since 2011 or what the current state of financial health of the sector is. The quality of decision-making is constrained by the quality of the information. The ability to monitor and ensure financial sector stability and safety and soundness of financial institutions depends on the quality of the information.
4. **Recommendation:** An urgent review must be undertaken to identify what information is required when by which stakeholders, and steps must then be taken to ensure that such information is also made publicly available and, ideally, such information must be available via a central portal which is maintained and promptly updated.

## Equity capital market regulation

1. **The level of turnover on POMSoX is negligible, as is the amount of capital raised via POMSoX.** There is a need to develop, including deepen and broaden, the securities market as an avenue for raising equity capital.
2. **Recommendation:**
	1. A review must be commissioned to investigate how to develop, stimulate and deepen the equity capital market.
	2. Consideration should be given to varying the stock exchange’s ownership from the current two shareholders by potentially allowing international ownership, which would import technology and knowledge to the local exchange. POMSoX must encourage greater competition through attracting new participants, domestic and or foreign, in the local market.[[51]](#footnote-52)
3. **Regulation and the infrastructure of the securities market are extremely inadequate.** Although the Securities Act 1997 vests certain regulatory and oversight powers in the PNGSC, the latter does not have powers to specify operating requirements and guidelines for brokers and to license and oversee registrars and depositories, nor does it have oversight powers over settlement systems. In addition to lacking the relevant powers, the PNGSC is understaffed for the kind of activities it is supposed to perform. Corporate stock ownership is recorded in the “PNG Registry” – an unlicensed and unregulated entity – and the ownership title is given in paper-form. The Securities Commission Act does not empower the PNGSC to license Registrars and Depositories. PNG Registry provides registrar services on its own and all listed companies currently use its services**.**[[52]](#footnote-53)The Securities Commission Bill 2015, the Capital Market Bill 2015 and the Central depository Bill 2015 should be wide enough in ambit to address these issues.

## Financial sector safety net

#### Contingency planning, contingency exercise and crisis preparedness framework

1. **Little, if any, contingency planning, contingency exercise and crisis preparation has taken place since 2011.** The 2011 FSSA noted that PNG’s crisis management framework is incomplete and needs strengthening. The authorities may not have given thought to or be aware of future challenges, nor do they appear to have contingency plans in place for such challenges should they realize.
2. **Recommendation:** The BPNG and the DOT urgently needs to undertake contingency planning and crisis preparedness. Testing of such plans must be undertaken and the effectiveness of such plans determine and, where necessary such plans must be refined.

#### Systemic liquidity framework

1. **The absence of an effective mechanism for providing central bank liquidity to banks could pose significant challenges in the event of a systemic crisis.** The BPNG’s draft Master Repurchase Agreement (MRA) currently is under legal review. Market consultation on the MRA is ongoing.
2. **Recommendations: The BPNG must**
	1. introduce promptly a standardized repurchase agreement and the interbank market must be stimulated.
	2. establish a standing Lender Of Last Resort facility by enabling banks readily to obtain access to central bank liquidity at a penalty rate against risk-free collateral.
	3. develop internal procedures for bank emergency liquidity arrangements.
3. **There is a need to promote a secondary market in debt securities.** The negligible secondary market trading in the capital market is clear testament to the need for improvement. From the perspective of financial sector stability and safe and sound financial institutions, a liquid money and capital market could facilitate liquidity management, an interbank market and asset and liability management. Also, a developed (deepened and broadened) securities market could be an effective channel for capital raising. (See *Review of the PNG Government Bond & Capital Market Development,* by RT Andreoli, 2015, for recommendations.)
4. **In terms of the rules applicable to users of KATS, a bank is prohibited from having a negative Exchange Settlement Account balance at daily close of business (17H00).** To avoid paying a penalty, a bank firstly would attempt to fund the shortfall from the interbank market. For the time being, in terms of a temporary arrangement, a remaining shortfall can be borrowed from the BPNG at the Kina Facility Rate.[[53]](#footnote-54) (See *Review of the PNG Government Bond & Capital Market Development,* by RT Andreoli, 2015, for recommendations.)

#### Bank recovery and resolution framework

1. **The importance of the issue of bank recovery and resolution is well-illustrated by the fact that three of the four banks in PNG should be considered systemically important banks.** Three of PNG’s four commercial banks, respectively, have market shares in key balance sheet and banking business categories of well in excess of 10 percent, with the largest bank constituting more than half of the banking sector and two of the other three banks constituting the vast bulk of the rest of the banking sector.
2. **The Banks and Financial Institutions Act 2000 caters for the eventuality where an authorized institution is likely to become unable to meet or fails to meet its obligations.** Under such circumstances, the BPNG is empowered to take control of an authorized institution or to appoint an administrator to take such control. A statutory manager has the powers and functions of a board of directors. The BPNG is empowered, where it considers that an authorized institution is insolvent and cannot be restored to solvency within a reasonable period, to apply to the court for an order winding up the authorized institution. The winding up is conducted under the Companies Act 1997 or any other law under which the authorized institution is incorporated.
3. **Since the promulgation of the Banks and Financial Institutions Act 2000, an international standard has been issued on bank recovery and resolution.** The bank recovery and resolution framework has not been updated since the promulgation of the Banks and Financial Institutions Act 2000.
4. **Recommendation:** The bank recovery and resolution framework must be reviewed and updated to fully align it with the international standards and sound international practices.

#### Depositor protection framework

1. **PNG does not have a depositor protection framework.** The absence of a formal depositor protection framework is at variance with international standards.
2. **Recommendation:** A bank depositor protection framework must be developed and a formal deposit insurance scheme established. Such a framework and scheme must be based on and fully aligned with relevant international standards and sound international practices. (Similarly, policy holder protection framework and a superannuation member protection framework also must be developed and appropriate structures established.)

## Legislative process

1. **There appears to be concerning shortcomings in the legislative process relating to the financial sector.** For example
	1. There does not appear to be a robust process of public and stakeholder consultation during the development of financial sector public policy, legislation and regulations. Allegedly, neither the general public nor POMSoX were consulted during the development of the new Securities Commission Act, which places a question mark over the legitimacy of such legislation. The effectiveness of the rule of law is dependent on and correlated to the level of acceptance of the law by the citizens subject to the law. Accordingly, it is vital to ensure that legislation takes the people’s interests into account and reflects the will of the people, which are preconditions to ensuring that the people will respect the rule of law.
	2. There does not appear to be adequate transparency in the legislative process itself. It was reported in the media that a new Securities Commission Act, a new Capital Markets Act and a new Central Depository Act were promulgated during 2015. However, the mission was not able to confirm this with parties with firsthand knowledge thereof or obtain a copy of any of these legal instruments.
	3. There is no official central data base of financial sector legislation: Accordingly, it is not possible for a citizen readily to determine what the applicable legislative prescriptions are. Even the BPNG to date has not been able to obtain a signed copy of the 2013 amendments to the Superannuation (General Provisions) Act 2000. In December 2015, the PNGSC was not in possession of an official version of the abovementioned three pieces of legislation, even though reportedly it had been promulgated months previously.
	4. When legislation is amended, it appears that no official consolidated legal instruments are prepared and placed in the public domain. The mission was not able to obtain a consolidated version of key legislation which had been amended. The law must be readily accessible to citizens, which implies that it is necessary for the legislature to ensure that citizens have access to consolidated legal instruments, thereby obviating the need for citizens to compile consolidated legal instruments.
2. **Recommendations:**
	1. Ensure public and stakeholder consultation during the development of financial sector public policy, legislation and regulations.
	2. Ensure that newly promulgated legislation promptly is placed in the public domain.
	3. Create, maintain and give ready access to an official comprehensive central data base of financial sector legislation.
	4. Ensure that consolidated legal instruments are placed in the public domain.

# Proposed Changes to Financial Sector Regulatory Architecture

## Background[[54]](#footnote-55)

1. **Financial services can contribute meaningfully to growth and development of the PNG real economy.** Financial services are an important and indispensable component of a modern economy.
2. **Financial services can and must play a greater and more effective role in PNG.** There are areas of concern as regards the interface between, and interaction of, the real economy and the financial sector, including the low level of access to finance and the consequent low level of financial assets and liabilities of the household sector. The moribund capital market in debt and equity is another area of concern.
3. **Financial sector regulatory architecture globally has developed in response to the recognition of the importance of a range of objectives.** These include independence (to enable objective, unbiased and merit-based decision-making); market failures (and the consequent need for statutory regulation and supervision); financial sector stability; safety and soundness of financial institutions; effectiveness and consistency; efficiency and competition; integrity; consumer protection; and financial inclusion and transparency and disclosure (to ensure timely, relevant and reliable information which can enable checks and balances to operate effectively).
4. **As the awareness and understanding of risks grew, institutional arrangements evolved.** Traditionally, banks were supervised by central banks, capital markets essentially were self-regulated by the dominant stock exchange, and insurance supervision grew as a function of government departments. The growing understanding of the importance of independent (non-political) and statutory regulation led to the creation of dedicated agencies responsible, separately for the regulation of securities markets and the supervision of insurance. A desire to achieve greater effectiveness, consistency and synergy has resulted in a trend towards integration of some or all of these regulatory agencies, including bank supervision. Often, these were precipitated by financial scandals or crises that prompted a call for enhanced regulation**.**
5. **As a result, there is a wide variety of forms of financial sector regulatory architecture. In a number of jurisdictions, it remains the case that all three financial sectors (banks, insurance and securities business) are subject to separate regulatory agencies.** This is true, for example in Spain and Hong Kong. In some other jurisdictions, a single regulatory authority is responsible for the regulation and supervision of all three sectors (banks, insurance, and securities business). The U.K. was the first major example in a large financial sector, followed by Germany and Japan. In other jurisdictions, there are two or more separate regulatory authorities. In other jurisdictions again, there may be a different split of responsibilities between multiple authorities. In Canada, for example, banks and insurance are the responsibility of one authority, while securities businesses are regulated separately (in fact separately in each province). In two countries (Australia and The Netherlands), there are two agencies which split responsibility according to function (one authority being responsible for prudential supervision and another for business conduct). This latter form is known as the Twin Peaks model. In practice, the Twin Peaks model tends to result in one authority being the lead regulator for banks and insurance and the other for securities regulation, largely because business conduct issues are of prime concern for securities business, while prudential safety is the main concern for bank and insurance business**.**

