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SAMOA

FINANCIAL SECTOR ASSESSMENT PROGRAM

July 2015

FINANCIAL SYSTEM STABILITY ASSESSMENT

This Report on the Financial System Stability Assessment for Samoa was prepared by a staff team of the International Monetary Fund. It is based on the information available at the time it was completed in May 2015.

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SAMOA

FINANCIAL SYSTEM STABILITY ASSESSMENT

May 12, 2015

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This report is based on the work of the Financial Sector Assessment Program (FSAP) mission that visited Samoa in October-November 2014. The FSAP findings were discussed with the authorities during the Article IV Consultation mission in February-March 2015. The main authors of the report are Erik Lundback and Claudio Visconti.

- The team was led by Erik Lundback, IMF and Marius Vismantas, World Bank, and included Claudio Visconti, Ivan Guerra, Kazuaki Washimi (all IMF), Ernesto Aguirre, Keith Bell, Michael Lau (IMF external experts), Ulle Lohmus, Serap Gonulal, Mahadevan Balakrishnan, Gunhild Berg, Mustafa Ulukan (all World Bank).

- The FSAP met with Prime Minister and Minister of Finance, Mr. Tuilaepa Sailele Malielegaoi, Governor of the Central Bank of Samoa, Ms. Maiva Atalina Ainuu-Enari, Chief Executive Officer of the Ministry of Finance, Mr. Iulai Lavea, other senior officials, and management of all major financial institutions.

- This is the first FSAP to Samoa. FSAPs assess the stability of the financial system as a whole and not that of individual institutions. They are intended to help countries identify key sources of systemic risk in the financial sector and implement policies to enhance its resilience to shocks and contagion. Certain categories of risk affecting financial institutions, such as operational or legal risk, or risk related to fraud, are not covered in FSAPs.

- Banks are dealing with the effects of recent natural disasters and are vulnerable, making close monitoring through on-site supervision top priority. Broad action is needed to strengthen prudential oversight and governance of Public Financial Institutions, of which some have very poor asset quality, reflecting policy lending in response to past shocks. Financial regulation and data reporting need to be upgraded.

CONTENTS

Glossary

AML/CFT	Anti-Money Laundering/ Combating the Financing of Terrorism
BCBS	Basel Core Principles for Effective Banking Supervision
BCP	Basel Core Principles For Effective Banking Supervision
CBS	Central Bank of Samoa
CBA	Central Bank of Samoa Act
DBS	Development Bank of Samoa
ELA	Emergency Liquidity Assistance
DIS	Deposit Insurance Scheme
FIA	Financial Institutions Act
FI	Financial Institution
IBC	International Business Company
IFRS	International Financial Reporting Standards
MCIL	Ministry of Commerce, Industry and Labor
MFI	Microfinance Institution
MOF	Ministry of Finance
MTO	Money Transfer Operator
NPL	Non Performing Loan
NPS	National Payment System
PFI	Public Financial Institution
RBS	Risk-based Supervision
SAT	Samoa Tala
SBEC	Small Business Enterprise Centre
SHC	Samoa Housing Corporation
SIFA	Samoa International Financial Authority
SLAC	Samoa Life Assurance Corporation
SME	Small and Medium Size Enterprise
SNPF	Samoa National Provident Fund
SOE	State Owned Enterprise
SPBD	Samoa Pacific Business Development
UTOS	Unit Trust of Samoa

EXECUTIVE SUMMARY AND KEY RECOMMENDATIONS

The Samoan financial sector is dominated by commercial banks and Public Financial Institutions (PFIs). The four commercial banks provide almost 60 percent of credit to the economy, and the most important PFIs, the Samoa National Provident Fund, and the Development Bank of Samoa, account for around 30 percent. There is also a small and shrinking offshore banking sector without linkages to the domestic financial sector.

Banks are liquid and report high capitalization, but close supervisory attention is required in light of high and rising non-performing loans (NPLs) and the results of the FSAP stress tests.[1] Banks are still dealing with the effects from past natural disasters, and assessments of their health are impeded by the significant uncertainty surrounding the quality of balance sheet data, in particular on asset quality and provisioning. High loan concentration and exposure to natural disasters represent significant risks to the financial system. The stress tests illustrate that the local banks are relatively less resilient and could not withstand a severely adverse scenario. Thus, close monitoring, through on-site supervision and asset quality reviews, paired with prompt corrective action and a plan to address NPLs (including in PFIs) as needed, are top priorities.

PFIs are particularly vulnerable to shocks due to low asset quality and strong linkages with state owned enterprises. This is largely the result of increased policy lending in response to the extraordinary economic stress from recent natural disasters. Significant stress in PFIs could have significant impact on other financial institutions (FIs) through the effect on the economy, and explicit and implicit government guarantees raise potential fiscal risks. The authorities, therefore, are encouraged to step up oversight of the PFIs, including through enhanced data collection and on-site reviews. Where substantial adjustments are needed, new lending should be restricted.

The Central Bank of Samoa (CBS), as the main supervisor and regulator of domestic financial institutions, has made important efforts to strengthen its oversight in recent years. These efforts include conducting on-site inspections, introducing elements of risk-based supervision, expanding staff resources, initiating PFI supervision, submission of a new CBS Act (CBA) to reform governance and safeguards, promoting financial inclusion, and progress on Anti-Money Laundering and Combating Financing of Terrorism (AML/CFT). Still, much remains to be done, including improving the quality and coverage of the financial sector data, upgrading legal, regulatory and supervisory frameworks, and building capacity and staff.

Banking supervision and regulation need substantive improvement. Specific areas include: (i) stepped up regular on-site inspections; (ii) upgraded prudential data reporting (iii) strengthened prudential guidance and supervisory powers; and (v) a modernized Financial Institutions Act. The strengthening of the AML/CFT framework should continue. The recommendations from the 2007 BCP assessment regarding the international banking sector, supervised by the Samoa International

[1] Most of the detailed data for the analysis of financial institutions are as of June, 2014.

Finance Authority, (SIFA), still largely remain to be implemented. Over time, supervision and regulation of all financial intermediaries, including credit unions and offshore banks, should be unified under the CBS.

Strengthening regulation and oversight of non-bank FIs is also needed. CBS off-site reviews must be intensified and should cover all PFIs. The ongoing strengthening of regulations is needed and welcome. The regulatory and supervisory architecture in the insurance market and its enforcement also need substantial improvement.

The legal framework to deal with severely distressed FIs should be reformed. The CBS should be empowered to act in a timely manner to take preventive and corrective actions, to start resolution actions before a FI becomes insolvent, and to transfer assets and liabilities of a distressed FI to a sound entity. A new CBS Act is being finalized, which should include welcome provisions for the CBS as lender of last resort, but additional legal reform is needed.

A framework for coordination between the Ministry of Finance and the CBS should be in place for financial stability assessment and financial sector contingency planning. Contingency plans should cover the system and individual systemic institutions. The CBS should regularly analyze systemic risks, including through stress testing and macro-financial mapping.

The role and governance of the PFIs should be reformed with an aim to achieve the specific socio-economic objectives they have been set up for. Accordingly, the effectiveness of allocated resources and mandates should be assessed, and government policies be developed to focus the role of PFIs and the involvement of the government in the financial sector. The new Ministry of Public Enterprises should formulate a coherent framework for PFI governance and performance.

There are structural impediments to access to finance for households and businesses, which should be addressed. They include (i) high collateralization of loans; (ii) large share of customary land, not usable as collateral; (iii) absence of a credit bureau and a movable collateral registry, though the latter is in the process of being established; and (iv) high concentration and limited competition in the banking sector.

The national payment system, overseen by the CBS, should continue to be developed. A new system, with key components of a modern payment and settlements system, is planned to be procured by the CBS. A number of regulations still need to be issued for implementation of the new National Payment Systems Act.

To best use the limited capacity of a small country, the authorities must have a strong focus on the near-term priorities. These should be: strengthened on-site and off-site supervision of banks and PFIs, upgraded prudential requirements for banks and PFIs, including review of relevant legislation, establishment of contingency planning, and enhanced data collection and analysis. Encouragingly, the authorities have broadly accepted the recommendations of the FSAP and are making progress in implementation. Technical assistance to support near-term priorities have been, requested and is already in train.

Table 1. FSAP—Key Recommendations	
Recommendation	Timing*
Cross-cutting	
Improve the quality and coverage of data. CBS to collect granular data on banks, PFIs, insurers, and other financial intermediaries for prudential and financial stability analysis.	ST
Upgrade the regulatory and supervisory frameworks to modern standards, including amending the FIA and CBA to support corrective actions and resolution.	MT/ST
CBS should raise capacity and hire additional staff for financial oversight, and over time assume supervision and regulation of all financial intermediaries.	MT/ST
Banking supervision and regulation	
Conduct regular on-site inspections, and in-depth assessments of financial statements (including asset quality reviews, of potentially vulnerable banks.	ST
Upgrade supervisory guidance to banks, especially regarding risk management and NPL write-offs.	MT
PFIs - supervision and regulation	
CBS to produce periodic financial soundness indicators for PFIs and ensure proper IFRS accounting, especially for loan classification, NPLs, and provisioning.	ST/MT
CBS to issue and upgrade prudential regulations for PFIs.	ST
CBS to start on-site inspections of PFIs.	ST
Off shore bank regulation and supervision	
Enhance operational independence of SIFA to supervise international banks and remove potential for conflict between SIFA's promotional and supervisory roles.	MT/ST
PFIs – governance	
Government to reform mandates and governance of PFIs for defined policy objectives based on cost-benefit assessments, and to ensure efficient operations.	MT
Crisis preparedness	
Adopt a full set of enforcement and resolution instruments.	ST
Create an appropriate scheme and operational framework for ELA.	ST
Systemic financial stability	
CBS and MOF to create financial stability and contingency planning committees.	MT/ST
CBS to analyze systemic risks, including stress testing and macro-financial mapping.	MT
Central bank policies and operations	
CBS to unwind lending to DBS and SHC.	MT
Access to finance	
Focus on indirect measures to enhance access to finance, including credit bureau, economic use of customary land, and complete setting up a personal property registry.	MT
Insurance	
CBS to develop insurance supervisory strategy and capacity building plans.	MT
Payment system and financial market infrastructure	
CBS to implement the new National Payment Systems.	MT

*Short-term (ST), Medium-term (MT)

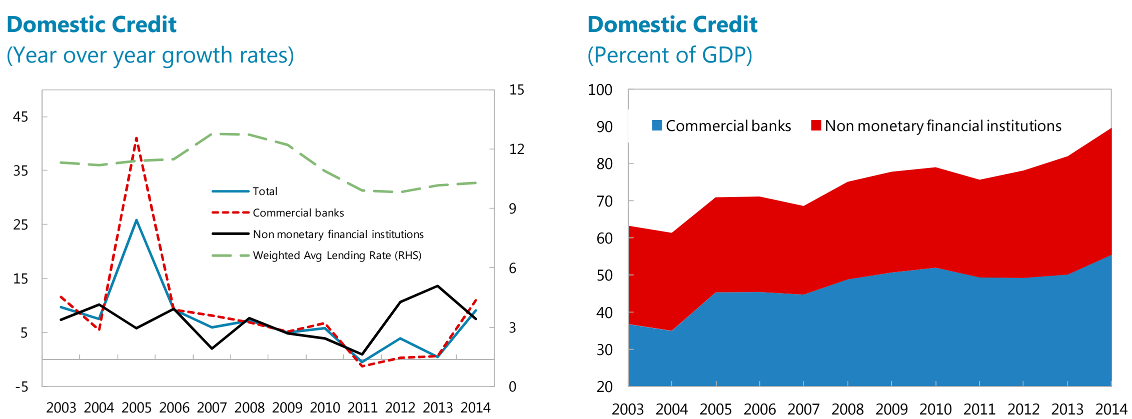
MACROECONOMIC CONTEXT AND FINANCIAL SYSTEM STRUCTURE

A. Macroeconomic Context

1. Samoa is a small island economy with a population of 188 thousand and a GDP per capita of around US$4,100. The economy has been dependent on agriculture, tourism, and remittances. Australia and New Zealand are the main export markets and source of remittances. The economy is slowly recovering from the effects of cyclone Evan in 2012 and underlying inflation remains subdued. (Appendix Table 1, Figure 1). The current account deficit has widened, but reserves are broadly adequate. Public debt has risen in recent years, leaving limited fiscal space to address future disasters and backstop the financial sector. The Tala is pegged within a ±2 percent band to a trade and payments weighted currency basket, and most capital account transactions require approval from the Central Bank of Samoa (CBS).

