L Wilson Kamit: Financial sector reforms in Papua New Guinea

Speech by Mr L Wilson Kamit, CBE, Governor of the Bank of Papua New Guinea, at the opening of new the ANZ Harbour City Head Office, PNG, Port Moresby, 24 July 2009.

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Mr Garry Tunstall, ANZ Managing Director North West Pacific, Mr Vishnu Mohan, Incoming ANZ Managing Director North West Pacific,

Thank you, University of Music – Kaugere

Thank you for the invitation to officiate at the opening of ANZ's new head office and branch. I wish to make some comments on the banking and financial system before we start on the existing part of the programme.

Legislative and policy changes

At the turn of this decade, PNG embarked on a comprehensive structural reform process, which was supported by the international multilateral financial institutions and the bilateral friends of PNG. One aspect of the reform program was to broaden the scope and improve the effectiveness of financial sector regulation, drawing on international best practices. The reforms:

- Gave full responsibility to the Central Bank for licensing and supervising authorised deposit taking institutions, superannuation funds, fund managers, life insurance companies and life insurance brokers;
- Strengthened information gathering and investigative powers;
- Enables and instills good governance, transparency and accountability of institutions;
- Enables vetting of directors and senior managers of authorised financial institutions; and
- Effectively prohibits pyramid schemes which have been a major problem in recent times.

There is an "open invitation" for opening up banks and financial institutions in Papua New Guinea as long as one observes the licencing requirements. In essence, an applicant must:

- Have sufficient capital and have ready access to shareholders funds and resources if needed. It is NOT sufficient to wait for funds from the shareholder when an institution comes under stress.
- Management experience in banking and finance.
- The applicant and its affiliates must be solvent.
- Have the plan to offer financial services including opening up of branches and agencies.

These licencing requirements are essential to enable the entry into the financial system of Papua New Guinea of the serious, the committed and the resilient development parties who are prepared to continue to invest and expand in Papua New Guinea.

These licencing requirements are essential to "keep out" the inept and inept practices that will threaten the soundness of the banking and financial system. Our own experiences of the lost decade "the 1990's" attests to this stance. Under the reforms, the Bank of PNG had to shut down a major bank, liquidate 86 savings and loan societies and oversee a number of financial institutions manage and trade themselves back into business. The process is still continuing with a small number of institutions still under Statutory Management or In Liquidation.

The financial sector

The reformation of the financial sector created the foundation for financial stability which has led to rapid economic growth unprecedented in PNG. The financial sector has seen major transformation in asset size since 2000. Total assets of the financial system grew from under K4.0 billion in 2000 to over K20.0 billion as at end of March in 2009, with the banking system maintaining 65.2 percent of the market share, authorized superannuation funds (ASFs) account for 26.4 percent, savings and loans societies 4.1 percent, licenced financial institutions (LFIs) of 3.2 percent, and life insurance companies (LICs) of 1.1 percent. Consistent with the rapid increase in asset size, return on assets and equity of the banking sector increased significantly following the reforms. Banks in PNG remain one of the most profitable in the region.

The financial sector reforms assisted significantly in preventing the domestic banking system from the adverse effects of the global financial crises. The successful aversion was also due to the following factors:

- Lending by the commercial banks virtually funded domestically by deposits from the public;
- The banking system is well funded with ample liquidity and has a stable interest rate environment;
- Effective financial system supervisory framework which emphasis on the maintenance of capital adequacy, low level of non performing loans, good corporate governance and management gave confidence to the economy; and
- Sound fiscal management by the government, including debt retirement program provide private sector confidence;

Improvement in the sovereign risk rating of PNG from BB to BB+.

The above factors reflect that an effective regulatory framework, sound fiscal and monetary policies and adherence to basic principles of banking can safeguard the financial system from the adverse effects of external banking or financial crises.

Papua New Guinean economy

The fast pace of private sector credit growth and the development of the LNG have changed the landscape of risk profile in PNG. The following are risks which are most likely to affect the banking system in the short and medium term.