## Optimal financial sector regulatory architecture

1. **Optimal financial sector regulatory architecture can facilitate the financial sector making a meaningful contribution to growth and development of the real economy.** No single model of financial sector regulatory architecture is perfect or the best under all circumstances. There is no international standard in this area. It is generally agreed that suboptimal financial sector regulatory architecture can inhibit the potential contribution of financial services to growth and development. The financial sector regulatory architecture must take local conditions into account. Optimal financial sector regulatory architecture does not guarantee optimal regulation and supervision, which are dependent also on a range of other factors.
2. **It is generally acknowledged that “structure must follow strategy.”** One way of looking at this is to ensure that the effective pursuit of regulatory objectives is given primacy over structure for the sake of structure, and over personalities.
3. **This report focuses on the regulatory objectives of financial sector stability, prudential safety and soundness of individual financial institutions, and the conduct of business in the securities area.** The financial sector and financial services are also subject to a range of other objectives, including competition, consumer protection and financial inclusion. Financial stability enables institutions and markets to work effectively and efficiently. Safe and sound institutions ensure that the interests of key stakeholders, including depositors and investors are safeguarded. Free and fair contestable markets ensure that capital can be allocated effectively and efficiently. The relevant financial institutions include banks and other deposit-taking institutions, insurers, superannuation funds and securities businesses.
4. **The debate about regulatory architecture relates to the most appropriate structuring of the authorities in pursuit of the greatest effectiveness in achieving the regulatory goals.**
5. **In PNG, the prudential regulatory objectives (of financial sector stability and prudential safety and soundness of individual financial institutions) are being pursued by the BPNG, the PNGIC and the PNGSC.** The question arises whether the current financial sector regulatory architecture best serves the needs of PNG.
6. **It is necessary and important from time-to-time to revisit the financial sector regulatory architecture, to ensure that it remains optimal.** Prevention is better than cure – it is better to prevent a future crisis than to have to grapple with a crisis. Change is a constant - the nature and extent of the engagement between the real economy and the financial sector is in interminable flux. Customers’ needs change, financial services providers change and they change their offerings, the international landscape changes, and regulators seek to improve their approaches to the regulation and supervision of financial institutions and financial services. In addition, there are changes in demographics, economic development and technology. The scope for regulatory arbitrage may change, and regulatory arbitrage may undermine regulatory objectives.

## Preconditions for change to financial sector regulatory architecture

1. **Ideally, financial sector regulatory architecture must be reviewed when there is financial sector stability.** The timing of the review of the financial sector regulatory architecture is important. Under crisis conditions, there may well be a sense of urgency to address problems, but the pressures of the situation may dictate priorities which may not be conducive to determining an optimal solution from a long term perspective.
2. **This review of the PNG financial sector regulatory architecture is taking place at a time when all indications are that the PNG financial sector is stable.** A backdrop of financial sector stability is conducive to sound analysis, balanced conclusions and appropriate prioritization.
3. **Macroeconomic stability (arising from sound monetary, fiscal and exchange rate policy) ideally must be in place.** Although these elements are mostly outside the control of the financial sector, they can impact adversely the stability and effectiveness of the financial system.
4. **There is some turbulence in the area of PNG macroeconomics.** Fiscal underperformance and foreign exchange stresses, arising from downward trends in international commodity prices and structural issues relating to the flow of foreign exchange into the country may be contributing to this turbulence. To date, this turbulence seemingly has not (yet) had any material impact on financial sector stability.
5. **Other preconditions which may be important determinants to the outcome of the proposed changes include the following:** There must be a sound legal and regulatory framework for the financial sector; and sound governance of agencies comprising the financial sector regulatory architecture and safety net. It is important to identify where existing preconditions are not ideal. If serious enough, it may be necessary to address deficiencies prior to effecting change to the financial sector regulatory architecture, unless the proposed changes to the financial sector are aimed at addressing such deficiencies.
6. **Though there are challenges in relation to some of the other preconditions mentioned above, in the view of the mission, these challenges are not so fundamental that they must not be permitted to delay or derail the proposed changes to the financial sector regulatory architecture.**

## PNG authorities’ needs and views

1. **The PNG authorities expressed concerns regarding the existing financial sector regulatory architecture. These concerns can be summarized as follows:**
	1. There is dissatisfaction with the level of coordination, cooperation and information sharing among the various domestic financial sector regulatory authorities, which impedes their ability to pursue their objectives and discharge their mandates.
	2. There is unease about the potential for overlaps, gaps and regulatory arbitrage, which may pose threats to financial stability. Inability to take a holistic view and silo approaches are not in the society’s best interests.
	3. It is recognized that regulatory and supervisory frameworks, including the supervisory approaches, differ, and that these differences result in constraining inconsistencies and undermine the effectiveness and efficiency of the supervisory function.
	4. There is concern that financial conglomerates may not be effectively supervised.
	5. Some authorities suggested that a single regulator may be able to enhance the overall quality of regulation and bring about efficiency gains.
	6. There are concerns about the various authorities’ capacity and capability effectively to discharge their respective mandates.
	7. There is a worry that the legal, regulatory and supervisory frameworks, and day-to-day supervision, are not keeping pace with the developments in the market, new and emerging risks, as well as with international pronouncements and sound practice.
	8. It is suboptimal and unsettling when regulatory and supervisory capacity is significantly determined and influenced by the profitability of the BPNG.

These concerns have led the authorities to conclude that there may be advantage in creating a single integrated financially self-sustaining authority. The mission shares these concerns.

1. **The mission consulted the private sector on the merits of the current financial sector regulatory architecture as well as permutations of possible changes thereto.** Though market participants were cautious in expressing their views on these matters, almost without fail, market participants supported change. The BPNG was singled out as the authority with the highest credibility and capacity to make a positive difference.

## Approach to the proposed changes to the financial sector regulatory architecture

1. **It is suggested that only minimal and necessary change be effected to the financial sector regulatory architecture.** Changing financial sector regulatory architecture can be extremely difficult, given among other challenges, potential political, legislative, legal, governance, management, risk and resource impediments.

## Key public policy objectives relating to the financial sector

1. **The mission does not propose any change to the key public policy objectives in relation to the financial sector, which include the following:**
	1. Maintain price stability[[55]](#footnote-56)
	2. Maintain financial sector stability[[56]](#footnote-57) [[57]](#footnote-58) [[58]](#footnote-59) [[59]](#footnote-60)
	3. Ensure effectiveness of the payment system[[60]](#footnote-61)
	4. Protect the interests of depositors of authorized institutions,[[61]](#footnote-62) the interests of policyholders[[62]](#footnote-63) and the interests of members of superannuation funds.[[63]](#footnote-64)
	5. Improve financial inclusion (including access to finance, and financial deepening and broadening)[[64]](#footnote-65)
	6. Ensure consumer protection[[65]](#footnote-66) and acceptable market conduct[[66]](#footnote-67)
	7. Promote fair and effective competition[[67]](#footnote-68)

## Considerations regarding integration of regulatory agencies

1. **There has been a pronounced trend internationally towards amalgamation of regulatory agencies.** Many countries started off with a financial sector regulatory structure which consisted of separate regulatory and supervisory agencies for separate types of financial institutions, whether banks, insurers or financial market institutions. This is commonly referred to as the institutional approach to financial sector regulatory architecture. During the past two decades, many countries have effected structural changes to their financial sector regulatory architecture in the light of the realization that a purely institutional approach to financial sector regulatory architecture does not provide all the answers and may result in gaps. As a consequence, the models today range from institution-based to various permutations of regulatory integration. A unitary agency, which is responsible for all institutions and all functions, represents the extreme form of integration. The nature and extent of integration must take each country’s circumstances into account.
2. **Key considerations relating to regulatory integration include the following:**
	1. Integration holds out the promise of economies of scope and scale. There could be greater consistency, less potential for overlaps and gaps, less potential for regulatory arbitrage, and greater potential for resource optimization. Regulatory approaches, strategies and standards could be harmonized. Cross-cutting work can be facilitated. Cooperation, coordination and information sharing could be enhanced, both domestically and internationally. A holistic view and more effective systemic risk management and prompt policy responses may be possible. A counterargument against integration includes that specialization may have a better chance of achieving improved understanding of, and solutions to, complex and specialized issues.
	2. The role of the central bank requires careful consideration. A central bank which is also the integrated financial sector regulatory authority raises concerns about concentration risk, both in relation to power and as a single point of default. In recognition of such concerns, measures can be implemented to create an arm’s length relationship between the central bank and the integrated financial sector regulatory authority. Other considerations include that of coordination, cooperation and information sharing; contingency planning and crisis management, crisis simulation exercises; and recovery and resolution.
	3. The more complex and interwoven a financial system and its services become, including the existence or potential for financial conglomerates in a market, the stronger the argument for an integrated approach becomes. As traditional institutional and functional boundaries blur, the need for an integrated framework rises, to counteract the potential for overlaps and gaps, and to counteract regulatory arbitrage. BSP is a multi-national financial conglomerate operating in more than a handful of jurisdictions and involved, among others, in banking, insurance and securities business. The Kina Group has also become a financial conglomerate.
	4. Implications and management of the change from the status quo to the status to-be. These include the implications on the legislative, regulatory and supervisory frameworks, and day-to-day supervision.
	5. The governance (including risk management and internal controls) of an integrated financial regulatory authority takes on greater importance as the potential impact of the quality of such governance on the financial system rises.