2. To support the economy monetary policy has been accommodative, but bank credit growth has been low until recently. The CBS policy rate, as indicated by its 91-day bill rate, has remained largely unchanged, at 0.2 percent, since the 2009 tsunami. Bank credit to the economy was nevertheless stagnant for several years, with a recent jump due to a few larger projects (Figure 1). Lending rates have stayed high at over 10 percent. The CBS has provided credit, guaranteed by government, to Public Financial Institutions (PFIs) to support hard-hit sectors, and non-bank credit has been growing rapidly. Interest rates on PFI lending vary, but tend to be 1-2 percentage points below commercial banks' lending rates.

Figure 1. Domestic Credit



Source: CBS.

B. Financial Sector Structure

3. **Banks account for more than half of all financial sector assets, but the active role of PFIs is reflected in the significant share held by non-banks.** Total financial system assets correspond to about 120 percent of GDP with bank assets accounting for almost 60 percent of system assets or 70 percent of GDP (Table 2).

Table 2. Financial System Structure (Percent of total assets)

	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	Dec. 2014
Commercial banks	**59.9**	**60.4**	**59.7**	**58.7**	**57.9**	**57.0**	**57.2**
Australia New Zealand Bank (Samoa) Ltd	26.6	25.6	24.6	23.7	24.9	24.6	26.0
Westpac Bank Samoa Limited	16.8	16.2	14.7	15.8	13.7	11.9	12.2
National Bank of Samoa Limited	8.5	8.2	8.9	8.6	8.9	7.4	9.0
Samoa Commercial Bank Limited	8.1	10.4	11.5	10.7	10.5	13.1	10.1
Non monetary financial institutions	**40.1**	**39.6**	**40.3**	**41.3**	**42.1**	**43.0**	**42.8**
National Provident Fund	25.9	24.7	25.4	26.1	26.9	24.4	24.4
Development Bank of Samoa	8.2	8.0	8.6	8.8	9.2	9.6	9.4
National Pacific Insurance Ltd	1.8	3.0	2.3	2.3	1.4	1.2	1.2
Samoa Life Assurance Corp.	2.1	2.0	1.9	2.0	2.0	1.7	1.7
Public Trust Office	0.6	0.5	0.5	0.5	0.5	0.4	0.4
Samoa Housing Corporation	1.5	1.4	1.5	1.6	2.0	2.1	2.1
Unit Trust of Samoa						3.6	3.7
Total Financial System	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Total Financial System (percent of GDP)	99.4	109.3	102.5	99.0	100.3	119.2	120.1
Commercial banks	59.6	66.1	61.2	58.1	58.1	67.9	68.7
Non monetary financial institutions	39.8	43.3	41.3	40.8	42.2	51.2	51.4
Nominal GDP (in millions of Tala)	1,661	1,623	1,767	1,847	1,835	1,847	1,900

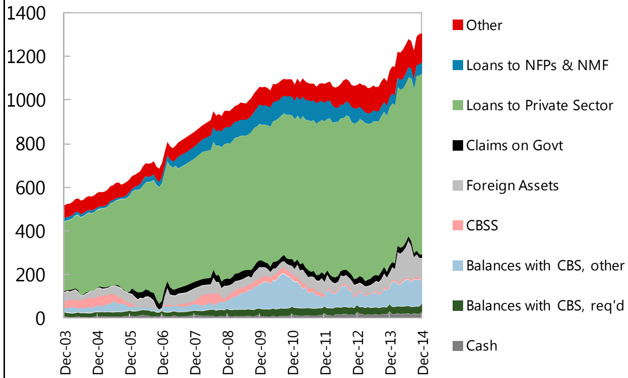
Source: CBS
Note: For fiscal year ending in June.

4. **The commercial banks comprise two subsidiaries of foreign banks and two local banks.** Subsidiaries of Australian banks ANZ and Westpac hold 45 and 21 percent of total banking assets, respectively.[2] The two locally owned banks, Samoa Commercial Bank and National Bank of Samoa have shares of 18 and 16 percent, respectively. Assets are concentrated in lending products with most of the lending targeting construction, trade and tourism sectors (Figures 2 and 3). Claims on the central government are very small (1.3 percent of assets), and banks do not hold government securities. Claims on the public sector, including SOEs and PFIs, were less than 6 percent at June 2014.

[2] In January, 2015, Westpac announced the sale of its Samoa operations to Bank of South Pacific Ltd, headquartered in Papua New Guinea, pending regulatory approval.

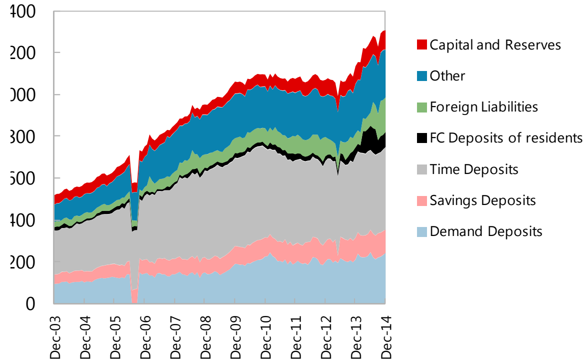
Figure 2. Banking System Balance Sheet Structure

Banking System Assets
(Millions of Tala)



Note: NFP & NMF stands for non-financial public enterprises and non-monetary financial institutions.
Source: CBS.

Banking System Liabilities
(Millions of Tala)

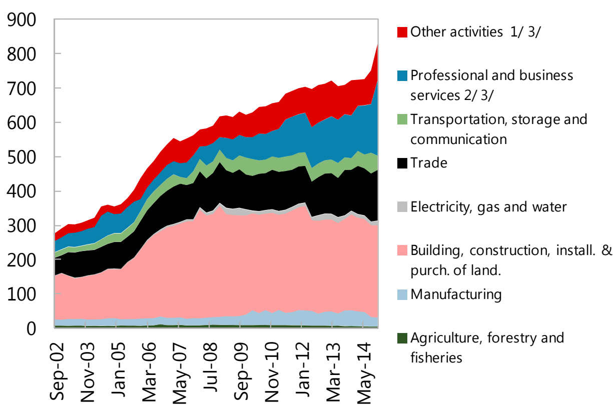


Note: Data points missing.

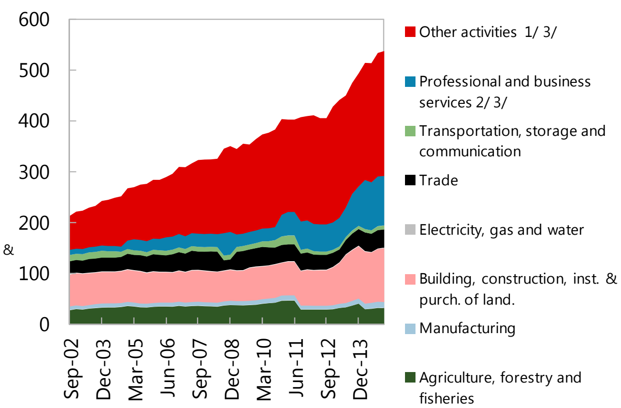
5. Non-banks are important providers of credit. The main non-bank institutions are the Samoa National Provident Fund (SNPF), a social security fund; the Development Bank of Samoa (DBS); the Samoa Housing Corporation (SHC); and the investment fund Unit Trust of Samoa (UTOS) (Box 1). The SNPF and DBS are the largest in terms of assets, but both UTOS and the SHC have been expanding rapidly in recent years. Like banks, PFIs lend for construction and real estate, but are also focused on other activities, including Small and Medium sized Enterprises (SMEs), State Owned Enterprises (SOEs), and loans to households. Funding sources include members' contributions/premium (SNPF/SLCA), loans from the CBS and international financial institutions (DBS, SHC), and investments (UTOS), but no retail deposits.

Figure 3. Loan Placements by Sector

Distribution of Loans: Banks
(In millions of Tala)



Distribution of Loans: Non-Banks
(In millions of Tala)



Source: CBS.
1/ Mostly personal loans not included elsewhere.
2/ Figures have been revised since March 1999.
3/ Figures have been revised since October 2005, due to reclassification of financial assets to their appropriate sectors.

6. One microfinance institution (MFI) and a number of credit unions represent a small share of the market. Samoa Pacific Business Development (SPBD) is the only MFI in Samoa with SAT 10 million in assets. There are 13 credit unions licensed by the Ministry of Commerce, Industry and Labour (MCIL), but there may be more in operation. Based on uncertain data, total assets are estimated at about SAT 20 million.

7. The off-shore financial sector is limited in size and scope. There are seven offshore banks licensed in Samoa with total assets declining from US$112 million in 2005 to US$ 54.4 million mid-2014, i.e., about one tenth of the on-shore sector, and are well capitalized. The operations of two of the banks are restricted to serving members of their groups, while the other banks are affiliates of investment advisers, dealing with their clients. There appear to be no linkages between the on-shore and off-shore financial sectors.

8. There is a small insurance sector in Samoa. Total assets correspond to about 5 percent of GDP with premiums at 1.2 per cent of GDP in 2013. There are five active licensed insurance companies in Samoa, four non-life and one life insurer. Non-life insurance accounts for 85 percent of premiums. Motor insurance is the main non-life business segment.

9. Money and capital market activity is very low. CBS securities are issued, but these are low yielding and only bought by commercial banks. The total outstanding volume is around SAT 9.5 million, and there is no secondary trading. inter-banking activity is very limited. There are no Treasury bills outstanding and bonds are not issued. In terms of other securities, e.g., company shares, there are very few or no transactions.

10. The lack of collateral and active security markets have been structural impediments for liquidity management by the CBS. The CBS has only occasionally provided liquidity support through its rediscount window and the repo facility has never been used. In the wake of liquidity crunches following shocks to the economy, the CBS had to introduce a temporary facility for banks to borrow against their required reserves.[3] Going forward, the CBS should continue to investigate avenues to use market-based sterilization instruments to better manage liquidity. In this context, the Public Financial Management Act should be adjusted to allow issuing T-bills, which could be used as collateral, without parliamentary approval.

[3] Banks could borrow up to 50 percent of their required reserves (4.5 percent of deposits) for a maximum of 189 days. The facility was closed in June 2013.

Box 1. Public Financial Institutions

Samoa National Provident Fund. Established in 1972 as a compulsory retirement savings scheme in which a minimum 5 percent contribution is paid by employees and employers. However, most Samoans do not contribute to the scheme.

Unit Trust of Samoa. Established in 2010 to provide investment opportunities to small investors in the context of the Government's policy of privatizing state-owned enterprises. UTOS is structured as an open-ended private unit trust. By intermediating funds among SOEs and maintaining a leveraged position, it generates high returns to unit-holders (17.3 percent in FY2014).

Development Bank of Samoa. Established in 1974 to provide development assistance to the public, and on-lends funds from international financial institutions and credit lines provided by the CBS.