Despite the global financial crises, the PNG economy has performed relatively well in the last 5 years on the back of high international commodity prices, and prudent management of fiscal and monetary policies. The economy grew at an average rate of 5-6 percent in real GDP terms between 2004 and 2008, leading to an improvement in balance of payments position and record international reserves adequate for 9-11 months of import cover. However, there are challenges we still have to face:

1. A significant decline in commodity prices can have an adverse impact on the economy through a fall in producer incomes, increase fiscal deficit, lower investments and increase public borrowing. Decline in incomes can lead to an increase in non performing loans in those sectors and undermine soundness of the financial system;
2. The possibility of a delay in the development of the LNG project can result in asset quality issues of the banking system.

3. Financial institutions can introduce risk in their operations through imprudent management practices. These include credit, operations, and market risks. Credit Risk is the threat of default by borrowers and transactional counterparties as well as the loss of value of assets due to deterioration in credit quality. Operational risk is the threat of loss resulting from inadequate or failed internal processes, people and systems or from external events, including legal risk, while market risk is the threat of loss due to movement in prices on the holding of interest bearing securities, equities, foreign exchange, commodities and derivative instruments.

4. The Central Bank must ensure that it maintains supervision standards that will ensure a continuing sound financial system. There is no room for complacency or special dispensation for participants in the financial system.

Opportunities

Despite the risks, the financial sector reforms have created the foundation for stability and growth, which provides an opportunity for the financial sector to introduce new financial products. The new area of banking that has been successful in several developing countries is electronic or mobile banking. Electronic banking products have enabled banks to capture the un-banked population, provide financial literacy and significantly reduce the cost of banking. Mobile phone banking and branchless banks operating through agents have become a norm in many countries to bring banking services to the rural areas.

The rugged terrain, remoteness of many communities and the fragmented characteristics of the PNG economy suggest that mobile money or electronic banking is the way forward to provide financial services to the mass in the rural areas.

The rapid economic growth in the last five years has created opportunities for bank expansion. The increase in business activities requires commercial bank presence in respective regions of the country. The presence of a fully licensed bank can increase the efficiency of the financial intermediation process and promote economic development. However, these financial innovations will only succeed if:

- Infrastructure is in place for investors to build on. Mobile banking and branchless banking requires transport, power, and communication infrastructure. Eg. The Namatanai sub-branch of a bank closed down due to communication and power problems despite transport linkages (road and sea). There is no communication between Dogura and Alotau for an ordinary mobile phone call, so how can one undertake mobile (branchless) banking without communication infrastructure.
- Law and Order/Security issues are a serious concern. The law and order problems have caused the banks to reduce the size of their representations throughout PNG. Over the years, banks had to close down in provincial centres. The closure of branches in Popondetta twice in the last few years is a topical illustration.
- An alarming law & order issue is the threat to staff of financial institutions. Officers and families of staff employed in the financial system should not be placed in situations of psychological stress and anxiety caused by unsavoury elements of our society.

  The cases of kidnapping and threatening staff and their families is a problem that must stop. Bank staff must be allowed to contribute to the development of our nation without threat or intimidation whilst carrying out their duties.

Ladies and Gentlemen, let me spend a few moments on the ANZ Bank. The reason why we are here today. ANZ bank is a significant corporate citizen contributing to the development of Papua New Guinea (PNG). It employs Papua New Guineans, it pays its taxes and meets the Bank of Papua New Guinea requirements. The opening of the new office complex is an apparent reflection of determination of ANZ bank to take on the banking challenges offered in the advent of global financial crises, the fast pace of private lending growth, development of the LNG project and a changed risk landscape of PNG.

In an environment where many banks and financial institutions around the world affected by the global financial crises are contracting, it is pleasing to note that we in Papua New Guinea are still expanding.

The opening of the new office complex reminds us that the ANZ Bank is here to stay and take on those challenges in providing efficient and affordable banking services. It has been a partner in development in the past, and on hindsight stands ready to take on new opportunities that are available in PNG.

I would like to congratulate ANZ bank on this achievement. I particularly wish to acknowledge the contributions made by Mr Garry Tunstall to the banking and financial system, and to the PNG Institute of Banking & Business Management and PNG to which he is a codirector. I also acknowledge the great contribution by Mrs Desley Tunstall for her tireless assistance to the under privilege in the community especially the Children's Ward at the Port Moresby General Hospital. I also welcome the new Managing Director Mr Vishnu Mohan and his wife Mrs Bubby Mohan. I wish everyone at ANZ Bank all the very best here in their new Harbour City home.

It now gives me great pleasure to cut the ribbon and officially open ANZ Harbour City.

Thank you.