## Basis and criteria used as reference for development of change proposals

1. **In the view of the mission, the fundamental issues relating to the PNG financial sector regulatory architecture include: How best**
	1. to position the PNG financial sector regulatory architecture for the future. The key considerations include the following:
		1. PNG’s development needs (-financial literacy; financial inclusion.) The proposal contains recommendations relating to consumer protection.
		2. Financial innovation: The proposal contains recommendations relating to capacity creation and development. One of the scale benefits should be a greater capacity to accommodate, cater for and deal with innovation.
		3. Technology: One of the scale benefits should be a greater capacity to gain access to, accommodate, cater for and deal with technology.
		4. International standards and sound practices: This is a key theme of the proposal.
	2. to overcome the shortcomings in coordination, cooperation and information exchange.
	3. to address the PNG capacity issue in relation to public policy development and its encapsulation in legislative, regulatory and supervisory frameworks, and day-to-day operations and supervision.
	4. to ensure that the PNG regulatory authorities are soundly financed, governed and resourced.

## Considerations regarding integration of regulatory authorities

1. **The following considerations arising from the implications of the change proposal were also taken into account**:

#### Role of the BPNG

1. **The question arises whether requiring the BPNG to discharge the mandate of an integrated prudential regulatory authority would be asking too much of the BPNG.** An integrated financial sector architecture may impose a high demand on the BPNG. The non-core AML/CFT, exchange control mandates already impose a heavy burden on the BPNG. In addition, the BPNG voluntarily has become the driver of the national financial inclusion strategy, is responsible for managing the national foreign exchange reserves, and will now be planning an important role in the PNG sovereign wealth fund. On the other hand, the needs of the economy may overshadow the additional challenges which an integrated financial sector architecture may impose on the BPNG. These challenges include regulatory inconsistencies, regulatory gaps, and lack of a holistic approach. Subject to strong governance and other checks and balances, it is well-possible that the BPNG could bring about better outcomes than are being achieved with the current arrangements.
2. **With the establishment of an integrated financial sector architecture, there may be concerns that the BPNG may become too powerful**. Another concern is that such an entity would constitute a high, even excessive, concentration of risk potential, thus constituting a single point of default which has the potential to cause irreparable damage to the financial sector and the economy. These are real and valid concerns.The mission shares these concerns, but holds the view that this risk can be counteracted by, among others, appropriate governance and transparency arrangements. The power of the BPNG over the authority could be contained sufficiently by constituting the integrated prudential regulatory authority as a financially self-sustaining subsidiary of the BPNG with its own board containing some independent members (not financially associated with the BPNG or licensed financial institutions), appropriate delegations of authority under relevant legislation. This must include a requirement for an annual descriptive and performance report to Parliament and the general public. A board member must be subject to the same corporate governance requirements, including fit and proper requirements, as a board member of a bank. Staff functions of the authority, such as accounting (but not budgeting and financial management), auditing, human resource management, information technology (but not management information), physical facilities and physical security could be outsourced to the BPNG. The board would delegate the day-to-day management of the authority to a chief executive officer.

#### Quality of policy, legislation and regulatory frameworks

1. **An integrated financial sector regulatory architecture holds the potential for improved quality policy, legislation and regulation.** Access to more and higher quality resources would imply greater capacity to develop and maintain sound policy, legislation and regulatory frameworks. Greater resources for training and development of staff also would bolster capacity.
2. **Policy, legislative and regulatory overlaps and gaps would be identified more readily, as would opportunities for regulatory arbitrage.** An integrated and comprehensive approach to addressing these issues should be more effective. Risks, such as shadow banking activities at the periphery of banking, insurance and securities, should be identified more readily, as would risks which emanate from the interface between the real economy and the financial sector.

#### Quality of supervisory frameworks and day-to-day supervision

1. **An integrated financial sector regulatory architecture holds the potential for improved quality and consistency of risk-based supervisory frameworks and day-to-day supervision.** Access to more and higher quality resources would imply greater capacity and capability to develop and maintain consistent risk-based supervisory frameworks and day-to-day supervision. Greater resources for training and development of staff also would bolster capacity. Personnel would have greater career opportunities in such an environment. The foregoing should counteract the loss of any personnel arising from a merger. The end result should be more effective challenge and assertive, consistent, risk-based enforcement by the supervisory authorities.

#### Cooperation, coordination and information exchange

1. **An integrated financial sector regulatory architecture should facilitate greater coordination, cooperation and information sharing.** Within an integrated authority it should be much easier to avoid silos.

#### Dealing with conglomerates and regulatory arbitrage

1. **A better understanding of the group structure, linkages within the group, and risk profile of the group is possible if a comprehensive view can be obtained of a conglomerate.** Also, a better resourced integrated authority should be able to counteract inappropriate resistance to regulatory and supervisory change and pressure from vested interests more effectively.
2. **Shadow banking activities at the periphery of banking, insurance and securities should be identified more promptly.** Being in a position to take a holistic supervisory view of a conglomerate should enable the authorities to identify risks to the safety and soundness of the bank/s, insurer/s and securities entities in the group more readily.

#### Synergies and efficiency

1. **An integrated financial sector regulatory architecture holds the potential for synergies and cost savings.** The creation of an integrated regulatory authority would result in economies of scale and scope. Cutting out duplication in support functions, such as administration, accounting, auditing, financial control, information technology and human resources would result in cost savings. Other costs, such as rent, utilities, stationery and training could be optimized. Then there is the potential for discharging the relevant mandates more effectively with the same number of people.

#### Accountability

1. **A single regulatory authority would strengthen accountability.** Where the division of responsibilities between regulatory authorities is clear, the scope for escaping blame is limited. Where there is a single regulatory authority, it cannot escape blame for regulatory failure.

#### Risks and costs of change

1. **The risks arising from the proposed change should be limited.** The proposed change is of a very limited nature and would pose limited risk. Similarly, in view of the limited change proposed, the cost of the change would be limited.
2. **The potential for loss of experience and specialist knowledge exists, though it is limited.**  Where an integrated authority is created through a merger or takeover, there always is the risk of loss of experience and specialist knowledge. However, in the circumstances of this case, such loss should be limited, as the nature and extent of experience and specialist knowledge which might be lost is not as valuable, given that the PNGIC applied a compliance-based approach while PNGSC has undertaken limited operational activities to date. Thus, even though there may be resistance to change, it would have limited downside potential, as it would have limited impact irrespective whether or not the proposed change is successful or not.

## Enhancing the current arrangements

1. **The mission holds the view that the option of attempting to enhance current arrangements may well not have the desired effect of overcoming the concerns with the current arrangements.** The authorities’ concerns regarding the current arrangements are valid and serious, and require an effective and sustainable solution. Previous recommendations to address these concerns have not resulted in success. The 2011 FSSA called for greater coordination between the BPNG and the PNGIC. It also stressed the need for a more risk-focused approach. In addition, it pointed to the need for more stable funding, more staff and more flexible pay systems, and the use of funds to be transparent to ensure accountability. To date, the implementation of these recommendations has been limited.

## Recommendations for change to the financial sector regulatory architecture

#### Introduction

1. **The mission has come to the view that there it is now opportune for further integration of the financial sector regulatory architecture.** As a small jurisdiction, PNG is likely to benefit from scope and scale economies arising from integration, as well as greater consistency in approach. Moreover, integration should facilitate cooperation, coordination and information exchange. Overlaps, underlaps and regulatory arbitrage would more effectively and consistently be counteracted. The cost of change would be modest and there should be limited if any loss of specialist capacity. On the contrary, under an integrated model, there would be greater potential for capacity development. This conclusion on balance coincides with the views of most public sector and private sector interlocutors**.**

#### Change recommendations

1. **Based on its review, the mission concludes that there is a clear case for integration of the financial sector regulatory architecture. The mission recommends that**
2. As a first step, integrate general insurance regulation, licensing and supervision into the BPNG.
3. As a second step
	1. Constitute the Bank Supervision Deparment and the Insurance (General and Life) and Superannuation Department as the BPNG’s microprudential[[68]](#footnote-69) regulation, licensing and supervision division/unit.
	2. Clearly separate and maintain apart the macroprudential surveillance and financial inclusion functions from the BPNG’s microprudential unit.
4. As a third step, integrate the regulation, licensing and supervision of securities into the BPNG’s microprudential unit, as the Securities Department. (This is a temporary structure, for a period of three years, but not more than five years).
5. As a fouth step, in the medium term, transfer the BPNG’s microprudential division/unit and Securities Department to a(n independent) subsidiary of the BPNG, which is to be consitituted as an integrated financial sector regulation licensing and supervision authority.

## Conditions necessary for the proposed prudential integrated regulatory authority

#### Structural issues

1. **The mission advises the establishment, on a temporary basis, of an integrated microprudential regulatory and supervision division/unit within BPNG.** The mission considers it an imperative to create an arm’s length relationship between the BPNG and the proposed single integrated prudential regulatory authority, while retaining a strong link to the BPNG. In this way, the proposed prudential integrated regulatory authority would benefit from greater independence from the BPNG while still being able to leverage off the aegis of the BPNG.
2. **Within the medium term, say within three years but not later than five years, the proposed integrated financial sector regulatory and supervisory authority (IFSRSA) must be established as a separate legal entity (autonomous subsidiary) within the BPNG group.** Of the many types of IFSRSA governance structures available, the mission considers this to be the most appropriate for PNG. As a separate legal entity, the IFSRSA will be more focused on its distinct role and responsibility than if it were set up as a department or series of departments within the BPNG. Yet, being housed within the BPNG group provides benefits in terms of coordination, cooperation, information exchange and leveraging off the BPNG’s resources and capacity. And, from the perspective of the general public, a separate entity provides greater visibility and a more effective platform to inform the public about the IFSRSA’s objectives, role, duties, responsibilities and approaches to financial sector regulation. Also, IFSRSA’s governance and financial sustainability will be more transparent.
3. **The proposed IFSRSA must have clear public policy objectives, a well-defined mandate, and the necessary powers to fulfill its mandate.**
4. **Operational independence of the IFSRSA would be enhanced by ensuring that the IFSRSA maintains separate accounting and management information systems, keeps its funds separate from the BPNG and has dedicated staff.**
5. **A formal framework should be in place for the close coordination, cooperation and information sharing, on a routine basis, between the IFSRSA and the BPNG.** A MOU must be developed, concluded and maintained between the IFSRSA and the BPNG to clarify their respective objectives and any potential overlaps, gaps and conflicts of interest. The MOU must deal with coordination, cooperation and information sharing between the IFSRSA and the BPNG. The specific information to be shared must be identified and the issue of confidentiality and information sharing with third parties must be addressed. Typically, such information would be information relevant to the BPNG’s financial stability objective and the IFSRSA’s safety and soundness of individual institutions objective. The MOU must also deal with contingency planning, simulation exercises, crisis management, recovery and failure resolution coordination arrangements. The IFSRSA and the BPNG must involve one another in relevant contingency planning, simulation exercises and crisis management.