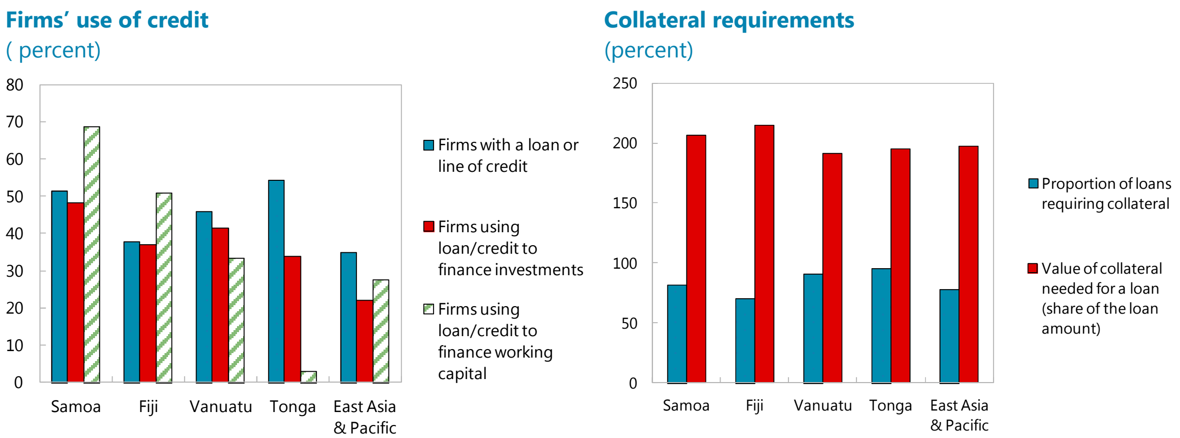
Samoa Housing Corporation. Established in 1989 to facilitate access to housing. The SHC is funded by loans from the CBS, which are guaranteed by the government.

Samoa Life Assurance Corporation. Established in 1976 to provide life insurance to its members, it also provides credit insurance and policy, and mortgage loans to policyholders.

C. Access to Finance

11. Access to checking or savings accounts is nearly universal, but access to credit is constraining Small and Medium sized Enterprise (SME) growth. Recent data on SME's access to finance is not available, but the 2009 Enterprise Survey showed that 51 percent of SMEs had a loan or line of credit outstanding (Figure 4). While this compares favorably among Pacific island countries, 16 percent of Samoan SMEs identified access to finance as a major constraint, and a 2012 assessment found large unmet demands for financing.

Figure 4. Access to Credit – International Comparison



Source: Enterprise Surveys, 2009.

12. Given the risk-aversion of banks and the succession of major exogenous shocks, the Government provides incentives to banks to increase credit to SMEs. The Small Business Loan Guarantee Scheme, managed by the Small Business Enterprise Centre (SBEC), provides a loan guarantee for participating banks (see Box 2). The guarantee fund totals SAT 8.5 million.

Box 2. The Small Business Loan Guarantee Scheme

The Small Business Loan Guarantee Scheme is intended to incentivize banks lending to SMEs. It is supported by the Government of Samoa and a grant from NZAID. A 100 percent guarantee is provided for loans up to SAT 10,000 and an 80 percent guarantee for loans between SAT 10-50,000. The majority of the portfolio is with the DBS. Banks are responsible for the credit assessment and can determine interest rates freely. No additional collateral is provided for the loans. When loans are considered as a loss for the bank, SBEC repays the bank and starts collecting directly from the enterprise.

A thorough review and reform of the SBEC could strengthen the scheme. There are no clear eligibility criteria, the coverage ratio is very high at up to 100 percent, and payout for non-performing loans is very favorable for the banks.

RISKS AND VULNERABILITIES

A. Risk Assessment

13. The Samoan economy has weathered a series of large exogenous shocks in the past few years, and is gradually recovering. The global financial crisis resulted in a major downsizing of an automobile parts plant in 2009; the economy was subsequently hit by a tsunami in 2009 and cyclone Evan in 2012, resulting in further GDP contraction. The effects of the shocks were mitigated by swift government response to raise reconstruction expenditure, which to a considerable extent was financed by grants and concessional lending from abroad. Households and small businesses were directly supported by higher remittances from overseas.

14. The main economic risk in the near-term is likely from natural disasters (Appendix Table 2). Considering episodes of natural disasters in the last several decades, consecutive cyclones although less likely, cannot be ruled out. In addition, the Samoan economy could be hit by adverse global economic and financial developments, in particular if they impact economic activity in Australia and New Zealand. Other potentially important risks are: (i) asset quality deterioration due to the weak economic recovery or if government guarantees and other support of SOEs cannot be honored or are weakened; (ii) loss of confidence in banks and PFIs; (iii) a sharp exchange rate depreciation; and (iv) rising interest rates.

B. Vulnerability Analysis

15. Bank lending was stagnant after the natural disasters and concentration increased (Appendix Figure 3). As household and business leverage rose, banks preferred lending to larger borrowers, making loan portfolios more concentrated. As a result, the large borrower limit of 25 percent of capital, while appropriate, has constrained lending, especially for the local banks with smaller capital bases.

16. The series of shocks to the economy also took a toll on asset quality. System non-performing loans (NPLs) have risen to over 8 percent of total loans, with all banks above 4 percent. (Appendix Figure 4, Appendix Table 3). Local banks have higher and growing NPL ratios, but with increased loan-loss coverage. The high NPL coverage ratio reflects the lack of regulatory incentive for write-offs, as well as the fact that long-standing loans in arrears are often eventually repaid by the borrower. Asset classification, NPL write-offs and provisioning policies warrant further examination in particular in some banks.

17. Profitability remains high, but has been declining, and efficiency is down.[4] Banks' net interest margins have been stable due to high interest rate spreads (Appendix Figure 5). However, negative loan growth, higher costs, and high provisioning have affected profitability, and while still high, returns on assets and equity have been declining for the past three years with a slight rebound in 2014.

18. The Samoan banking sector as a whole reports high capitalization, but parts of the system are vulnerable to shocks due to weak asset quality (Appendix Figure 6).[5] Market participants unanimously report that many clients are highly indebted and could have difficulty in absorbing further shocks. There is no data collected on corporate and household balance sheets. There is also uncertainty about the underlying data, which suggest vulnerabilities could be even larger, and banks' asset quality and provisioning should be carefully reviewed.

19. While liquid reserves with the CBS are large, liquidity positions should be closely monitored and maturity gaps identified. On average, banks hold around 20 percent of deposits in reserves at the CBS. The loan-to-deposit ratio is around 100 percent, but higher for foreign banks, which have more access to wholesale funding (Appendix Figure 7). Dollarization is limited due to capital controls and almost all foreign currency assets and liabilities are concentrated in the foreign banks.[6]

20. PFIs hold large NPLs, making them vulnerable to shocks. The policy lending extended through some of the PFIs likely means that these loans are of lower quality, especially since borrowers, including many weak SOEs, are already stretched. Moreover, accounting standards are not always followed, particularly with respect to the recognition of non-performing assets, which may mask overall credit risk. In particular the DBS is struggling with a weak lending portfolio and losses, part of which reflects directed lending extended in the context of the government's response to the latest natural disasters.

21. The financial position of PFIs could have systemic implications due to macro and fiscal linkages. From the macro side, PFI credit to the economy is important (about 33 percent of GDP) and a disruption could affect other Financial Institutions (FIs) through reducing economic activity and other second-round effects. From the fiscal side, the borrowings by SOEs have explicit government guarantees corresponding to about 6½ percent of GDP. Furthermore, most liabilities of the PFIs are likely seen as implicitly guaranteed by the government, with some potentially at risk due to the lending profile of the PFIs Thus, the fiscal position is vulnerable to a shock to, or accumulated poor

[4] Efficiency is measured as the ratio of operating expenses (net of interest expenses) to operating income.

[5] Samoa has adopted a Basel 1 capital adequacy regime, with a Tier one minimum of 7.5 percent.

[6] Foreign currency loans account for about 4 percent of total assets, and all foreign currency deposits account for about 8 percent of total deposits.

performance of, the PFIs. Public debt is already fairly high and if government finances come under stress, the government's credibility as a backstop for the financial system, including for bank deposits, could become fragile.[7]

22. The direct linkages of PFIs to the banking sector nevertheless appear to be limited. Lending exposure of commercial banks to the PFIs is minimal, even though UTOS has started borrowing from the banking system. Banks hold PFI deposits, but they are not a crucial funding source, accounting for about 9½ percent of total commercial banks' non-capital liabilities. Results from analyses of network linkages and domestic systemic importance, conducted with significant data and information uncertainties suggest that risks are concentrated in cross-exposures among the PFIs and SOEs.[8] For instance, UTOS' assets and liabilities are for the most part linked to state-owned institutions, while the DBS is funded by loans from the CBS and the SNPF.[9]

23. The insurance sector in Samoa is underdeveloped and small. As such, it does not constitute a financial stability risk. However, the sector is largely unsupervised, which could lead to individual company failures, and lack of consumer protection and confidence, thereby causing reputational damage and the stifling of market development.

C. Stress Tests

24. Subject to constraints posed by data gaps, stress tests of the banking system showed that the local banks were relatively more vulnerable to shocks.[10] The tests of the four commercial banks were conducted top down (TD) by the FSAP team and bottom up (BU) by the banks (Appendix Table 4). Simplifying assumptions were necessary to deal with residual data anomalies, particularly on allocation of exposures, NPLs, and provisioning.

Single-period sensitivity stress testing (TD)

25. The banks appear to be relatively robust to a range of shocks, reflecting high initial capital buffers (well above the minimum of 15 percent). For example, even assuming impairment of the five largest exposures, and 100 percent provisioning of the uncollateralized component, no bank fell below the minimum capitalization (with a 20 percent haircut on collateral the two local banks fell below the *minimum threshold by about 1 to 3* percentage points). Similarly, banks were

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[7] The 2015 Debt Sustainability Analysis shows Samoa faces a moderate risk rating of debt distress, based on an assessment of public external debt, but a heightened overall risk of debt distress, reflecting significant vulnerabilities related to contingent liabilities from government guarantees and on-lending to public enterprises.

[8] For more details on the tools applied see Marco A. Espinosa-Vega and Juan Solé, *Cross-Border Financial surveillance: A Network perspective*, IMF Working Paper 10/105; and Brämer and Gischer, *Domestic systemically important banks: an indicator-based measurement approach for the Australian banking system*, Working paper 3/2012, December 2011, University of Magdeburg..

[9] These loans are individually larger than the capital base of the lenders, which is substantial exposure to one entity, but these loans are covered by government guarantees.

[10] The PFIs were excluded from the stress tests due to lack of granular data, e.g., on credit, market, liquidity, or operational risk, which adds to uncertainty about the impact of shocks to the financial system.

relatively robust to interest rate, exchange rate, and interbank contagion shocks. However, industry concentration was found to be a source of vulnerability—material increases in ten individual industry sector NPLs would cause two local banks to fell below the minimum capitalization by about 1-2½ percentage points.

Multi-period multi-variable scenario solvency stress tests (TD)

26. In keeping with the risk analysis described above, the scenario stress tests were based on shocks from natural disasters and a weaker external economic environment.[11]

- *Baseline*: The October 2014 World Economic Outlook, projecting a generally positive-trending macro-economic environment.

- *Moderate shock:* In a scenario that mirrors the cyclone event of 2012, a class 4 cyclone strikes the two main islands in the first year, causing widespread damage. Economic growth declines by around 3½ percentage points before recovering to baseline growth over a four year period. This scenario captures a quite likely scenario of a possible near-term shock to a still recovering financial sector.

- *Severe shock:* In addition to the first cyclone, another class 4 cyclone strikes a year later. This is coupled with a recession in Australia and New Zealand, causing reductions in exports and tourist demand and remittances. This scenario represents a major shock, which is less likely, but still plausible considering past experiences. Growth declines by 4½ percentage points in 2014/15 and further by 5 percentage points in 2015/16 relative to the baseline, with a slower recovery.

