

Benny Popoitai: The savings and loan industry - Papua New Guinea

Speech by Mr Benny Popoitai, MBE, Deputy Governor of the Bank of Papua New Guinea, to the Savings and Loan Societies/Credit Union Day luncheon, Port Moresby, 21 October 2004.

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Acknowledgement

Mr. Michael Koisen, President and Board of Directors' Chairman of the Federation of Savings and Loan Societies Limited Members of the Federation of Savings and Loan Societies Limited Participants to the Federation of Savings and Loan Societies Workshop Distinguished guests Ladies and Gentlemen

Thank you for the invitation to participate at this year's International Credit Union Day (ICUD) and to open the Federation of Savings and Loan Societies Limited's Strategic Planning Workshop.

Introduction

The theme for this year's celebration is: Credit Unions:

Dream.....Belong.....Achieve

Dream Belong Achieve

To me - it means that all S&L Societies must do all within the bounds of the S&L Act to deliver the services required of it. After all every member, manager & board-member wants to be part of the success story.

This is a worthwhile theme, given the past history of the credit union movement in Papua New Guinea and the developments taking place today. It is now an ideal time for all of us involved in the movement as well as in the wider management and participation in the financial service sector to take stock of our achievements. We need to also assess the challenges that remain. In so doing, we acknowledge the efforts of many people, including all of you here today, who have and continue to promote the savings and loan society movement in Papua New Guinea.

Today is also the time when we join our colleagues in the 40,000 other Credit Unions in 94 different countries to celebrate this movement. About 112 million people around the world participate in this movement, reflecting its cooperative and financial empowerment ideals.

My speech will focus on the three theme words; namely, Dream, Belong and Achieve. Specifically the roles and challenges we as the regulator, you as the providers and the wider community as the participants or recipients play or face towards the development of the movement in contributing towards a sound financial system that is beneficial to all in the country.

The dream

The Bank of Papua New Guinea's involvement with the savings and loan society movement goes back a long way. In fact, prior to the Central Bank's own establishment in 1973, the Reserve Bank of Australia's branch in Papua New Guinea encouraged the development of the movement to promote financial knowledge and skills amongst the populace, in the lead-up to independence. The Bank of Papua New Guinea has since carried on this dream.

The Societies promoted thrift amongst their members, educated them in financial responsibility, received their savings and in turn, provided loans to enhance their economic well-being. This also enabled their participation in the economic growth of the nation.

The services that the savings and loan societies provide are complementary to those provided by other financial institutions such as banks and finance companies. Operationally they differ from other

financial institutions in the way they are run. That is, the members have a say in how their society is being run through representation on the Board and at annual general meetings. As such, the members collectively own the society.

The success of a society therefore depends on the ability of the board and its management to run the society's business professionally and prudently, while the members need to provide effective oversight on the affairs of their society through their supervisory committee representative. The Savings and Loan Societies Act provides this selfregulating mechanism where, if managed effectively, the movement would ensure greater prosperity for all.

Belong

The movement has over the years, developed with mixed results. From just over 200 societies in mid-1977 with 90,681 members, the number has declined to 20 active societies in June 2004 with only 127,276 members. Total assets have however grown from K14.1 million to K172.8 million over this period.

The decline in the number of societies and the slow growth in membership reflect the problems the movement has been plagued with. Some of these problems still exist today, providing challenges as well as opportunities for all of us to consider. These problems include mismanagement by the board and management of the societies, failure to comply with Directives from the Registrar and requirements of the Savings and Loans Act. Mismanagement has occurred by granting loans in excess of lending limits, lending to friends and relatives who do not qualify for loans, uncontrolled expenditures, and outright abuse and theft of society property.

The Bank recognizes the important role the movement plays in the financial system and for the people of Papua New Guinea. We have sought the assistance of the Federation of Savings and Loan Societies Limited, overseas Credit Unions and other interested parties to help promote the movement.

A five-year revitalisation programme in the 1990's saw the liquidation and de-registration of dormant societies, introduction of a centralised computer system and promotion of provincial and industrial-base societies. A new feature of the industry involves the establishment of contributor-based societies.

The achievements

As mentioned earlier, the Savings and Loan industry in Papua New Guinea today consists of 20 savings and loan societies. Five (5) are provincial based while the rest are industrial based societies. Total assets of the industry were approximately K172.8 million with loans and advances forming about 48.74% of total assets at end June 2004. Members' savings deposits were about K133.8 million from 127,276 members.

The overall health of the industry is satisfactory. Capital, asset quality and liquidity are satisfactory, while earnings are relatively fair.

a. Capital Adequacy

The capital of the industry is satisfactory. Accumulated profits increased from K12.9 million in June 2003 to K21.9 million in December 2003 and slightly decreased to K20.8 million at end-June 2004. However, capital funds to total assets increased to 18.9% from 12.4% in the same period last year.