#### Governance issues

1. **The single most important factor determining the effectiveness of the authority is the quality of its governance.** The governance framework must encapsulate relevant international standards and appropriate ethics prescriptions and a code of conduct. A single-minded commitment to sound governance must permeate the authority. The board of the authority must ensure that its governance is beyond reproach, and that it itself complies with both the letter and the spirit of all the governance-related prescriptions which it imposes on and demands of financial institutions. The board must ensure that the authority is a role model on sound governance for an industry which is built on the confidence of the general public and its customers.
2. **The board of the authority must be staffed by fit and proper people.** Such people must have the necessary professional knowledge, skills and experience, among others, in the fields of accounting, auditing, banking, commerce, economics, finance, governance, industry, internal controls, insurance, law and risk management. Such people must be of undoubted character and must be free of commercial and political conflicts of interest. Accordingly, there should be no place for political appointees and persons who derive a non-negligible amount of money directly or indirectly from the financial sector.
3. **Appointments to the board of the authority must be made on merit, including relevant technical and professional knowledge, skills and experience.** The authority must be independent of politics and its legal and regulatory framework must buttress such independence, inter alia by prohibiting any outside party from giving it instructions, and by prohibiting it from taking instructions from any outside party. The authority, its board and its personnel must have legal protection (in the form of statutory indemnity) against legal challenges, and against the related costs in opposing such legal challenges, in relation to the good faith discharging its/their duty. Board members must be protected from arbitrary dismissal, by having fixed term appointments which can only be rescinded in the event of incapacity, fundamental dereliction of duty or successful challenges based on their fitness or probity.
4. **The board must be composed of the BPNG governor who will be the chairman of the authority, the BPNG assistant governor responsible for financial sector stability, two executive directors (CEO and deputy CEO of the authority) and at least two independent directors.** The directors must hold office for a period not exceeding three years at a time, with a maximum of nine years. Care must be taken to stagger the appointments to ensure continuity**.**
5. **The board of the integrated regulatory authority would have and be responsible for the overall control of the institution.** The board must meet at least four times per year. The board must delegate day-to-day management of the institution to the chief executive officer. The board must determine overall policy, including putting in place a framework for policy independence and financial sustainability. The board will charge the chief executive officer with implementing sound internal controls, human resource policy; organizational structure, and risk management. The board must delegate the day-to-day operations of the authority to its CEO who must be a board member. The CEO must be accountable to the board of the authority for the discharging of the functions necessary to fulfill the regulatory mandate of the authority. Financial sector input can be channeled through industry advisory committees**.**

#### Capacity

1. **The integrated financial sector regulatory, licensing and supervisory authority must be appropriately staffed and resourced.** The litmus test for the required staff capacity and capabilities lies in the question whether the staff have the capacity and capabilities effectively to challenge those being regulated, licensed and supervised. Absent such capacity, the regulatory authority would not be adding economic value, thus constituting a burden on the financial system and the economy. The authority must have the capacity also to develop public policy frameworks, regulatory frameworks and supervisory frameworks; and enforcement, all of which must be aligned with sound international standards and practices.

#### Acknowledge and cater for diversity in institutions

1. **The kinds of risks posed by the various financial institutions differ.** In developing the public policy frameworks, regulatory frameworks and supervisory frameworks, due cognizance must be taken of these differences. A one-size-fits-all approach would not be appropriate.

#### Financial self-sufficiency

1. **The integrated financial sector prudential regulatory, licensing and supervisory authority must be financially self-sufficiency.** In the event that such functions are not financially self-sustaining, from time-to-time the independence and capacity of such functions could be impaired and compromised.
2. **It is proposed that the necessary funding to attain financial self-sufficiency be raised through levies imposed on the licensed financial institutions.** The extent of the levies would be determined by the projected reasonable operational costs necessary to enable the regulatory authority to discharge its mandate. The levies imposed, respectively, on the various types of financial institutions must be based on the cost of the resources allocated, respectively, to enabling the regulatory authority to discharge its mandate in relation to such types of financial institutions. This basis would impose a discipline on the regulatory authority to apply the 80:20 principle, say, of focusing 80 percent of its resources on those institutions which hold 80 percent of the systemic risk potential. Inevitably, some cross-subsidization will take place, but the authority must ensure that it is strictly justified and limited to the minimum.
3. **Such independence and financial self-sustainability must be counterbalanced with appropriate transparency, disclosure and effective accountability measures.** The responsible Minister must be provided with a regular, say quarterly, operational report which includes giving account of performance against measureable targets. An annual report must be submitted to Parliament and the board and management of the authority must stand ready to give account of their performance in discharging the authority’s mandate. The quarterly reports must be submitted by the end of the following quarter and the annual report must be submitted within four months of a year end.

#### Remuneration framework for regulatory staff

1. **It is generally accepted internationally that the staff of financial sector regulatory authorities need to be compensated on a basis that would enable the authorities to attract personnel which effectively can challenge those being regulated and supervised.** This is a fundamental and indispensable criterion. Ignoring this criterion would be tantamount to ignoring the requirement that public funds must provide value for money and may not be wasted. It may become impossible to populate a regulatory authority with staff which effectively can challenge the staff of financial institutions when there is too wide a discrepancy in their respective remuneration scales. Currently, the regulatory and supervisory staff of the BPNG and the PNGIC are on the public sector pay scale which may not be attractive enough to attract and retain the desired quality candidates.
2. **The precedent set by the NDB is instructive.** The NDB is not a department within the public sector, nor is it a public body. Consequently, it is not subject to the Public Services (Management) Act 1995 or the Salaries and Conditions Monitoring Committee Act 1998.
3. **Recommendation:** The remuneration of staff of the proposed integrated regulatory authority must be untied from the public sector pay-scale and they must be remunerated on a market-based pay-scale.

## Anticipated desirable corollary outcomes arising from the proposed changes

1. **The mission is of the opinion that desirable corollary outcomes which could arise from the proposed changes to the PNG financial sector regulatory architecture could include:**
	1. Clarity of regulatory objectives;
	2. A resilient and flexible financial sector regulatory architecture which would be capable of facilitating development and growth while ensuring financial sector stability and safe and sound institutions;
	3. Sound governance of regulatory authorities;
	4. Effectiveness of the accountability arrangements pertaining to regulatory authorities;
	5. Effective and consistent policy, legislative, regulatory and supervisory frameworks, and day-to-day supervision, including assertive enforcement; and
	6. Greater efficiency through competitive neutrality and more contestable and fair financial markets.

## Next steps in the review and change of financial sector regulatory architecture

1. **This report constitutes the first step to a change to the financial sector regulatory architecture, namely a thorough and comprehensive analysis of the status quo, and generation of well-founded recommendations for change.**
2. **Next, the recommendations for change must be studied by the relevant authorities and a consensus be developed on decisions for change.** Both the DOT and the BPNG must be involved in this process.
3. **Once the necessary public policy consensus has been achieved, an overarching action plan must be developed for implementation of the consensus change decision/s.**
4. **Thereafter, the implementation of the public policy consensus must be project managed professionally, with the joint DOT and BPNG Working Group overseeing compliance with the plan and effectiveness of the outcomes.** This overarching action plan must be broken down into a range of subcomponent detailed action plans necessary to achieve the overall objective/s. The action plans must have clearly defined objectives, steps, deadlines and parties responsible.