27. The results from the scenario tests illustrated less resilience of the local banks. Data anomalies mean that the starting capital positions may not be accurate, which affects the exact outcome in terms of the level of capitalization and other key indicators. The tests, nevertheless, provide insights on the relative resilience of the banks. The results demonstrated resilience to the first cyclone (scenario one), but in the very severe scenario of a second cyclone and a downturn in the external economic environment, accumulating charges to profits and losses were only able to be fully absorbed by the less leveraged and less credit impaired foreign banks. The two local banks approached the minimum tier 1 threshold of 7.5 percent CAR in the third year and one bank continued to deteriorate whereas the other began to recover thanks to a somewhat less vulnerable starting position.

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[11] The impact on banks was calculated as multi-period projections of assessed credit, interest and exchange rate, and operational impacts. For the TD stress testing, the profit and loss, and balance sheet impacts were modeled quarterly. Conversion of macro-economic impacts to credit impacts were undertaken using various statistical methods, direct conversions from changes in GDP at sector levels, heuristics, and expert opinion.

Bottom-up solvency stress tests

28. The BU exercise showed a greater degree of resiliency. In this exercise, banks estimated credit, interest and exchange rate, and operational risk impacts on the profit and loss, balance sheet and capital. Banks used their own methodologies and the results showed minimal negative impacts on capital adequacy. However, this reflected likely over-optimistic assumptions, mainly regarding profitability. The process was nevertheless productive in discussing with the banks the accumulating effects of shocks on capital.

Liquidity stress

29. The liquidity stress testing suggests that banks' liquidity positions are relatively robust. When tested under the Basel Liquidity Coverage Ratio all banks were well above 100 percent, with over 200 percent for the system, and the lowest ratio for one of the foreign banks. In a very severe "general run" scenario, assuming non-resident parent funding, and government and SOE deposits are retained, one foreign bank depleted liquidity in 19 days, while the remaining banks had liquidity beyond 30 days. The general run could be triggered, for instance, by perceived problems in parts of the banking sector, and could be aggravated in the event of weakened confidence in the government's ability to provide a liquidity back stop.

FINANCIAL SECTOR POLICIES AND OVERSIGHT

A. Financial Stability

30. The team concluded that the framework for financial stability analyses and policy should be further developed in a number of areas. There is no financial stability unit dedicated to systemic issues in the CBS, and no formal cooperation between the CBS and the Ministry of Finance (MOF) focusing on financial stability. There are also significant data gaps with respect to banks, and especially non-banks. Finally, there is little reporting on financial stability to the public, besides descriptions of recent developments.

31. Steps should be taken to close these gaps. Recommended measures included (i) create high and operational level financial stability committees, consisting of CBS and MOF staff, formalized through a Memorandum of Understanding, and tasked with analysis of financial stability risks and policies and the coordination of contingency plans; (ii) establish a financial stability unit in the CBS, assigning staff to regularly assess financial stability and to support the financial stability committees; (iii) improve the quality, coverage and granularity of financial supervisory data for analysis of banks and non-banks;[12] (iv) develop research capacity on financial stability, including simple stress testing; (v) consider collecting financial data on businesses and households; and (vi) publish a basic Financial Stability Report.

[12] Auditing firms are not subject to quality assurance reviews, which is a weakness that should be addressed.

32. The government has submitted a new CBS Act (CBA) to reform governance and safeguards. This is welcome and the new CBA is mostly in line with IMF technical assistance recommendations, but there are some exceptions, which should be addressed. Most importantly, safeguards for credits to the Government could be stronger in terms of ceiling on the amount, maturity limit, and market based remuneration and the terms of nonexecutive directors are not mentioned.

B. Financial Regulation and Supervision[13]

33. The principal domestic financial sector supervisor is the CBS and its mandate and responsibilities have been expanded. It has responsibility for the supervision and regulation of domestic commercial banks and, following legislative amendments, for insurance companies, PFIs, Monetary Transfer Operators (MTOs), and foreign exchange dealers.[14] Credit unions are intended to be added to CBS's responsibilities. Over time, the CBS should supervise all lending, deposit taking, and other financial intermediary institutions. Supervision and regulation of offshore banks should eventually be moved to the CBS from the Samoa International Finance Authority (SIFA). There is no capital market supervision, although the Finance Sector Plan envisages a capital market authority under the CBS. Currently, Supervision of the MFI and credit unions by MCIL is virtually non-existent. CBS does not have resources adequate for its increasing responsibilities, and staffing should be increased (as already planned).

Domestic banks

34. Supervision is primarily off-site, although staff maintains frequent contact with counterparts at banks. Banks file a suite of returns originally designed for the monetary survey from which data are manually extracted for analysis of performance, and adherence to prudential standards. The CBS should introduce a parallel prudential data survey requiring a new set of more granular supervisory data in electronic format to automate data transmission. Use of the power provided in the Financial Institutions Act (FIA) for CBS to request verification of returns' accuracy by a bank's external auditors should also be considered.

35. The 2007 BCP Assessment identified significant weaknesses in the supervision of domestic banks. CBS's initiatives to deal with those weaknesses were hampered by the string of shocks hitting Samoa, and the diversion of resources to develop a supervisory regime for PFIs. While there was progress related to AML-CFT, other recommendations largely remain to be addressed, including: (i) issue more detailed guidance to banks on standards for credit policies and its use to evaluate effectiveness of banks' systems and controls for managing credit risk; (ii) collect information on connected lending, use off-site surveillance and on-site inspections to monitor banks' compliance with restrictions on such exposures, and seek legal power to rule on the existence of specific cases of

[13] A full BCP assessment was not performed during the FSAP as the added value from using the needed extra resources, also for the authorities, is not obvious for Samoa's small and quite simple banking sector, and the 2007 assessment is still relevant to build upon.

[14] The CBS mandate is derived from the 1984 CBA and the 1996 Financial Institutions Act.

connected lending; (iii) require banks to establish Board-approved, comprehensive risk management policies which enable them to identify, evaluate, monitor and control all their material non-credit risks, including interest rate, market, country and operational risks; and assess the adequacy of these policies and procedures during on-going supervision; (iv) require banks to report all single exposures exceeding 10 percent of capital for fully effective monitoring of concentration risk.

36. Supervisory Guidance to the domestic banks remains confined to the nine "Prudential Statements" issued by CBS between 1995 and 1999. These publications lack the detailed, prescriptive guidance that has become the international standard; and powers for enforcement should be strengthened. The CBS should review BCBS publications on Prudential Standards, in particular those dealing with corporate governance and liquidity, as well as those to which the 2007 Assessment refers. It could also benefit from reviewing Prudential Standards already in force elsewhere.

37. A planned program of targeted on-site inspections of domestic banks on a two-year cycle was not fully developed and delivered. Only in 2013 were on-site inspections conducted at the four commercial banks on credit, liquidity, and AML-CFT. While on-site inspections of all banks in 2015 are planned, near term priority should be given to the local banks, given the resources fielded by the foreign banks' own internal audit services, and the fact that CBS is a member of the Supervisory College for one of them.[15]

38. The CBS appropriately aims to conduct Risk-Based Supervision (RBS), but there are still apparent gaps in implementation. Full implementation of RBS requires effective and timely follow-up to close out issues raised in the supervisory cycle. Review of the on-site inspections conducted in mid-2013 revealed instances where this was not achieved.

39. The FIA requires amendment. Inter alia, the CBS should: (i) be accorded specific powers to waive the large exposure limit when appropriate; (ii) have authority to effect change in a bank's Board and senior management. The statute currently: (i) lacks a definition of "significant shareholder", the capacity to deem parties to be related and to require deduction of related-parties' exposures from capital when assessing an institution's capital adequacy; (ii) contemplates involvement of the Court in certain administrative remedial measures, which has potential to obstruct the application of such measures.

Offshore banks

40. SIFA is responsible for the supervision and regulation of international financial services, but faces severe weaknesses.[16] The 2007 Assessment expressed concern regarding, inter

[15] In terms of exchange of information with other jurisdictions, and in the context of the assumption of Westpac Bank by the Bank of South Pacific Ltd, it is important for the CBS to establish working relations with the supervisory authorities in Papua New Guinea as soon as possible.
[16] SIFA was established in 2005, under the Samoa International Finance Authority Act, and supervises and regulates banks subject to the International Banking Act, 2005.

alia: (i) potential for infringement of the operational independence of SIFA, given the legal powers of the Minister of Finance to grant licenses and to take other important supervisory measures; (ii) potential conflict between the promotional and supervisory roles of SIFA; (iii) minimal published data on the offshore sector; (iv) need to introduce on-site inspections with an emphasis on asset quality and classification; (v) lack of individual capital requirements based on risk profile; and (vi) lack of guidance on banks' risk management. None of these concerns has been addressed and there is still no Supervisory Guidance from the SIFA to the international banking sector, or any supervision beyond SIFA's receipt and filing of a quarterly report and its review of audited accounts prior to the grant of an annual license renewal to each of the seven offshore international banks.

Non-banks

41. Strengthening oversight of non-bank FIs is needed, given potential vulnerabilities. With the amendment of the FIA in 2001, the CBS became responsible for supervising the DBS, and the SNPF. UTOS and the SHC were brought under CBS supervision during 2014.[17] To date, CBS supervision has been limited and almost exclusively off-site, and is hampered by the quality and methods for collection of data, and insufficient staffing with appropriate skills. There are furthermore potential overlaps between the government's power over the PFIs and the CBS' supervisory powers. This raises reputational risks to the CBS given its mandate vis-à-vis its ability to take action. Finally, policy lending through the CBS should be discontinued to avoid a conflict between the CBS' supervisory capacity and its creditor position.

42. Recent efforts to intensify supervision of PFIs are welcome, but additional action is needed. The PFIs should be supervised according to the nature of their operations to address financial stability concerns. For instance, lending should be subject to requirements on classification of, and provisioning for, non-performing loans and the corresponding reporting standards while capital requirements should be aligned with those for financial intermediaries with similar operations. Near-term supervisory priorities include: (i) develop or revise, and bring into force, prudential statements for the SNPF, SHC, DBS, and UTOS, with the two latter being supervised as banks given their balance sheet structures; (ii) improve the collection and verification of data; (iii) start regular on-site inspections; (iv) formulate plan to address non-performing assets where needed (v) deepen off-site analysis, eventually including simple stress testing; and (vi) map and assess the potential linkages with the economy and fiscal position.

Insurance

43. The regulation and supervision of the insurance sector need substantial improvements. The Insurance Act of 2007 established the Office of Insurance Commissioner under the CBS, providing statutory power for regulating, licensing, and supervising the insurance industry. The CBS currently relies on off-site supervision and lacks technical capacity in the insurance area. Financial reporting and auditing practices are inadequate, and policyholder's rights are not properly protected.

[17] In terms of supervision, CBS records summary data for SLAC while it is monitored by the MOF.

44. The CBS should develop a strategy for an effective supervisory framework. A high level supervisory framework document should be prepared to describe (i) the general approach to effective supervision and its underlying principles, and (ii) a plan for development of staff skills and supervisory capabilities. Staff training, especially in techniques of financial analysis and on-site inspection, should be a priority.

Payment system and remittances

45. The national payment system is at an early stage of development, but the authorities are making important strides to modernize it. There is no Real Time Gross Settlement System or other electronic clearing and settlement system. The only interbank payment system is the cheque clearing with manual settlement in the CBS' Exchange Settlement Account. The CBS should consider implementing a high value cheque clearing process for same day settlement, and to reduce the settlement and credit risks. A new National Payment Systems Act was adopted in April 2014 paving the way for reforms. A new ATS+ system will be procured by the CBS, which is welcome.

