

Anselmo L S Teng: Risk management in financial services

Opening speech by Mr Anselmo L S Teng, Chairman of the Monetary Authority of Macao, ASHK (Actuarial Society of Hong Kong) Regional Conference, Macao, 28 January 2008.

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President Ng, Distinguished Guests, Dear Delegates, Ladies and Gentlemen,

1. Welcome to Macao! I would like to say thank you, on behalf of the Macao SAR Government, to members of the Actuarial Society of Hong Kong for choosing Macao, where east and west meet, as venue for this regional conference. I am sure you will find fascination in the sophisticated mix of Chinese and south European culture provided by this unique city.

I am honoured to be invited to make an opening remark in this occasion. What I intend to do through out the next twelve minutes or so is first to give you an up-date about Macao and its latest economic development, as well as an introduction of its financial sector; then I'll move on to say a few words on the main theme of this conference.

2. Macao is no doubt in the lime light. This enclave is a small but open economy with a relatively simple economic structure and a developing financial sector. It is governed under the principle of "One Country, Two Systems" in the context of our Basic Law. It is a free port, an independent tariff area; there is free flow of merchandize, financial assets and capital. The Pataca, our legal tender, is linked to the Hong Kong Dollar at 1.03 Patacas to 1 Hong Kong Dollar.

Benefited from the satisfactory performance of the tourism sector, Macao's economy continued to show remarkable growth in the first three quarters of 2007. Real GDP soared 30.9% year-on-year in the third quarter, sustaining the growth of 25.7% and 31.6% in the first and the second quarter respectively.

The opening of new tourist facilities successfully attracted more visitors, evidenced by the double-digit growth of visitor arrivals and service exports. Large-scale investment projects in the private sector continued to contribute to Macao's robust economy.

For the year 2007, visitor arrivals reached 27 million, equivalent to a hefty growth of 22.8% over a year earlier. Mainly due to the fast growing pace in recent years, Macao's economy has virtually reached its full employment level as the unemployment rate hovered in a range of 2.9-3.2% in the first 11 months of 2007 while inflationary pressure apparently intensified in the second half of 2007 and reached 5.57% for the whole year.

3. With an area of 28.5 sq.km. and a population of about 530,000, the burgeoning economy no doubt has put human resources and infrastructure under great strain. To maintain a sustainable growth, we have to overcome the bottleneck and diversify.

To enhance the capacity of our development, the Macao SAR Government has embarked on a number of infrastructural projects. Internally, a light rail mass transit system will link up all essential spots in a few years. Externally, the airport will be expanded while the Hong Kong-Zhuhai-Macao Bridge is on the drawboard. We have applied a number of incentive schemes to encourage our youths to acquire more knowledge so as to make preparation for a transformation to a knowledge-based economy. The most significant measure is the provision of 15 year free education to our kids. We are fully aware of our strong connections with Mainland China and Portuguese speaking countries and also our competitive edge in terms of comparatively low cost, quick and free flow of information, flexible business structure and low tax regime. We have fully exploited all these. Thus Macao has been able to benefit from the Closer Economic Partnership Agreement with the Mainland and play a key role in platforms servicing Portuguese speaking countries; important economic bases of Mainland China, particularly Guangdong West; and ethnic Chinese merchants all over the world. We also realize that our tourism services industry needs non-gaming elements. Ladies

and gentlemen, you may take a break to tour around Macao to appreciate Macao as a metropolis which provides culture, entertainment, recreation, as well as convention and exhibition facilities to tourists and business visitors.

4. When we talk about diversification, we put the financial sector in our agenda as it accounts for about 10% of our GDP. It is a high value-added, profitable and capital intensive industry which is most suited to an economic ecology like Macao. The Monetary Authority of Macao is the sole regulator of the financial sector, which is dominated by banks and insurance companies. At the moment, there are 28 banks operating in Macao of which 3 are operating under offshore regime. In addition, there is a finance company with restricted banking activities and a non-bank credit institution which specializes in the issuance and management of electronic money stored value card service. In the insurance sector, there are 11 life insurance companies and 13 non-life ones. Besides, there are other institutions operating in our financial sector which include money changers, cash remittance companies and financial intermediaries. The capital of all these institutions are provided by investors from Mainland China, Portugal, Hong Kong, the U.S., the UK, France, Canada, Singapore and Chinese Taiwan, in addition to local participants. In fact, overseas capitals account for the majority in our financial sector. It is even more obvious in the banking industry. Doubtless, from a global perspective, the financial sector of Macao is highly internationalized.