# Appendix 1: Financial services regulatory architecture[[69]](#footnote-70)

1. **The main arguments in favor of integration concern consistency of approach and the avoidance of regulatory gaps.** In October 2008, the group of 30 international banks published a report of a survey of 17 jurisdictions concerning their regulatory architecture.[[70]](#footnote-71) Professor David Llewellyn of Loughborough University provided a useful summary of the case for integration in a paper presented to the World Bank in 2006.[[71]](#footnote-72) Although events have developed since then, the two papers represent a useful summary of the case for and against regulation. The main elements of the case for integration are as follows:
	1. Where financial services are provided by conglomerates, bank risks are sold to other institutions and financial products are becoming more complex, an integrated regulatory authority can track the development of risks across sectors and ensure consistency;
	2. Where financial services are provided by different entities, a single regulator can ensure requirements are consistent and do not lead to competitive inequality or attempts at regulatory arbitrage;
	3. There may be economies of scale, a better ability to deploy skilled staff efficiently in different sectors, and reduced regulatory costs;
	4. A single structure is easier to understand and can be held accountable; and
	5. Gaps in the coverage of regulation are less likely.
2. **The case for integration is not clear cut and there are arguments in favor of multiple regulatory authorities:**
	1. In most countries, financial conglomerates do not predominate and financial products sold by banks, insurance and securities businesses remain distinct;
	2. The risks involved in different businesses remain distinct;
	3. Separate regulatory authorities can focus on the specific risks of the institutions they a regulate and develop an understanding of the nature of the business, whereas, in an integrated regulator, either the specialism remain split (in which case, synergies and cooperation may be no better than in separate authorities) or they are combined, in which case understanding of the sectors may be diluted;
	4. The public may perceive that all institutions are regulated in the same way and receive the same protection. Abram and Taylor (2000) noted: [[72]](#footnote-73)“Perhaps the most worrisome of all the criticisms of unified regulation is ….that the public will tend to assume that all creditors of institutions supervised by a given supervisor will receive equal protection;”
	5. The potential for learning from best practice developed in separate regulatory authorities may be lost; and
	6. The difficulties in managing a large agency with different and perhaps competing objectives may increase costs.
3. **A particular issue arises with respect to the role of the central bank. Traditionally, banking supervision has been undertaken by the central bank**. In most countries, where there has been integration of regulatory functions, this has taken place outside the central bank. The principal exceptions are Singapore, where the Monetary Authority of Singapore combines regulatory responsibilities within the central bank and The Netherlands, where the central bank is also responsible for prudential (but not business conduct) regulation. The other country adopting the Twin Peaks model (Australia) retains a central bank (the Reserve Bank) as a separate entity. In this context, it is important to note that the Dutch central bank, although a member of the European Monetary System, is not the monetary policy authority. A single integrated regulator will, in any case, be a very powerful institution and, when combined with that of monetary policy and the other functions of a central bank will create a body with very substantial powers of economic activity. Some have also argued that combining the responsibility for monetary policy with that of supervision creates an inherent conflict of interest and may result in monetary policy decisions being influenced by knowledge of the circumstances of a particular institution. On the other hand, others have argued that the reverse is the case and that a broad knowledge of the circumstances of financial institutions is of assistance in determining monetary policy. Empirical studies have found few examples of monetary policy being loosened to suit banks in trouble.
4. **More recently, there has been an increasing concern that responsibility for financial stability should be combined with a “macro-prudential” responsibility.** The risks to financial stability may not simply be the sum of the known risks to particular institutions but the result of broader economic factors, or even the combined effect of decisions made by individual institutions that, although rational in isolation, result in macro level distortions or the buildup of risk positions not known to individual institutions. It was to combine the responsibility for prudential supervision with that of financial stability that the U.K. abandoned the integrated model in favor of the twin peaks model adopted by the Dutch (although unlike the DNB, the Bank of England is responsible for monetary policy).
5. **The creation of a powerful integrated regulator increases the importance of strong corporate governance arrangements.** International standards have always stressed the importance of independence, accountability and transparency. The Boards of regulatory authorities should be chosen on the basis of criteria related to the professional skills (preferably through open competition in a transparent process) and not be subject to political or commercial interference. Board members should be protected from arbitrary dismissal. Regulators should be given immunity from civil proceedings taken against them for decisions made in good faith. Any matter that requires consultation with the government should be subject to an open and transparent process. Regulators should be accountable to the public and its representatives (for example by being required to explain its performance against published and specific objectives and being subject to questioning by the public or their elected representatives). Individual decisions made by the regulatory authority should always be accompanied by a written description of the reasons for the decision, an opportunity to be heard prior to a decision being made, and an avenue of appeal to an independent court or tribunal.
6. **In addition, regulatory authorities should abide by the kinds of corporate governance principles they require of public companies.** The separation of the posts of chairman and chief executive and the presence on the Board of a majority of independent directors is a practice becoming more common amongst regulatory authorities. The kind of Board structure described here is considered advisable because of the wide and potentially draconian powers given to regulatory authorities. Since they are able to remove the livelihood of individuals and corporations, it is important that appropriate checks and balance should be in place, within as well as external to the authority itself. A fully independent Board, with an independent chairman, with a role distinct from that of chief executive provides the first line in a series of checks and balances. For this to work effectively, it is vital that appointments are made on professional grounds. The importance of strong corporate governance arrangements would become even more important where the central bank were the integrated regulator, given the wide powers over the economy it would hold. This may be one reason why there are relatively few examples of a central bank becoming a single integrated regulator. The one main example (the Monetary Authority of Singapore) has moved away from the approach where the governor is the chairman and chief executive of the Board.

# Appendix 2: Legal and legislative framework

### Background

1. **Key elements of the current legal and legislative framework relevant to this report is summarized hereunder**.

### System of state

1. **Papua New Guinea is a federal constitutional parliamentary democracy and monarchy with three spheres of government: central, provincial and local.** The head of state is HM Queen Elizabeth II who is represented by a governor-general indirectly elected by the unicameral parliament, the House of Assembly. The 109 members of the House of Assembly (MPs) are directly elected through universal adult suffrage. The governor general appoints a prime minister from among the MPs, who is usually the leader of the majority party or largest party within a coalition, following a general election. A cabinet, formally referred to as the National Executive Council, of 28 persons, is appointed from amongst the MPs by the governor-general, on the advice of the prime minister. There are 22 provincial assemblies: 20 for the provinces and one each for the autonomous region of Bougainville and the National Capital District of Port Moresby.[[73]](#footnote-74)

### Constitution

1. **The Constitution and the Organic Laws are the Supreme Law of Papua New Guinea.[[74]](#footnote-75)** The main governing legislation is the Organic Law on Provincial Governments and Local-level Governments 1995 and the Organic Local-level Governments Administration Act, 1997.
2. **The division of law-making powers between the National Government, Provincial government and the Local-level Governments are based, among others, on the following principles:[[75]](#footnote-76)**
	1. The National Government, Provincial Governments shall respectively have specific powers;
	2. The powers that are not so specified shall be assumed to remain with the National Government;
	3. Both Provincial Government and Local-level Government powers are subject to the National Law, but only to the extent that the national interest so requires, otherwise they shall have relative autonomy to operate.
3. **The law-making powers of the National Parliament include the following:[[76]](#footnote-77)**
	1. A law-making power that is not otherwise specified (in section 42 or 44 of the Organic Law on Provincial Governments and Local-level Governments) remains with the National Parliament;
	2. Subject to section 41 of the Organic Law on Provincial Governments and Local-level Governments, the National Parliament may make an Act of the Parliament on a matter specified (in section 42 or 44 of the Organic Law on Provincial Governments and Local-level Governments) only where the matter is of national interest. (Underlined by author.)
4. **The Banks and Financial Institutions Act 2000 constitutes a matter of national interest,** for purposes of the Organic Law on Provincial Governments and Local-level Governments.[[77]](#footnote-78)
5. **The Superannuation Act 2000 constitutes a matter of national interest, for purposes of the Organic Law on Provincial Governments and Local-**level Governments.[[78]](#footnote-79)
6. **The Life Insurance Act 2000 constitutes a matter of national interest, for purposes of the Organic law on Provincial Governments and Local-level Governments**.[[79]](#footnote-80)
7. **The Insurance Act 1995 constitutes a matter of national interest, for purposes of the Organic Law on Provincial Governments and Local-level Governments.[[80]](#footnote-81)**
8. **The National Payments System Act 2013 is a law that is made for the purpose of giving effect to the public interest in public safety, public order and public welfare.[[81]](#footnote-82)**
9. **The Independent Consumer and Competition Commission Act 2002 is an act which relates to a matter of national interest.[[82]](#footnote-83)**
10. **The National Executive Council (NEC) is established by the Constitution.[[83]](#footnote-84)** The NEC consists of all the Ministers, including the Prime Minister who is the Chairman of the NEC when he is present.[[84]](#footnote-85)
11. **All appointments of chief executive officers of Regulatory Statutory Authorities, as described in the Constitution, shall be made by the Head of State acting with and in accordance with the advice of the NEC and in accordance with the recommendation from the Public Services Commission.** The Constitution provides that a body corporate established by an Act of Parliament to perform specific statutory function, and, a body corporate incorporated by authority of an Act of Parliament, are Regulatory Statutory Authorities.[[85]](#footnote-86) The Bank of Papua New Guinea, the Independent Consumer and Competition Commission, the PNGIC, the National Development Bank and the PNGSC are Regulatory Statutory Authorities.
12. **The Preamble to the Constitution specifies National Goals.** The third National Goal is that of national sovereignty and self-reliance which asserts that Papua New Guinea should be politically and economically independent, and the economy basically self-reliant. To this end, leaders are called upon to make all their decisions in the national interest.

### Central bank

1. **The central bank of Papua New Guinea, the Bank of Papua New Guinea (BPNG) is responsible independently for monetary (and exchange rate) policy, the payment system and financial stability**.
2. **The Bank of Papua New Guinea (BPNG) is required to act as the central bank for Papua New Guinea**.[[86]](#footnote-87) The BPNG has four objectives[[87]](#footnote-88), as follows:
	1. To formulate and implement monetary policy with a view to achieving and maintaining price stability; and
	2. To formulate financial regulation and prudential standards to ensure stability of the financial system in PNG; and
	3. To promote an efficient national and international payments system; and
	4. Subject to the above, to promote macro-economic stability and economic growth in PNG.
3. **The functions[[88]](#footnote-89) of the BPNG include regulating banking, credit and other financial services as empowered by the Central Banking Act, 2000, or by any other law**. Also, the BNPG may perform any function conferred on it by or under any international agreement to which PNG is a party, and any other function conferred on it by or under any other law.
4. **The DOT and the BPNG are required to keep each other fully informed of all matters that jointly concern the DOT the BPNG**.[[89]](#footnote-90) The BPNG is required to advise the DOT Minister[[90]](#footnote-91) as soon as practicable where it considers that a body regulated by the BPNG is in financial difficulty.
5. **The BPNG’s Board is responsible for determining the BPNG’s policies, excluding the formulation and implementation of monetary policy and the regulation of the financial system, which is the responsibility of the Governor.**[[91]](#footnote-92)
6. **The Governor is not subject to the direction or control of any person other than as specified in the Central Banking Act.[[92]](#footnote-93)** The Governor is required to advise the Minister where conditions exist that may be likely to affect adversely the achievement of the financial and economic policies of the Government.[[93]](#footnote-94) The Governor is appointed by the Head of State acting on advice.
7. **The Governor has the authority to exercise the BPNG’s powers for the purposes of achieving the objectives and functions of the Central Banking Act, 2000, and implementing the policies of the BPNG**.[[94]](#footnote-95) The salary, allowances and benefits (financial and otherwise) of the Governor are required to be fixed by the National Parliament following consideration of the recommendation by the Salaries and Remuneration Commission as provided for by the Constitution, 1975. No condition of engagement shall have effect where it is inconsistent with the BPNG’s objectives and functions or the autonomy of the Governor or its limits or prevents the Governor from ensuring that the BPNG’s objectives are carried out.[[95]](#footnote-96)
8. **The Governor may be removed from office only by the Head of State, acting on advice, in accordance with the Central Banking Act, 2000.[[96]](#footnote-97)** Where the BPNG Board is of the opinion that the Governor is guilty of conduct prejudicial to the performance of his duties, it may make a recommendation to the Minister that the Governor be removed from office. The Minister will submit the Board recommendation and the Governor’s opposing submission, if any, to the NEC for its decision. The NEC decision may be fully reviewed (including on its merits) by any competent court. As soon as practicable after the office of the Governor becomes vacant, the Head of State, acting on advice, shall appoint a person to the office.[[97]](#footnote-98)
9. **The BPNG Board comprises not less than nine and not more than eleven members, including the Governor and Deputy Governor**. Other ex officio appointees include the head of the Council of Churches, the president of the Chamber of Commerce, the president of the Institute of Accountants, the chairman of the PNGSC. In addition, three other persons of good standing and with generally recognized standing and professional experience in monetary and banking matters are appointed by the Head of State acting on advice.[[98]](#footnote-99)
10. **The BPNG is required within six months of every calendar year end, which constitutes its financial year end, to deliver to the Minister a report on the operations of the BPNG during that financial year, audited financial statements for that financial year, the auditor’s report on those financial statements.** An informed reader should be in a position, based on this information and the BPNG’s policy statements, to make an informed assessment of the BPNG’s performance in carrying out its core functions during that year.[[99]](#footnote-100)
11. **The BPNG may make a loan or advance to a bank or financial institution on such conditions as it thinks proper where it considers it necessary to do so in order to safeguard monetary stability or otherwise considers it desirable to smooth the operation of the payment systems and maintain a stable financial system**.[[100]](#footnote-101)