46. International remittances are mainly transferred through 15 licensed MTOs (78 percent) and the four banks (22 percent). In FY2014 inflows through about 525,000 transactions represented about 21 percent of GDP. While the number of MTOs seems adequate, the cost of remittances is high as a percentage of average transaction value (about 10 percent). Areas for reform, beside modernizing the payment system include (i) enhanced transparency on the cost of sending money; (ii) stepped up consumer protection and education; (iii) implementation of a code of conduct for remittances; and (iv) further cooperation on AML/CFT issues with key jurisdictions abroad.

C. Banking Resolution, and Crisis Prevention and Management Frameworks

47. The legal framework to deal with severely distressed FIs should be upgraded to make the available options for the CBS more effective. The legal basis for directing FIs to take needed action, especially when affecting personal and property rights, is not precise enough. The available options (license revocation or liquidation through the court without prior resolution action) could be disruptive to the system. The legislation does not provide for depositor preference and, as a consequence, the CBS is not allowed to take key resolution actions that alter the priority of payments established by a different law. The CBS may apply for court-supervised management, but the court maintains full control and decision power on the administrator, its powers, and length of administration.

48. The FIA should be amended to establish a new special resolution regime for banks. It should provide clear regulatory powers to the CBS to issue a framework for preventive and corrective actions. It should include: (i) precise triggers for resolution actions before the FI becomes insolvent; (ii) powers to undertake resolution actions under its direct administration (e.g., remove and replace management, and appoint an administrator); (iii) specific legal basis for the use of resolution tools (e.g., transfer or sell selected assets and liabilities of a distressed FI, establish a temporary bridge institution, and override rights of existing shareholders to recapitalize, restructure and dispose of the FI business); and (iv) legal powers to apply special rules in cases with systemic implications.

49. A funded Deposit Insurance Scheme (DIS) with contributions from the industry should be considered over the medium-term once pre-conditions are in place. Pre-conditions include a strengthened bank supervision framework and an upgraded bank resolution regime. The DIS should protect small depositors and be a tool in a new resolution framework, with least cost principle funding to help key resolution actions.

50. Liquidity management and support should also be upgraded. In normal times, the CBS must closely monitor the liquidity of banks including assets that could be used as collateral for liquidity support. The proposed amendment of the CBA would provide a proper emergency liquidity assistance (ELA) framework with safeguards against potential losses and adequate protection for the CBS financial position in concurrence with the MOF.[18] On this basis the CBS should develop an operational framework for ELA,

51. The MOF and the CBS should coordinate to develop a contingency plan. It should cover both the system and individual systemic institutions, and in times of crisis be followed under the general supervision of the financial stability committee. It should include coordination with foreign supervisors and consider emergency financial arrangements. Plans could be tested through "war games."

D. Public Financial Institutions – Mandates and Performance

52. PFIs collectively play an important role in the financial system, but they are not guided by a coherent policy framework. PFIs are governed under their own individual Acts and their activities have deviated from their original policy mandates without an accompanying market gap and/or cost-benefits analysis. This has resulted in overlapping functions among PFIs including, for instance, in lending operations. Alternatives should be explored to achieve the same policy objectives with less direct ownership or involvement in the financial sector, e.g., credit guarantees, improved business environment and financial infrastructure, reduction of informational asymmetries, and improving consumers' financial capability. The new Ministry of Public Enterprises in charge of all PFIs and other SOEs offers an opportunity to develop a policy coordination framework to more effectively achieve the government's socio-economic objectives.

53. There is a need to improve the effectiveness of the PFIs. Steps required include: (i) strengthen the stability and competitiveness of the financial system by effectively incorporating PFIs in the CBS supervisory and regulatory framework; (ii) contain potential fiscal risks by refraining from policy lending through PFIs without budgetary funding; (iii) enhance transparency and governance by improved accounting and disclosure practices; and (iv) build sustainable PFIs through

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[18] ELA should only be considered for non-banks in conjunction with arrangements that give the CBS powers to obtain information and direct as required the non-bank receiving financial support.

restructuring, potential divestment or privatization of some activities, and continuous re-evaluation of the justification for their activities and existence. The main recommendations for individual PFIs are:

- **Development Bank of Samoa**: Urgent measures are needed to address operational inefficiencies, political interference, and financial weaknesses; review the range and nature of operations, the effectiveness of management processes, and develop a more focused strategy to prioritize its long-term financial sustainability; and conduct a full asset quality review as soon as possible to determine the true financial position of the bank. The recently concluded review of the operations and structure of the bank offers a good opportunity to initiate much needed changes. Until management practices have been strengthened and the balance sheet position thoroughly assessed, new lending should be limited, within its original mandate, and closely supervised by the CBS.

- **Samoa National Provident Fund**: The SNPF should diversify its investment portfolio, including the share of offshore investments, to the extent permitted by the foreign exchange controls. To better reflect its mandate it should gradually reduce the lending-against-contribution share as intended. It should introduce multi-year budgets and strengthen credit and risk management capabilities.

- **Unit Trust of Samoa**: In the near term, the UTOS's mandate needs to be clarified and the increased risks to unit holders from leveraged operations need to be fully disclosed. Going forward, the trust should perform proper screening and monitoring of lending operations and investment decisions, which are prone to political interference, and improve accounting practices and credit and risk management capabilities. Finally, the government should soon decide whether to convert UTOS into a policy bank or deleverage it and continue as a conventional mutual fund.

- **Samoa Housing Corporation**: The SHC should clearly define and target its clientele and improve accounting, and credit and risk management. The newly assigned unfunded mandate should either be compensated from the state budget, or its social cost should be clearly reflected in SHC's financial reporting.[19]

- **Samoa Life Assurance Corporation**: SLAC should reduce lending to the insured as share of assets and move to a more diversified investment portfolio. CBS supervision should be strengthened as well as accounting practices, and credit and risk management capabilities.

[19] In May 2013 Cabinet approved the transfer of the Government Rental Portfolio to the SHC from the Ministry of Work, Transport & Infrastructure to operate as commercial rental properties, without a corresponding budget.

E. Access to Finance Policies[20]

54. While the difficult economic environment reduces the creditworthiness of borrowers, structural factors also limit access to finance. They include (i) high collateralization of loans (over 200 percent on average); (ii) large share of customary land not used as collateral; (iii) absence of a credit bureau and/or a movable collateral registry; and (iv) high concentration and limited competition in the banking sector.

55. The authorities are in the process of setting up a credit bureau and a registry for personal property securities. A law establishing movable collateral registry had been approved and implementation procedures are to be initiated. Recent changes to the Alienation of Customary Land Act allow banks to use capital improvements on leased customary land as collateral (see Box 3), although banks are still hesitant and uncertain about contract enforcement.

Box 3. Customary Land

Customary land, constituting approximately 80 percent of land in Samoa, is owned communally in accordance with traditional custom. It is held by the 'matai' (traditional chief and head of the family). Other types of land are freehold (12 percent of land area) and public land (7 percent). Most aspects of customary land are enshrined in legislation, such as the Constitution and the Alienation of Customary Land Act.

The government is pursuing reforms to promote the economic use of customary land. The Customary Land Advisory Committee was set up in 2013 to advise the government on reforms, among others. Using customary land as collateral remains one of the biggest challenges for obtaining mortgages and longer-term loans. Allowing for leases already in place to be used as collateral and making leases transferrable in the event of a default while not changing communal ownership of the land may be the most realistic option.

56. The high concentration in the banking sector and high interest rate spreads at the largest banks indicates limited competition. The largest bank has 45 percent of total assets and a HHI[21] above 0.3 indicates a high market concentration. The average interest rate spread in 2013 was 4 percent, with 6.2 percent for the largest bank. The spread decomposition shows overheads and provisions as main drivers. The only MFI is still small compared to banks, but over time it could add competition to the SME finance segment.

57. The authorities should pursue policies directed at increasing private financial sector competition while at the same time improving access to finance: (i) collect better and more data on financial inclusion of households and SMEs, and on financial services provided by MFIs and credit unions to support policies: (ii) continue the work to establish a credit bureau and a personal property

[20] The World Bank Financial Sector Assessment for the FSAP provides more in depth coverage of Access to Finance.

[21] The HHI index is calculated as the sum of the squared market share (by assets, loans or deposits) of each bank, where the market shares are expressed as factions. It increases if the number of banks in the market decreases or if the disparity of size among banks increases. Markets with values above 0.25 are considered to be highly concentrated.

registry; (iii) promote the economic use of customary land (iv) improve financial business education: and (v) review and reform the Small Business Loan Guarantee Scheme to strengthen risk sharing with banks, and to improve financial reporting by the SBEC.

F. Anti Money Laundering and Combating the Financing of Terrorism

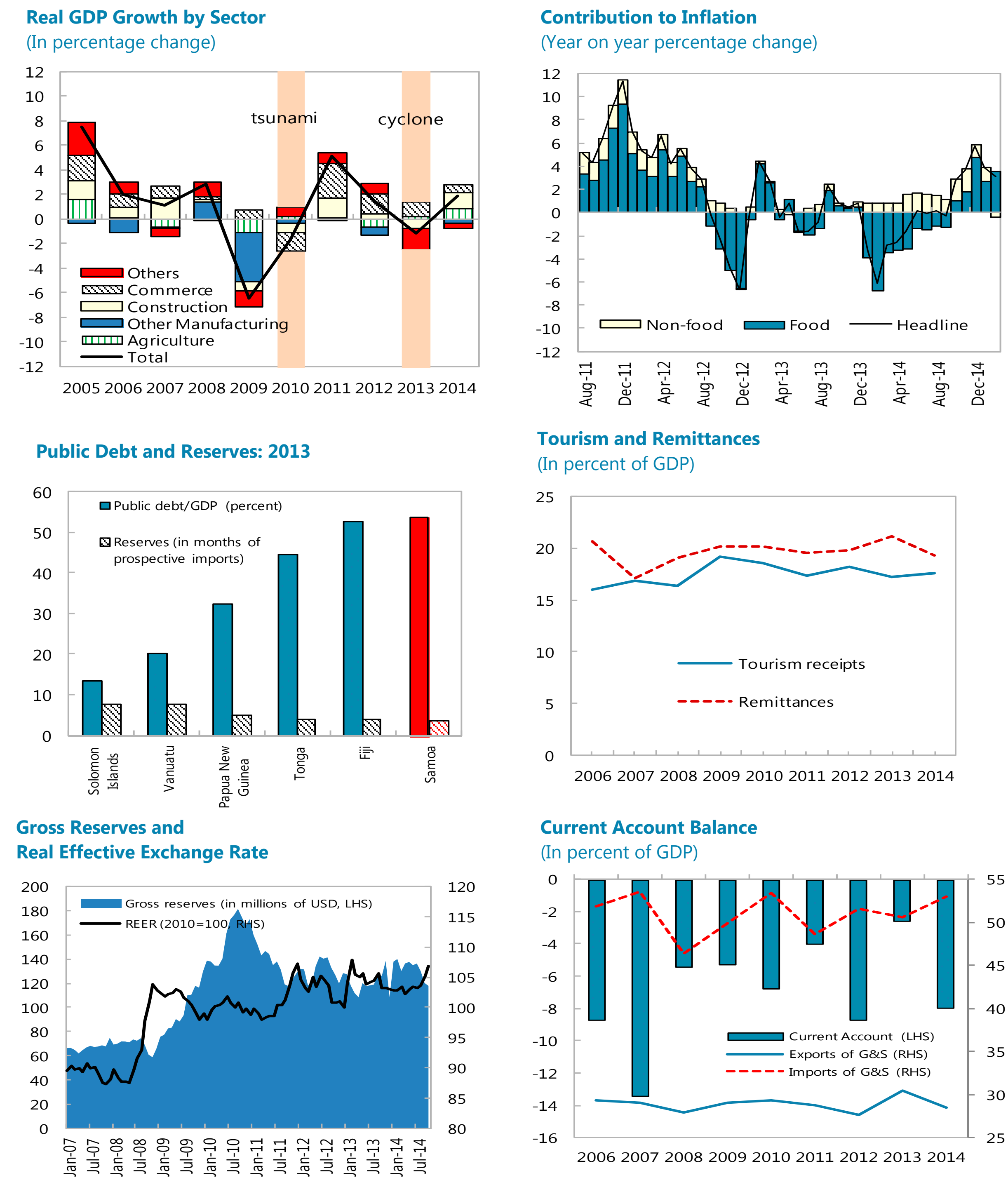
58. Samoa's AML/CFT regime was assessed in November 2014 by the Asia Pacific Group on Money Laundering (APG).[22] The detailed mutual evaluation report is scheduled to be discussed and adopted at the APG's July 2015 annual meeting.[23] Samoa's offshore financial sector poses heightened money laundering risks, which is in line with the conclusions in the country's 2012 national ML/FT risk assessment. In particular, international business companies (IBCs), which form the largest part of the offshore sector, are potential conduits for money laundering, in light of their tax exempt status. Recent measures have been enacted to address such risks (e.g., added requirements for keeping financial information of IBCs and abolition of bearer shares). However, questions remain on whether trust and company service providers (TCSPs) have adequate understanding of the business of the IBCs that they form in order to fulfill their AML/CFT obligations, and whether they can effectively identify and verify the beneficial owners of IBCs. Although supervision of TCSPs for AML/CFT compliance has become more regular, the depth of on-site inspections by the regulatory authority (the Samoa International Finance Authority) appears to be insufficient.