The capital of the industry is not threatened by Non-Performing Loans (NPLs) as NPLs as a ratio of capital funds improved from 30.0% in June 2003 to 10.8% in June 2004.

b. Asset quality

Asset quality of the industry is satisfactory. Loans and advances increased to K85.9 million in June 2004 from K80.5 million in June 2003, of which only 4.6% of the loan portfolio is non-performing. Provision to total loans decreased to 4.2% in June 2004 from 7.0% in the same period last year. However, provisioning level is sufficient to cover up to 89.8% of non-performing loans.

c. Earnings

Earnings of the industry are less than satisfactory. Net income decreased to K2.7 million in June 2004 from K4.8 million in June 2003. Return on Assets decreased to 3.0% from 6.2%, while net interest margin decreased to 3.0% from 3.6% in the same period last year. This is due to decline in Treasury bill interest rates, where most of the industry's unlet funds are invested.

d. Liquidity

Liquidity is adequate to cover for day-to-day liquidity requirements. Liquid assets decreased to K32.9 million in June 2004 from K41.4 million in June 2003, while loans to deposits increased to 64.2% from 58.9% in the same period last year. However, liquid assets level can cater up to 24.5% of any additional loan and withdrawal requests. Fixed assets decreased to 14.1% from 26.6% in June 2003.

The road head

The successes of the movement are shown by its performance over the years. I have mentioned some of the problem areas faced by the societies and we as the regulator.

Based on these experiences, the Bank of Papua New Guinea came up with certain arrangements to address these issues with a view to protecting members' funds from mismanagement and abuses. The Central Bank has had to place societies under administration for noncompliance. Currently, two societies remained under administration.

And besides liquidation, we have issued stricter Directives to suppress or control certain abusive practices and established an industry code of Conduct requiring all directors and management to sign up before assuming responsibilities.

The Bank's regulatory responsibility over the Savings and loan industry will remain a big challenge in the future, due significantly to the way the legislative framework is set out. This is an industry where, over the years, the Central Bank has been overwhelmed with dealing on a lot of administrative matters and issues. These matters could be dealt with through a strong industry association or each society's own internal risks management and control systems, and a strong corporate governance culture.

The Act, which governs the licensing and regulation of societies, requires that a society can only be licensed if it has secured more than 500 members who share a common interest. The composition of a board of directors of a society is determined by the members who perform a general election over a list of nominated candidates. Over the years this requirement has given rise to the establishment of 15 small industries based societies and 5 provincial based societies. These, of course, were the surviving societies after the liquidation of some 100 odd ones.

With such concentration of small interest groupings, experience have shown that there have been a continuing deficiency in establishing boards of directors with good background understanding of legal, accounting and business issues and ethics. These weaknesses, exacerbated by weak poor management reporting systems, have only resulted in ill-informed decision making and excessive borrowing beyond prudential limits. A number of those societies have been placed under statutory management due to these weaknesses to good corporate governance.

Another area worth noting is the role of an industry association in setting and influencing a strong governance and accountability regime towards an efficient self-regulating industry. A vibrant industry association could contribute to a successful self regulating industry, which can aspire to promote solvency and innovation in the operation of all societies. The societies, which are now operating do not compete with each other as they have been set up to serve specific interest groups.

They have therefore the opportunity within them to talk to each other and to be able to resolve very simple administrative matters, which could be commonly faced by them. I have come across different societies, which have turned to the Regulator for solutions to very similar questions and situations. While these societies are not discouraged to do so, it would be preferable that they first share their experiences and problems amongst themselves to find solutions.

There is potential for the movement to grow and offer the services the members need.

Corporate Governance and the requirement to ensure 'fit and proper' persons hold the positions on the board and management cannot be emphasized enough. It should be a challenge for every society, and more importantly every member, to ensure that credible people get to hold those responsible positions.

As part of enforcing good corporate governance, the BPNG established the industry code of conduct thus requiring all directors and management to sign up before assuming responsibilities. Furthermore the Bank instituted 'fit and proper' requirements to ensure all directors undergo these tests before taking up their roles. As part of this initiative they need to undergo certain training courses conducted by the Federation of savings and loans societies and BPNG.

Good Corporate Governance is the key to enhancing strong reporting system, efficient internal controls and risk management systems. Good governance is synonymous to an effective compliance culture. This should be the dream of all societies to Achieve.

We need to move from the dreaming stage, to the belonging stage and finally to the achieving stage. I hope the Federation's Strategic Planning workshop would deal with and address the issues I have raised. It is important that we all work together to ensure that the savings and loan industry achieve its full potential for the benefit of its members.

With these remarks, I would like to thank the organisers of the Credit Union Day celebrations.

I now declare the Strategic Planning Workshop of the Federation of Savings and Loan Societies Limited open.

Thank you!