### Banks and financial institutions

1. **The purposes of the Bank and Financial Institutions Act includes:[[101]](#footnote-102)**
	1. To make provision for promoting the general stability of the financial system in Papua New Guinea;
	2. To make provision for regulating Authorized Institutions;
	3. To protect the interests of depositors of Authorized Institutions;
	4. To confer upon the Central Bank certain functions and powers with respect to regulating Authorized Institutions.
2. **The principal function of the Central Bank shall be to promote the general stability and effective working of the financial system in Papua New Guinea**.[[102]](#footnote-103) The Central Bank shall have the powers conferred on it by the Banks and Financial Institutions Act 2000. Its duty is generally to supervise the institutions authorized by it in the exercise of those powers.[[103]](#footnote-104) The functions of the Central Bank under the Banks and Financial Institutions Act 2000 include:[[104]](#footnote-105)
	1. The protection of the interests of depositors and potential depositors;
	2. The collection and analysis of information in respect of prudential matters relating to Authorized Institutions;
	3. The encouragement and promotion of the carrying out by Authorized Institutions of sound practices in relation to prudential matters;
	4. The evaluation of the effectiveness of carrying out of those practices.
3. **The Central Bank is responsible for the following:[[105]](#footnote-106)**
	1. supervising compliance with the provisions of the Banks and Financial Institutions Act 2000;
	2. promoting, encouraging and enforcing proper standards of conduct and sound and prudent business practices amongst Authorized Institutions including by the issue of prudential standards; and
	3. suppressing or aiding in suppressing illegal, dishonorable or improper practices of Authorized Institutions.
4. **The Central Bank has all the powers of a natural person to do, in Papua New Guinea or elsewhere, all things necessary or convenient to be done for or in connection with the achievement of its functions under the Banks and Financial Institutions Act 2000.[[106]](#footnote-107)**
5. **The Banks and Financial Institutions Act 2000 identifies clearly its ambit by means of definitions of key terms, identifying clearly the entities to which it is applicable and setting minimum requirements and standards.**
6. **The Central Bank may make prudential standards for authorized institutions.[[107]](#footnote-108)**
7. **The Head of State, acting on advice, may make, amend or vary regulations.[[108]](#footnote-109)**

### Superannuation funds

1. **The purpose of the Superannuation Act includes to:[[109]](#footnote-110)**
	1. Make provision for and promote compulsory savings for retirement through mandatory or voluntary contributions to superannuation funds by employers and employees;
	2. Make provision for the licensing and regulation of the superannuation industry in Papua New Guinea in a manner consistent with the continued development of a viable and competitive industry;
	3. Make provision for the prudent management of superannuation funds and license holders; and
	4. Provide for the protection of the interests of members of superannuation funds.
2. **The principal function of the Central Bank under the Superannuation Act 2000 is to promote the general stability, regulation and supervision of the superannuation industry for the protection of the rights and interests of members.** Other functions of the Central Bank under the Superannuation Act 2000 include:[[110]](#footnote-111)
	1. Licensing of trustees, investment managers and fund administrators;
	2. Authorizing authorized superannuation funds (ASFs) to accept employer and employee contributions made under the Superannuation Act;
	3. Supervising compliance with the provisions of the Superannuation Act and any prudential standards;
	4. Collecting and analyzing information in respect of prudential matters relating to superannuation funds and license holders;
	5. Promoting, encouraging and enforcing proper standards of conduct and sound practices in the superannuation industry including the issue of prudential standards;
	6. Evaluating the effectiveness of carrying out those practices; and
	7. Suppressing or aiding in the suppression of illegal or improper practices within the superannuation industry.
3. **The Central Bank may issue a notice or direction to a recipient for the purposes of implementing, or ensuring compliance with, the provisions of this Act.[[111]](#footnote-112)**
4. **The Central Bank may make, vary or revoke prudential standards in relation to prudential matters to be complied with.[[112]](#footnote-113)**

### Life insurance

1. **The purpose of the Life Insurance Act includes to:[[113]](#footnote-114)**
	1. Make provision for the licensing and regulation of the life insurance industry in Papua New Guinea in a manner consistent with the continued development of a viable competitive industry;
	2. Make provision for the prudent management of license holders and life insurance agents;
	3. Provide for the protection of interests of policyholders and prospective policy holders of life policies.
2. **The principal function of the Central Bank under the Life Insurance Act 2000 is to promote the general stability, regulation and supervision of the life insurance industry for the protection of the rights and interests of policyholders.** The function of the Central Bank under the Life Insurance Act 2000 include:
	1. Licensing of life insurance companies
	2. Authorizing license holders to accept premiums paid in respect of life policies;
	3. Assuming responsibility for supervising compliance with the provisions of the Life Insurance Act 2000 and any prudential standards;
	4. Collecting and analyzing information in respect of prudential matters relating to license holders and life insurance agents;
	5. Promoting, encouraging and enforcing proper standards of conduct and sound and prudent business practices in the life insurance industry including the issue of prudential standards;
	6. Evaluating the effectiveness of carrying out those practices; and
	7. Suppressing or aiding in the suppression of illegal or improper practices within the life insurance industry.
3. **The Central Bank may issue a notice or direction for the purposes of implementing or ensuring compliance with the provisions of the Life Insurance Act 2000 or any prudential standard.[[114]](#footnote-115)**
4. **The Central Bank may make prudential standards in relation to prudential matters**.[[115]](#footnote-116) The Head of State, acting on advice, may make, amend or vary regulations.[[116]](#footnote-117)

### General insurance

1. **The purpose of the Insurance Act 1995 is not clearly and explicitly stated.** The heading of the Insurance Act 1995, which does not legally form part of the legislation, states that the Insurance Act 1995 relates to insurance and repeal of the Insurance Act (Chapter 255) and for related purposes. Section 1 of the Insurance Act 1995 states that it is a law that is made for the purpose of giving effect to the public interest in public order and public welfare.
2. **Subject to any directions of the Minister, the PNGIC is charged with the administration of the Insurance Act.[[117]](#footnote-118)** The appointment, suspension or dismissal of the PNGIC is regulated in the Regulatory Statutory Authorities (Appointment of Certain Offices) Act 2004. (Note: The Insurance Act 1995 contains 40 references to the Minister, but it does not identify which Minister is being referred to. In practice, the PNGIC reports to the Minister of Treasury)
3. **The PNGIC is required, in the exercise of his powers and functions, to operate within any framework of policy laid down from time to time in policy guidelines issued by the Head of State, acting on advice.[[118]](#footnote-119)**
4. The Head of State, acting on advice, may make regulations, not inconsistent with the Insurance Act, prescribing all matters that by the Insurance Act are required or permitted to be prescribed, or that are necessary or convenient to be prescribed for carrying out or giving effect to the Insurance Act.
5. The Insurance Act 1995 contains only one reference to “supervision,” and then only in relation to an exemption where a risk situated in Papua New Guinea is placed with a person other than a licensed insurer.[[119]](#footnote-120)

### Payment system[[120]](#footnote-121)

1. **The objectives of the BPNG include the promotion of an efficient national and international payments system[[121]](#footnote-122) and the general stability and effective implementation of the financial system.[[122]](#footnote-123)** To these ends, the BPNG is empowered and required to exercise regulatory and oversight powers over the national payments system as a whole and any specific system, payment services provider or payment instrument partially operating in the country and ensure that users of payment services and instruments are treated fairly and transparently.
2. **The relevant powers of the BPNG include the following:[[123]](#footnote-124)**
	1. Formulate and adopt a national payments system policy directed to the accomplishment of the principles established and in conformity with international standards;
	2. Formulate general or specific rules or guidelines;
	3. Give a license to payment service providers, operators and issuers of payment instruments under specific conditions;
	4. Designate a system as one involving systemic risk; and
	5. Establish and perform control and audit procedures.
3. **The BPNG may issue any measure permitted by law, orders, directions or guidelines to implement the National Payment System Act.** The BPNG shall cooperate with public authorities engaged in the regulation and supervision of financial institutions and other entities directly or indirectly involved in payment services, public authorities which regulate monitor and supervise capital markets, and any other relevant public authorities.[[124]](#footnote-125)