59. The authorities are encouraged to continue strengthening the AML/CFT framework to further mitigate risks of potential misuse of the offshore sector for money laundering purposes. This includes: (i) requiring TCSPs to obtain sufficient information about IBCs to enable them to fulfill their customer due diligence and suspicious transaction reporting obligations; (ii) enhancing the accuracy and timeliness of beneficial ownership information held by TCSPs on the IBCs that they form; and (iii) strengthening the intensity of on-site inspections of the international financial sector.

[22] Samoa is a member of the APG, a FATF-style regional body for countries in the Asia Pacific region.
[23] The following observations and recommendations are based, in part, on recent information shared with Fund staff by the APG with the consent of the authorities.

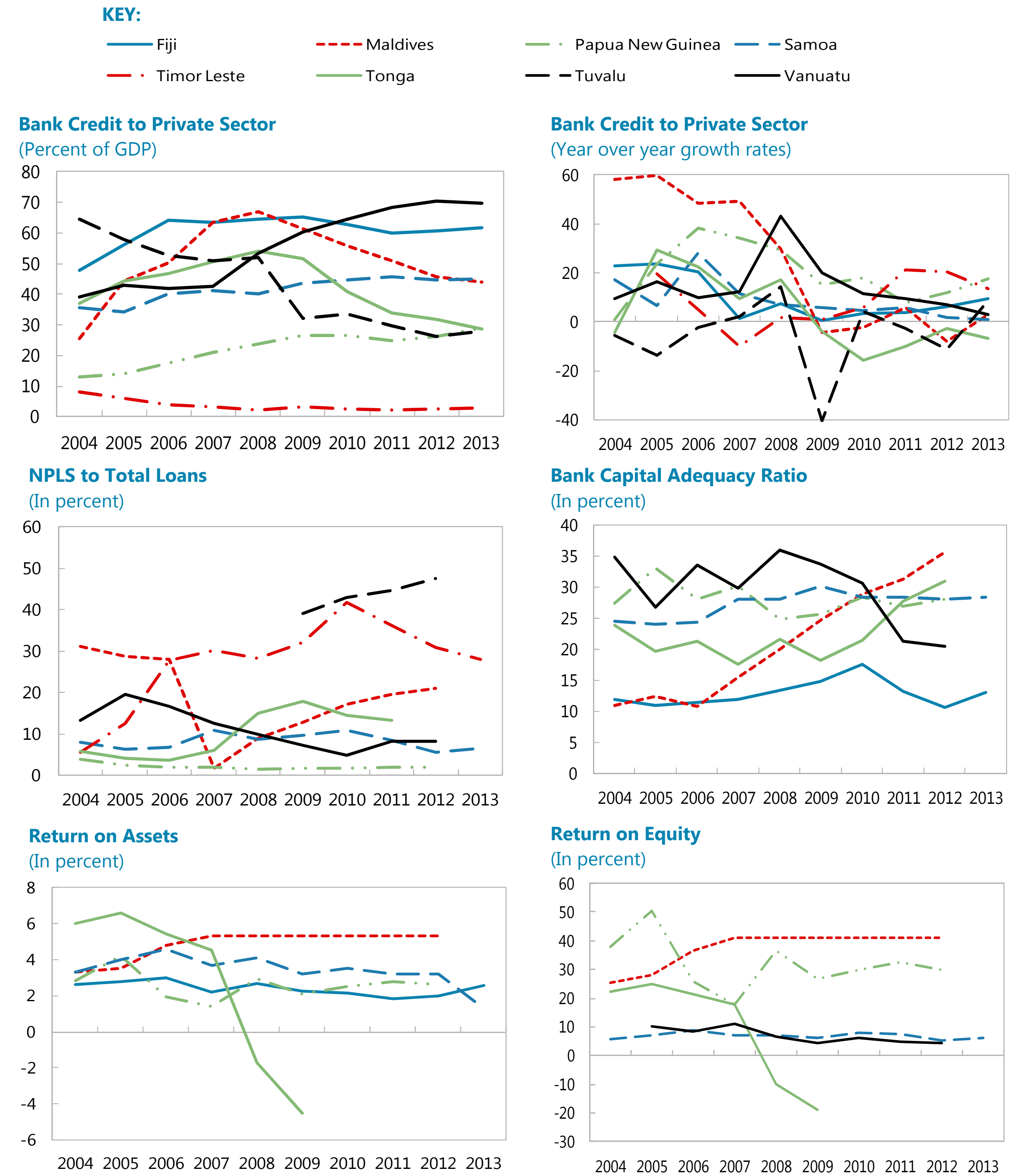
Appendix I. Tables and Figures

Appendix Figure 1. Selected Economic Indicators



Sources: Samoan Authorities, IMF APD LISC Database and IMF Staff calculations.
Note: Samoa's data is in fiscal year June/July.

Appendix Figure 2. International Comparisons

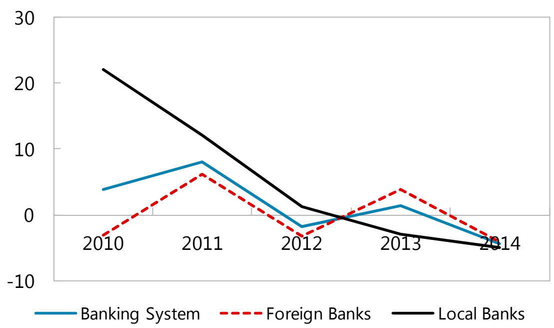


Sources: Country Authorities and IMF Staff calculations.

Appendix Figure 3. Loan Growth and Concentration

Bank loan growth has been low until recently.

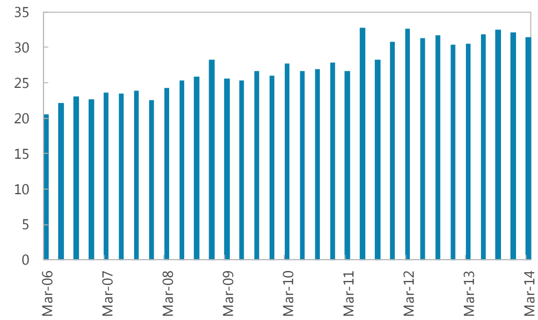
Annualized Loan Growth



Loans are increasingly concentrated.

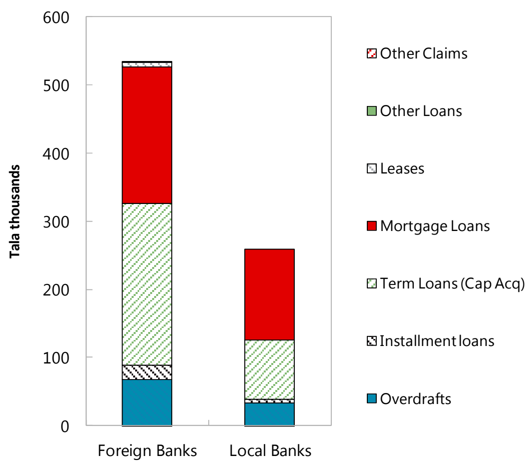
Top 10 Borrowers to Total Loans

(In percent)



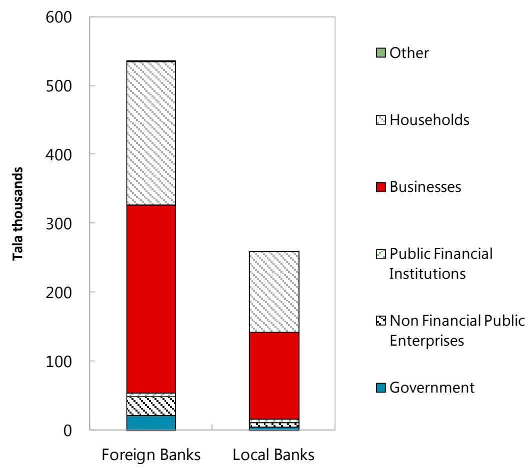
Banks offer mostly capital acquisition and mortgage loans,

Distribution of Loans by Product



Which are evenly distributed to households and businesses.

Distribution of Loans by Sector

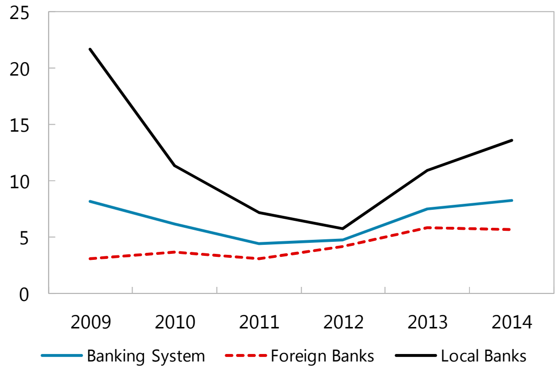


Source: CBS.

Appendix Figure 4. Asset Quality

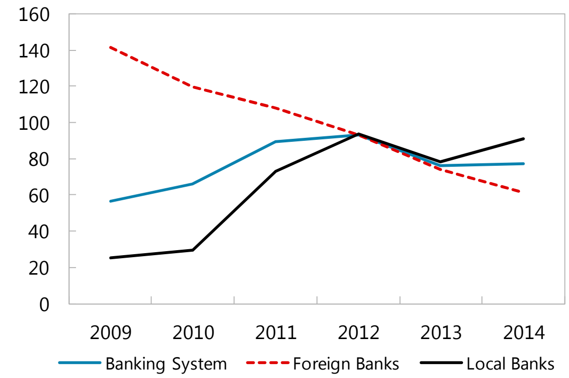
NPLs are growing at all banks except one.

NPLs to Total Loans



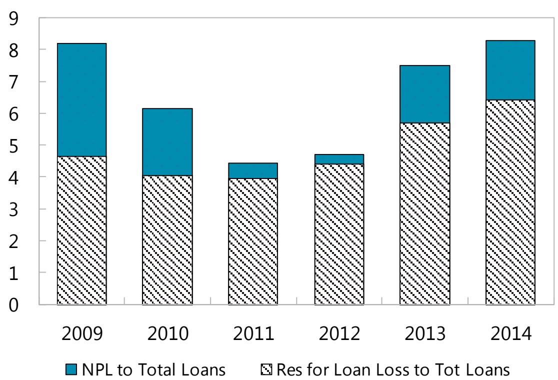
NPL coverage is dropping at all banks.