The most luring feature of the Macao financial sector is its profitability. The size of the financial sector here is not spectacular but the return on capital is lucrative. Further growth was registered for 2007. Both assets and deposits also grew by double digit for years. The insurance industry has also prospered in tandem with our burgeoning economy. After encouraging growth for a number of years, gross premium receipts for the first three quarters of 2007 exhibited a growth rate of 47.2% year-on-year.

5. The present environment of Macao provides fertile soil for actuarial science to flourish. The delegates know better than I do that actuarial science has a wide application. It is a combination of mathematics, economics and business understanding, under which financial risk can be managed soundly and practically. Certainly, risk management is nothing new. As you are all familiar with, it has its root in the insurance field. After years of development, it has become an indispensable tool to different sectors of the economy, be it an individual, a specific product category or a particular industry. Its extensive use is apparent in areas such as insurance, social security, financial products, investment and wealth management etc.

According to Principle 7 of the Basel's Core Principles for Effective Banking Supervision, "risk management is a process to identify, evaluate, monitor and control or mitigate all material risks and to assess the overall capital adequacy in relation to the risk profile". On the other hand, Insurance Core Principle ICP 18 defines "how supervisory authorities should require insurers to recognize the range of risks that they face and to assess and manage them effectively"; and ICP 19 "states how supervisory authorities should require insurers to evaluate and manage the risks that they underwrite, in particular through reinsurance, and to have the tools to establish an adequate level of premiums".

6. In Macao, banks and insurance companies, as a result of innovation in products and services, improved technology and other developments in the industry, have a larger pool of risk management tools and practices available. Of course, they are faced with continuous challenges as they manage risk, especially when they need to remain profitable and competitive. However, if financial innovation can be used properly, on one hand, to add value to the customers in terms of products and pricing, and to improve profitability on the other, while identifying and understanding during the process how risk profiles can change as a result, then good risk management can be deemed to have been in place. This complex process falls within the technical expertise of professional actuaries. In fact, professional actuaries are the key players in the process.

7. Viewing from a more macro perspective, the volatility of financial markets around the world underlines the imperative nature of risk management in maintaining stability of our global

financial system. Last year, there were worries over certain financial products, particularly subprime loans related, which might throw international financial markets into turmoil. Unfortunately, it has turned out to be a “Cassandra” one. Excess liquidity and recklessness of participants were causing misallocation of resources which would certainly give rise to inflated financial assets and their subsequent bust. Last Tuesday, the FED announced to cut Fed Fund rate by 75 basis points to alleviate the battered markets. This action will certainly give short term relief. However, how long the effect will last is still a question. This time, the pain comes not from the cost of borrowing but from the ability to lend. As we all know, gargantuan international banks are writing down the value of their SIV’s and bringing them back to their balance sheets. Such a move has already taken away tens of billions of dollars from their capital which will tremendously weaken their capacity to lend. Coupled with their suspicion they have conceived in respect of the viability of their counterparts, we shall witness some stagnation in the lending market for quite some time in the future. Such structural retrenchment in liquidity has little to do with cost of borrowing. As a result, there may be continued upheavals in financial markets.

8. As financial institutions offer more sophisticated products and services, there will be more associated risks in their on-going risk management framework. This is particularly true as they grow in size and complexity, and their ability to identify, define, measure, manage, and organize to manage their risks are of utmost importance and major concern, especially from the supervisory point of view.

Given the change in the international regulatory climate where risk-based supervision is becoming a “norm”, regulators have to work closely with many professions to ensure that prudential standards and disclosure requirements are set. We would be seeing more of this cooperative working relationship in the coming years between professional bodies, such as the International Actuarial Association, and the regulators for the purpose of setting standards and enhancing market transparency which are conducive to the healthy development of the industry.

The above observations are meant to provide certain insight to the main theme of this conference. I am sure that you’ll be hearing more indepth views from a good line up of regulators, practioners, and professionals during these two days.

9. As a final note, I strongly believe that the Society’s choice of holding its Regional Conference here in Macao is an appropriate one. The delegates will find world class standard in both hardware and software provided by this enclave. On top of that, delegates will certainly enjoy the nostalgia and excitement which are indigenious to Macao. On the other hand, I would like to emphasize that we treasure your presence not for the pecuniary benefit you have brought to our tourism services sector but the vision and perspective you are going to impart to our financial sector and our young citizens, particularly at a time when we are striving to diversify our economy. I do hope the spreading of your gospel, namely, actuarial science, as well as the main theme of the conference, will enable our financial participants to gain more insight into the industry and risk management and become more innovative in launching new products. Moreover, it may open a new horizon for our career minded youths. Macao welcomes your Society as always, whether for tourism, business, academic or professional exchange purposes.

Finally, please accept my best wishes for the success of this conference and please also remember to enjoy the charms of Macao after all the hard work.

Thank you!