### Consumer protection and competition

1. **The Independent Consumer and Competition Commission (ICCC) was established in terms of the Independent Consumer and Competition Commission Act 2002**.[[125]](#footnote-126)
2. **The primary objectives of the ICCC are:[[126]](#footnote-127)**
	1. To enhance the welfare of the people of PNG through the promotion of competition, fair trading and the protection of consumers’ interests;
	2. To promote economic efficiency in industry structure, investment and conduct;
	3. To protect the long term interest of the people of PNG with regard to the price, quality and reliability of significant goods and services.
3. **In seeking to achieve its primary objectives, the ICCC shall have regard to the following facilitating objectives: [[127]](#footnote-128)**
	1. To promote and protect the bona fide interests of consumers with regard to the price, quality and reliability of goods and services;
	2. To ensure that users and consumers (including low-income or vulnerable consumers) benefit from competition and efficiency;
	3. To facilitate effective competition and promote competitive market conduct;[[128]](#footnote-129)
	4. To prevent the misuse of market power;
	5. To promote and encourage the efficient operation of industries and efficient investment in industries;
	6. To ensure that regulatory decision making has regard to any applicable health , safety, environmental and social legislation;
	7. To promote and encourage fair trading practices and a fair market.
4. **The functions of the ICCC are:**[[129]](#footnote-130)
	1. To perform such functions relating to price regulation, licensing, industry regulation and other matters as are conferred on the ICCC by or under this Act or any other Act;
	2. To promote and protect the bona fide interests of consumers in relation to the acquisition and supply of goods and services;
	3. To make available information in relation to matters affecting the interests of consumers;
	4. To investigate complaints concerning matters affecting or likely to affect the bona fide interests of consumers in relation to the acquisition of goods and services and to enforce compliance with laws relating to such matters;
	5. To investigate complaints concerning market conduct and to enforce compliance with laws relating to market conduct;
	6. To make, monitor the operation of, and review from time to time, codes and rules relating to the conduct or operation of regulated entities;
	7. To advise and make recommendations to the Minister.
5. **The ICCC has power to do all things necessary or convenient to be done for or in connection with or otherwise incidental to the performance of its functions and to enable it to achieve its objectives.[[130]](#footnote-131)** The ICCC is not subject to direction by the Minister or any other person in the performance of its functions.[[131]](#footnote-132)
1. This report is part of technical assistance in the form of a financial services sector review provided by the World Bank to the Papua New Guinea Treasury and Bank of Papua New Guinea to support the development of the Financial Services Sector Development Strategy. Funding for the technical assistance has been provided by FIRST Initiative. [↑](#footnote-ref-2)
2. This report was drafted by Carel Oosthuizen, Independent Consultant, with the support of Craig Thorburn, Technical Advisor, World Bank, and Wei Zhang, Task Team Leader and Senior Financial Sector Expert, World Bank. The authors are thankful for the support provided by the Bank of Papua New Guinea, the PNG Department of Treasury, PNGIC, PNGSC and the financial institutions visited during the diagnostic mission. The assessment and recommendations are those of the authors and do not necessarily reflect the views of the Executive Directors of the World Bank or the governments they represent. The Word Bank does not guarantee the accuracy of the data included in this work. [↑](#footnote-ref-3)
3. See *Terms of Reference – Financial Services Sector Review,* Joint Communique of PNG Department of Treasury and BPNG, 2015. [↑](#footnote-ref-4)
4. See *Terms of Reference – Financial Services Sector Review,* Joint Communique of PNG Department of Treasury and BPNG, 2015. [↑](#footnote-ref-5)
5. Financial system microprudential regulation and supervision refers to regulation and supervision which is “bottom-up”, focusing on individual economic agents and sectors within the financial system, say, bank/banking/banking sector, insurer/insurance/insurance sector, and etcetera. This must be distinguished from financial system macroprudential surveillance, which is “top-down”, focusing on the financial system as a whole. [↑](#footnote-ref-6)
6. ST= Up to one year; MT= More than one year, and up to 3 years; LT= More than 3 years [↑](#footnote-ref-7)
7. See *Financial Inclusion in Papua New Guinea: Status Report*, by Jonathan Sibley of the World Bank, 2015. [↑](#footnote-ref-8)
8. See *Terms of Reference – Financial Services Sector Review,* Joint Communique of PNG Department of Treasury and BPNG, 2015. [↑](#footnote-ref-9)
9. As a rule of thumb, a high ratio of financial sector assets to GDP, say around 100%, is indicative of a relatively developed and sophisticated economy, whereas a low ratio, say below 50%, is indicative of a relatively lesser developed and lesser sophisticated economy. [↑](#footnote-ref-10)
10. Ten out of the 18 listed companies on POMSoX are listed on other exchanges. POMSoX total market capitalization was USD16.7 billion as of September 2015 (-based on market reports). However, excluding the 11 dual listings, such as Interoil, Newcrest Mining and Oil Search, the market cap of the remaining 7 listings, which are all domestic companies, was USD 1.6 billion. [↑](#footnote-ref-11)
11. Per PNG Financial Soundness Indicators, as submitted to the IMF. [↑](#footnote-ref-12)
12. See *Terms of Reference – Financial Services Sector Review,* Joint Communique of PNG Department of Treasury and BPNG, 2015. [↑](#footnote-ref-13)
13. See *Terms of Reference – Financial Services Sector Review,* Joint Communique of PNG Department of Treasury and BPNG, 2015. [↑](#footnote-ref-14)
14. See *Financial Inclusion in Papua New Guinea: Status Report*, by Jonathan Sibley of the World Bank, 2015. [↑](#footnote-ref-15)
15. See *Financial Inclusion in Papua New Guinea: Status Report*, by Jonathan Sibley of the World Bank, 2015. [↑](#footnote-ref-16)
16. See *Financial Inclusion in Papua New Guinea: Status Report*, by Jonathan Sibley of the World Bank, 2015. [↑](#footnote-ref-17)
17. See: <http://www.tsl.org.pg/about.html> [↑](#footnote-ref-18)
18. See *Financial Inclusion in Papua New Guinea: Status Report*, by Jonathan Sibley of the World Bank, 2015. [↑](#footnote-ref-19)
19. See *Financial Inclusion in Papua New Guinea: Status Report*, by Jonathan Sibley of the World Bank, 2015. [↑](#footnote-ref-20)
20. See *Financial Inclusion in Papua New Guinea: Status Report*, by Jonathan Sibley of the World Bank, 2015. [↑](#footnote-ref-21)
21. See *Review of the PNG Government Bond & Capital Market Development,* by RT Andreoli, 2015. [↑](#footnote-ref-22)
22. See *Terms of Reference – Financial Services Sector Review,* Joint Communique of PNG Department of Treasury and BPNG, 2015. [↑](#footnote-ref-23)
23. See *Review of the PNG Government Bond & Capital Market Development,* by RT Andreoli, 2015. [↑](#footnote-ref-24)
24. See *Review of the PNG Government Bond & Capital Market Development,* by RT Andreoli, 2015. [↑](#footnote-ref-25)
25. See also Appendix 2. Legal and legislative framework [↑](#footnote-ref-26)
26. Media reports mentioned that a new Securities Commission Act was promulgated during 2015. However, the mission has not been able to confirm this or obtain a copy thereof. As of 13 November 2015, POMSoX had not been furnished with or been able to obtain a copy of this legislation. According to POMSox acting general manager, there was no public consultation on this legislation, nor was POMSoX consulted on this legislation, [↑](#footnote-ref-27)
27. See *Terms of Reference – Financial Services Sector Review,* Joint Communique of PNG Department of Treasury and BPNG, 2015. [↑](#footnote-ref-28)
28. See *Terms of Reference – Financial Services Sector Review,* Joint Communique of PNG Department of Treasury and BPNG, 2015. [↑](#footnote-ref-29)
29. See *Terms of Reference – Financial Services Sector Review,* Joint Communique of PNG Department of Treasury and BPNG, 2015. [↑](#footnote-ref-30)
30. <http://www.bankpng.gov.pg/wp-content/uploads/2014/06/overview.pdf> [↑](#footnote-ref-31)
31. See: <http://www.bankpng.gov.pg/financial-system/introduction/> [↑](#footnote-ref-32)
32. Currently, 18 institutions are regulated under the BFIA, which includes 4 banks, 9 licensed financial institutions and 5 microfinance institutions. [↑](#footnote-ref-33)
33. Article 9 of Banks and Financial Institutions Act 2000. [↑](#footnote-ref-34)
34. The 2013 amendments to the Superannuation (General Provisions) Act 2000 addressed the recommendations contained in the June 2008 “Report of the BPNG/Treasury Working Group on the outstanding Superannuation Task Force Issues. To date, the BPNG has not yet received from the Department of Treasury a signed copy of these amendments. (See BPNG annual reports for 2013 and 2014.) [↑](#footnote-ref-35)
35. See *Terms of Reference – Financial Services Sector Review,* Joint Communique of PNG Department of Treasury and BPNG, 2015. [↑](#footnote-ref-36)
36. See *Terms of Reference – Financial Services Sector Review,* Joint Communique of PNG Department of Treasury and BPNG, 2015. [↑](#footnote-ref-37)
37. See *Terms of Reference – Financial Services Sector Review,* Joint Communique of PNG Department of Treasury and BPNG, 2015. [↑](#footnote-ref-38)