Loan Loss Reserves to NPLs



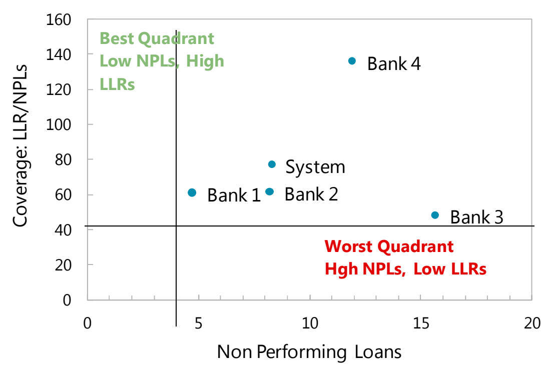
System NPL coverage (LLR) has dropped from 2012 levels.

NPL Coverage



System Risk Profile is high.

Banking System Risk Profile

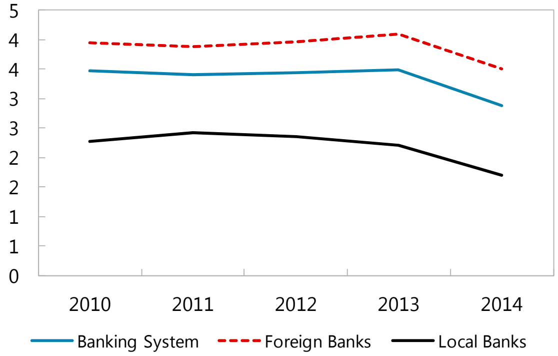


Source: CBS.

Appendix Figure 5. Profitability

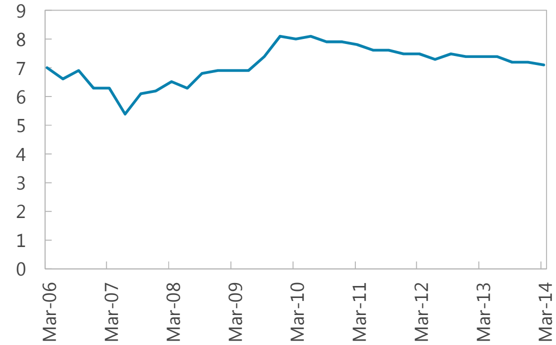
Net Interest Margins have not changed much,

Net Interest Margins
(In percent)



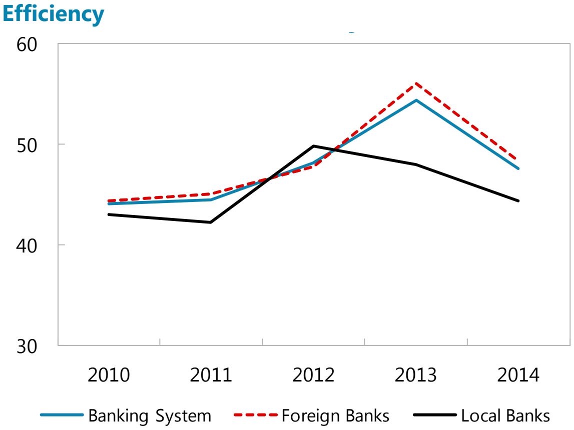
Reflecting stable and high interest rate spreads.

Interest Rate Spreads
(In percent)



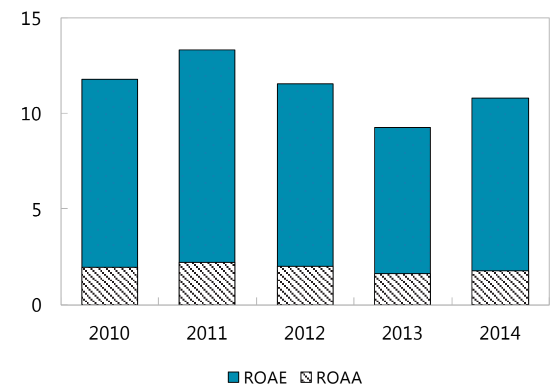
But costs have risen, especially at banks that have undergone 'cleaning of the books.'

Efficiency



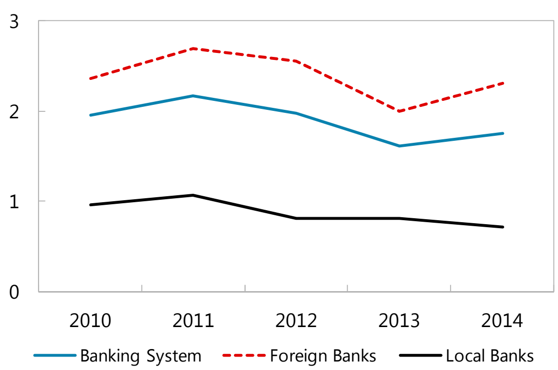
Negative growth, high provisioning and lower efficiency have impacted profitability with a slight rebound in 2014.

ROAA and ROAE



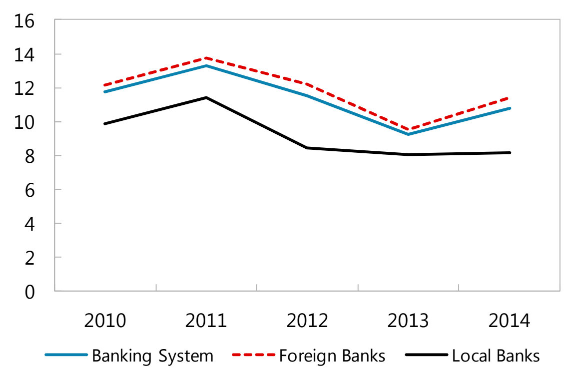
Local banks have lowest profitability,

Return on Average Assets



But Local banks boost their profitability through leverage.

Return on Average Equity

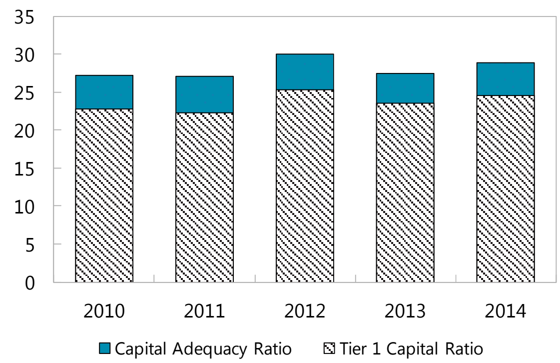


Source: CBS.

Appendix Figure 6. Capitalization

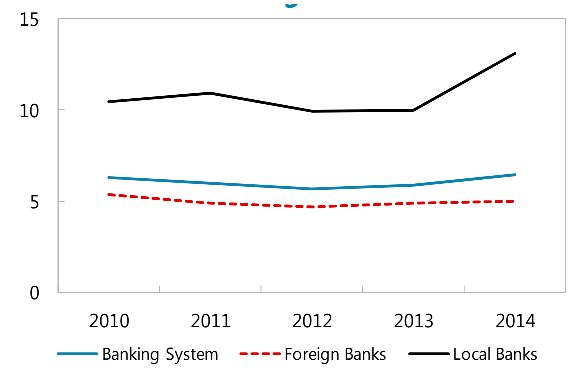
There are high levels and quality of capital in the system,

Capital Adequacy



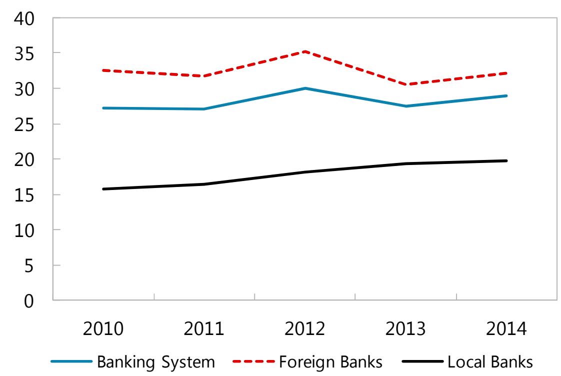
However, local banks are highly leveraged.

Leverage Ratio



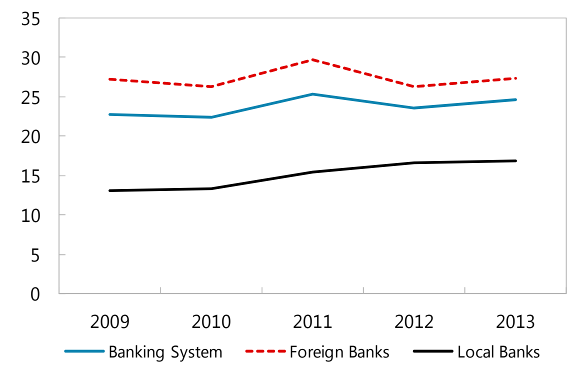
Foreign banks reinvest their profits.

Capital Adequacy Ratio



Local banks show lower capital.

Tier 1 Capital Ratio

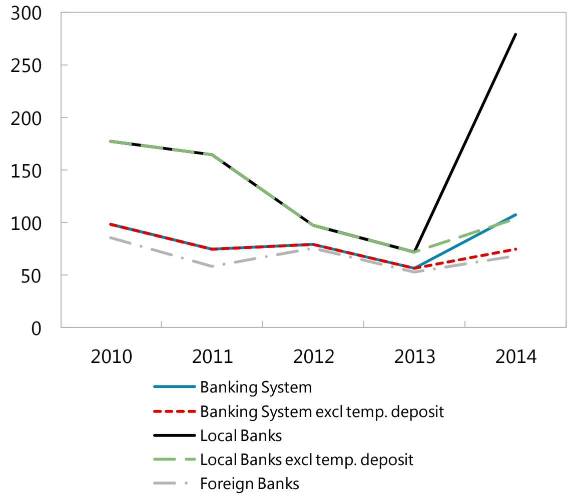


Source: CBS.

Appendix Figure 7. Commercial Banks' Liquidity

Banks are relatively liquid.

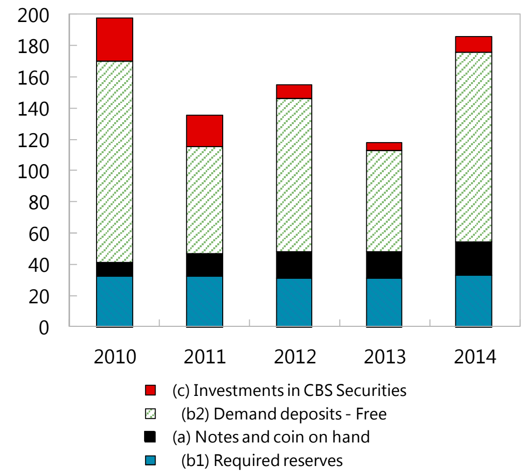
Liquid Assets/Liquid Liabilities*



*Local & Foreign,
Local Banks include temporary deposit for 2014

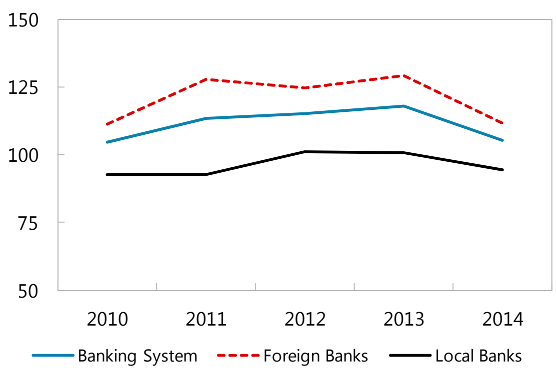
Most liquidity is in the form of excess reserves.
Holdings of CBS securities have reduced.