38. See *Financial Inclusion in Papua New Guinea: Status Report*, by Jonathan Sibley of the World Bank, 2015. [↑](#footnote-ref-39)
39. See *Terms of Reference – Financial Services Sector Review,* Joint Communique of PNG Department of Treasury and BPNG, 2015. [↑](#footnote-ref-40)
40. See *Financial Inclusion in Papua New Guinea: Status Report*, by Jonathan Sibley of the World Bank, 2015. [↑](#footnote-ref-41)
41. See *Terms of Reference – Financial Services Sector Review,* Joint Communique of PNG Department of Treasury and BPNG, 2015. [↑](#footnote-ref-42)
42. See *Review of the PNG Government Bond & Capital Market Development,* by RT Andreoli, 2015. [↑](#footnote-ref-43)
43. <http://www.fatf-gafi.org/publications/high-riskandnon-cooperativejurisdictions/documents/fatf-compliance-june-2015.html> [↑](#footnote-ref-44)
44. See *Improving Global AML/CFT Compliance: On-going process,* FACT, 26 June 2015. <http://www.fatf-gafi.org/publications/high-riskandnon-cooperativejurisdictions/documents/fatf-compliance-june-2015.html> [↑](#footnote-ref-45)
45. See *Terms of Reference – Financial Services Sector Review,* Joint Communique of PNG Department of Treasury and BPNG, 2015. [↑](#footnote-ref-46)
46. As there is little if any information on the PNGIC or the Insurance Act 1995 and related matters available in the public domain, the mission was dependent on the PNGIC for relevant information. The PNGIC does not have an internet website. [↑](#footnote-ref-47)
47. The mission was provided with 19 circulars dating from 2001 which deal mostly with administrative matters. [↑](#footnote-ref-48)
48. See *Review of the PNG Government Bond & Capital Market Development,* by RT Andreoli, 2015. [↑](#footnote-ref-49)
49. It has been reported in the media that a new Securities Commission Act, a new Capital Markets Act and a new Central Depository Act were promulgated during 2015. However, the mission has not been able to confirm this or obtain a copy of any of these from the PNGSC or anybody else. [↑](#footnote-ref-50)
50. See *PNG: Payment System Assessment Update,* by C Calozza and B Bossone, 2015 [↑](#footnote-ref-51)
51. See *Review of the PNG Government Bond & Capital Market Development,* by RT Andreoli, 2015. [↑](#footnote-ref-52)
52. See *PNG: Payment System Assessment Update,* by C Calozza and B Bossone, 2015 [↑](#footnote-ref-53)
53. See *Review of the PNG Government Bond & Capital Market Development,* by RT Andreoli, 2015. [↑](#footnote-ref-54)
54. See also Appendix 1. Financial sector regulatory architecture. Some of this content is based on an unpublished manuscript by David Walker. [↑](#footnote-ref-55)
55. Section 7 of the Central Banking Act, 2000. [↑](#footnote-ref-56)
56. Section 7 of the Central Banking Act, 2000. [↑](#footnote-ref-57)
57. Section 2 of the Banks and Financial Institutions Act 2000. [↑](#footnote-ref-58)
58. Section 2 of the Superannuation Act 2000. [↑](#footnote-ref-59)
59. Section 2 of Life Insurance Act 2000. [↑](#footnote-ref-60)
60. Section 7 of the Central Banking Act, 2000. [↑](#footnote-ref-61)
61. Section 2 of Banking and Financial Institutions Act 2000. [↑](#footnote-ref-62)
62. Section 2 of Life Insurance Act 2000. [↑](#footnote-ref-63)
63. Section 2 of Superannuation Act 2000. [↑](#footnote-ref-64)
64. Per report titled *Financial Inclusion in Papua New Guinea: Status Report*, by Jonathan Sibley of the World Bank, 2015. [↑](#footnote-ref-65)
65. Section 5(1) of Independent Consumer and Competition Commission. [↑](#footnote-ref-66)
66. Section 7 of the Securities Commission Bill 2015. [↑](#footnote-ref-67)
67. Section 5(1) of Independent Consumer and Competition Commission. [↑](#footnote-ref-68)
68. Financial system microprudential regulation and supervision refers to regulation and supervision which is “bottom-up”, focusing on individual economic agents and sectors within the financial system, say, bank/banking/banking sector, insurer/insurance/insurance sector, and etcetera. This must be distinguished from financial system macroprudential surveillance, which is “top-down”, focusing on the financial system as a whole. [↑](#footnote-ref-69)
69. Per David Walker, unpublished. Some adjustments effected by report author. [↑](#footnote-ref-70)
70. The Structure of Financial Supervision: Approaches and Challenges in a Global Marketplace; Group of October 2008. [↑](#footnote-ref-71)
71. Aligning Supervisory Structures with Country Needs World Bank Seminar, Washington DC, June, 6 and 7, 2006. [↑](#footnote-ref-72)
72. IMF WP 00/213. [↑](#footnote-ref-73)
73. <http://www.clgfpacific.org/userfiles/3/files/Papa%20New%20Gunea.pdf> (As on 2015 06 01) [↑](#footnote-ref-74)
74. Section 11(1) of the Constitution of the Independent State of Papua New Guinea, 1975. [↑](#footnote-ref-75)
75. Section 40 of the Organic Law on Provincial Governments and Local-level Governments. [↑](#footnote-ref-76)
76. Section 41 of the Organic Law on Provincial Governments and Local-level Governments. [↑](#footnote-ref-77)
77. Section 1(2) of the Banks and Financial Institutions Act 2000. [↑](#footnote-ref-78)
78. Section 1(2) of the Superannuation Act 2000. [↑](#footnote-ref-79)
79. Section 1(2) of the Life Insurance Act 2000. [↑](#footnote-ref-80)
80. Section 1(2) of the Insurance Act 1995. [↑](#footnote-ref-81)
81. Section 1(1) of the National Payment System Act 2013. [↑](#footnote-ref-82)
82. Section 1 of the Independent Consumer and Competition Commission Act 2002. [↑](#footnote-ref-83)
83. Section 149 of the Constitution of the Independent State of Papua New Guinea. [↑](#footnote-ref-84)
84. In other jurisdictions, this body typically is called the national cabinet. [↑](#footnote-ref-85)
85. Section 208A & B of the Constitution of the Independent State of Papua New Guinea, 1975. [↑](#footnote-ref-86)
86. Section 6 of the Central Banking Act, 2000. [↑](#footnote-ref-87)
87. Section 7 of the Central Banking Act, 2000. [↑](#footnote-ref-88)
88. Section 8 of the Central Banking Act, 2000. [↑](#footnote-ref-89)
89. Section 14 of the Central Banking Act, 2000. [↑](#footnote-ref-90)
90. The Central Banking Act, 2000, does not define the term Minister nor does it specify which Minister is being referred to. In most jurisdictions, in central banking legislation this term typically refers to the Minister of Finance. In PNG, the meaning to be attributed to this term is uncertain given the splitting of the roles of Minister of Finance and Treasury Minister. [↑](#footnote-ref-91)
91. Section 26 of the Central Banking Act, 2000. [↑](#footnote-ref-92)
92. Section 15 of the Central Banking Act, 2000. [↑](#footnote-ref-93)
93. Section 13 of the Central Banking Act, 2000. [↑](#footnote-ref-94)
94. Section 16 of the Central Banking Act, 2000. [↑](#footnote-ref-95)
95. Section 18 of the Central Banking Act, 2000. [↑](#footnote-ref-96)
96. Section 23 of the Central Banking Act, 2000. [↑](#footnote-ref-97)
97. Section 21 of the Central Banking Act, 2000. [↑](#footnote-ref-98)
98. Section 27 of the Central Banking Act, 2000. [↑](#footnote-ref-99)
99. Section 44 of the Central Banking Act, 2000. [↑](#footnote-ref-100)
100. Section 76 of the Central Banking Act, 2000. [↑](#footnote-ref-101)
101. Section 2 of Banks and Financial Institutions Act 2000. [↑](#footnote-ref-102)
102. Section 5(1) of the Banks and Financial Institutions Act 2000. [↑](#footnote-ref-103)
103. Section 5(2) of the Banks and Financial Institutions Act 2000. [↑](#footnote-ref-104)
104. Section 5(3) of the Banks and Financial Institutions Act 2000. [↑](#footnote-ref-105)
105. Section 5(4) of the Banks and Financial Institutions Act 2000. [↑](#footnote-ref-106)
106. Section 6 of the Banks and Financial Institutions Act 2000. [↑](#footnote-ref-107)
107. Section 27 of Banks and Financial Institutions Act 2000. [↑](#footnote-ref-108)
108. Section 53 of Banks and Financial Institutions Act 2000. [↑](#footnote-ref-109)
109. Section 2 of Superannuation Act 2000. [↑](#footnote-ref-110)
110. Section 7 of Superannuation Act 2000. [↑](#footnote-ref-111)
111. Section 24(2) of Superannuation Fund Act 2000. [↑](#footnote-ref-112)
112. Section 43 of Superannuation Act 2000. [↑](#footnote-ref-113)
113. Section 2 of Life Insurance Act 2000. [↑](#footnote-ref-114)
114. Section 29 of Life Insurance Act 2000. [↑](#footnote-ref-115)
115. Section 44 of Life Insurance Act 2000. [↑](#footnote-ref-116)
116. Section 143 of Life Insurance Act 2000. [↑](#footnote-ref-117)
117. Section 5 of the Insurance Act 1995. [↑](#footnote-ref-118)
118. Section 26 of Insurance Act 1995. [↑](#footnote-ref-119)
119. Section 37(2)(b)(iv)(C) of Insurance Act 1995. [↑](#footnote-ref-120)
120. See also the relevant information under the heading “Central Bank,” above. [↑](#footnote-ref-121)
121. Section 7(c) of the Central Bank Act 2000. [↑](#footnote-ref-122)
122. Section 3(1)(d) of the National Payment System Act 2013. [↑](#footnote-ref-123)
123. Section 3(2) of the National Payment System Act 2013. [↑](#footnote-ref-124)
124. Section 34 of the National Payment System Act 2013. [↑](#footnote-ref-125)
125. Section 4 of Independent Consumer and Competition Commission Act 2002. [↑](#footnote-ref-126)
126. Section 5(1) of Independent Consumer and Competition Commission Act 2002. [↑](#footnote-ref-127)
127. Section 5(2) of Independent Consumer and Competition Commission Act 2002. [↑](#footnote-ref-128)
128. Kina Group gained control over Maybank PNG during 2015. Notwithstanding that this transaction involved a bank, this transaction was not required to be reported to the ICCC, nor did the ICCC investigate the transaction. [↑](#footnote-ref-129)
129. Section 6 of Independent Consumer and Competition Commission Act 2002. [↑](#footnote-ref-130)
130. Section 7 of Independent Consumer and Competition Commission Act 2002. [↑](#footnote-ref-131)
131. Section 23 of Independent Consumer and Competition Commission Act 2002. [↑](#footnote-ref-132)