Liquidity Composition and Reserves
(In Tala Thousands)



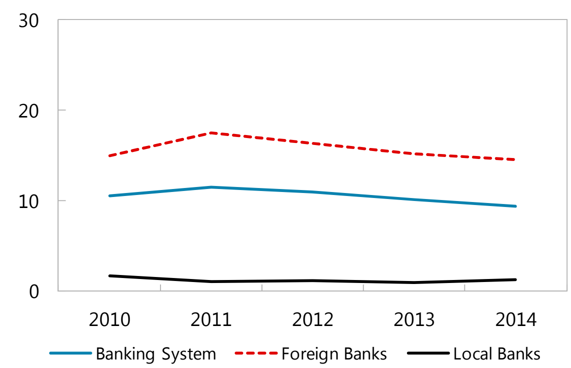
Loans are funded mostly with deposits.

Loan to Deposit Ratio



Foreign banks have more access to wholesale funding.

Wholesale Funding to Total Liabilities



Source: CBS.

Appendix Table 1. Selected Economic Indicators

2008/09–2015/16 [1]

						Prel.	Proj.	
	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
	(12-month percent change)							
Output and inflation								
Real GDP growth	-6.4	-2.3	6.2	1.2	-1.1	1.9	2.6	1.6
Nominal GDP	-2.0	-2.3	8.8	4.5	-0.6	0.7	5.0	3.8
Change in CPI (end period)	10.0	-0.3	2.9	5.5	-1.7	0.2	3.0	2.1
Change in CPI (period average)	14.6	-0.2	2.9	6.2	-0.2	-1.2	2.3	2.2
	(In percent of GDP)							
Central government budget								
Revenue and grants	29.6	34.0	30.7	30.1	33.9	38.5	35.5	30.3
Of which: grants	6.7	9.4	8.1	7.5	9.7	12.8	9.8	4.6
Expenditure and net lending	33.3	39.8	36.0	37.3	37.6	43.8	39.1	32.7
Of which: Development	11.0	13.2	10.1	12.5	11.5	15.1	12.3	6.9
Overall balance	-3.6	-5.8	-5.3	-7.1	-3.8	-5.3	-3.6	-2.3
External financing	2.7	8.8	5.5	7.2	3.5	2.9	4.3	2.6
Domestic financing	1.0	-2.9	-0.2	-0.1	0.3	2.5	-0.6	-0.2
	(12-month percent change)							
Money and credit								
Broad money (M2)	7.7	10.9	-0.8	-4.0	-0.8	18.7	…	…
Net foreign assets	9.2	32.7	-11.6	-5.9	-21.8	70.1	…	…
Net domestic assets	6.3	1.5	5.3	-3.1	9.0	1.9	…	…
Private sector credit	6.5	4.0	6.4	2.8	1.1	3.4	…	…
	(In millions of U.S. dollars)							
Balance of payments								
Current account balance	-32.3	-44.3	-30.7	-70.3	-20.7	-65.8	-59.4	-48.8
(In percent of GDP)	-5.3	-6.8	-4.0	-8.7	-2.6	-8.0	-6.9	-5.4
Merchandise exports, f.o.b. [2/]	11.1	17.5	23.8	29.4	27.2	25.9	26.7	27.5
Merchandise imports, f.o.b.	-229.3	-261.6	-288.8	-337.1	-305.8	-347.8	-347.1	-350.9
Services (net)	91.7	87.2	112.9	114.5	118.3	119.7	118.9	128.8
Income (net)	-32.0	-18.7	-27.2	-36.9	-32.8	-26.1	-25.6	-26.5
Current transfers	126.2	131.4	148.7	159.8	172.4	162.5	167.6	172.3
External reserves and debt								
Gross official reserves	95.3	165.3	158.4	157.1	137.3	155.3	167.3	178.4
(In months of next year's imports of GNFS)	3.3	5.3	4.6	4.7	3.8	4.3	4.6	4.8
Public debt [3/]	647.2	752.4	867.5	959.7	984.5	1015.5	1076.4	1121.2
(In percent of GDP)	39.0	46.4	49.1	52.0	53.6	55.0	55.5	55.7
Exchange rates								
Market rate (tala/U.S. dollar, period average)	2.7	2.5	2.3	2.3	2.3	2.2	…	…
Market rate (tala/U.S. dollar, end period)	2.5	2.3	2.4	2.3	2.3	2.2	…	…
Nominal effective exchange rate (2010 = 100) [4/]	99.4	100.0	99.1	100.9	104.0	106.5	…	…
Real effective exchange rate (2010 = 100) [4/]	102.6	100.0	100.9	102.9	104.6	104.7	…	…
Memorandum items:								
Nominal GDP (in millions of tala)	1,661	1,623	1767	1847	1835	1847	1940	2013
GDP per capita (U.S. dollars)	3,293	3,512	4,067	4,265	4,171	4,308	4,481	4,618

Sources: Data provided by the Samoan authorities and Fund staff estimates.

1/ Fiscal year beginning July 1.
2/ Includes re-export of fuel after 2009/10.
3/ Includes domestic and external public debt.
4/ IMF, Information Notice System (calendar year).

Appendix Table 2. Risk Assessment Matrix

<table>
<tr><th rowspan="2">Nature/Source of Main Threats</th><th colspan="2">Overall Level of Concern</th></tr>
<tr><th>Likelihood of Severe Realization of Threat in the Next 1–3 Years
(high, medium or low)</th><th>Expected Impact on Samoa if Threat is Realized
(high, medium or low)</th></tr>
<tr><td>Cyclone or tsunami hitting central parts of Samoa.</td><td>***Staff assessment: Medium***
• Samoa sits in the South Pacific Convergence, the origin and path of numerous tropical cyclones, among them Ofa (1990), Val (1991) and Evan (2012)
• Samoa also sits on the Ring of Fire seismic activity area. Impacts from tsunamis anywhere around the Pacific are a possibility such as in 2009.</td><td>***Staff assessment: High***
• Cyclones can cause widespread damage to agriculture and infrastructure impacting business continuity with Evan and the 2009 tsunami each causing up to 20-30 percent of GDP in damages.</td></tr>
<tr><td>Protracted period of slower growth in advanced and emerging economies and/or side-effects from global financial conditions, which spills over to Australia and New Zealand.</td><td>***Staff assessment: Medium to High***
• The likelihood of protracted slow growth or a surge in financial volatility is high, which may have a severe impact on Australia and New Zealand depending on the specifics of the shock.</td><td>***Staff assessment: High***
• A sharp decline in exports, tourism earnings and remittances would worsen the current account balance. It would also reduce fiscal revenue and weaken the reserves buffer.
• Samoa would be exposed to a drop in tourist arrivals, remittances and demand for its other exports.</td></tr>
<tr><td>Increasing asset quality deterioration in banks and PFIs. and weakening borrowers.</td><td>***Staff assessment: Medium***
• NPLs are high, which could further increase in a relatively weak economy or if government guarantees and other support of SOEs cannot be honored or are weakened;
• In particular PFIs may have weak underwriting standards.
• Households and business balance sheets have been stretched by recent shocks and are vulnerable.</td><td>***Staff assessment: High***
• Any increase in NPLs would directly affect capital as profitability is waning and there are few liquidity buffers.
• Lack of data, non-transparent reporting, conflicts of interest, and limited supervision make PFIs vulnerable.</td></tr>
<tr><td>Loss of confidence in banks and PFIs.</td><td>***Staff assessment: Low***
Samoa has not had a full blown financial crisis, and the government has been actively responding to shocks with support from abroad.</td><td>***Staff assessment: High***
• Foreign banks could be supported by parent banks, but support to domestic banks and PFIs may be constrained in the short-term.
• There is no deposit insurance.</td></tr>
</table>

Appendix Table 2. Risk Assessment Matrix (concluded)		
Nature/Source of Main Threats	**Overall Level of Concern**	
	Likelihood of Severe Realization of Threat in the Next 1–3 Years *(high, medium or low)*	**Expected Impact on Samoa if Threat is Realized** *(high, medium or low)*
Sharp exchange rate depreciation	***Staff assessment: Low to Medium*** Staff analysis and other indicators suggest no significant misalignment of the currency and reserves are adequate under the standard metric. Also, the Tala has been very stable against the currency basket despite severe shocks in recent years.	***Staff assessment: Medium*** • Potential effects on bank balance sheets. • Government debt would rise. • Competitiveness would be supported.

Appendix Table 3. Financial Soundness Indicators

(In percent)	June 2010	June 2011	June 2012	June 2013	June 2014
Asset Quality					
NPL to Total Loans	6.1	4.4	4.7	7.5	8.3
Res for Loan Loss to Tot Loans	4.0	4.0	4.4	5.7	6.4
Res for Loan Loss to NPLs (Coverage)	65.8	89.2	93.3	75.9	77.3
NPLs net of s/ Provisions to Regulatory Capital	18.8	10.4	11.2	19.9	15.5
Annualized Loan Growth	3.8	8.1	-1.7	1.5	-4.4
Profitability					
Net Interest Margin	3.5	3.4	3.4	3.5	2.9
Efficiency (Cost/Income)	44.1	44.5	48.2	54.4	47.6
ROAA	2.0	2.2	2.0	1.6	1.8
ROAE	11.7	13.3	11.5	9.3	10.8
Liquidity and Funding					
Loan-to-Deposit Ratio	104.6	113.4	115.2	118.1	105.4
Liquid Assets / Liquid Liabilities	76.6	44.7	54.8	35.0	56.3
Wholesale Funds / Total Liab.	10.6	11.5	11.0	10.1	
ST Borrowings / Total Liab. (due to banks)	5.0	4.6	5.0	2.6	5.0
Capital Adequacy & Leverage					
Capital Adequacy Ratio	27.2	27.1	30.0	27.4	28.9
Tier 1 Capital Ratio	22.8	22.3	25.4	23.6	24.6
Financial Leverage (times)	6.3	6.0	5.7	5.9	6.4

Source: CBS and staff calculations

Note: For fiscal year ending in June

Appendix Table 4. Banking Sector Stress Testing Matrix (STeM)

Domain		Assumptions: Bottom-Up Tests by Banks	Assumptions: Top-down Tests by FSAP Team
Banking Sector: Solvency Risk			
1. Institutional Perimeter:	Institutions included:	4 banks	4 banks of which two foreign: (ANZ Samoa and Westpac Samoa) and two local: (National Bank of Samoa and Commercial Bank of Samoa).
	Market-share:	100 percent of Banking Sector	4 banks: 100 percent of domestic banking sector assets and 59 percent of Domestic Financial System assets.
	Data and baseline date:	Institutions' own data (historical and as at 30 June 2014). Institution to be assessed on a standalone basis.	Institutions' data as provided by institutions (questionnaire templates): Historical credit and other risk data to 2007, and selected current data (as at 30 June 2014). CBS data as reported by institutions: Historical macroeconomic, credit and selected risk data to 2007 plus current data (at 30 June 2014) The assumptions comprised: (i) each bank with minimum NPLs in each industry sector equal to 25 percent of the weighted average of its NPLs across all industry sectors; and (ii) where provisions were recorded for an industry sector, but no NPLs, a level of NPLs was assumed at least equal to the provisions allocated to that industry sector.
2. Channels of Risk Propagation:	Methodology	Banks' internal models. Balance sheet approach (per templates)	Balance sheet approach incorporating satellite models for risk adjusted P&L, and on and off balance sheet impacts. Excel based sensitivity analysis.
	Satellite Models for Macro-Financial linkages:	Banks' internal models Expert judgment	Eviews models for local data availability) for credit losses, and credit growth; Credit growth incorporating IMF/CBS estimates. Integration of solvency and funding through increased funding costs under stress and loss of income through impairments. Triangulation through Heuristics and Expert Judgment.
	Stress test horizon:	4 years	4 years

Appendix Table 4. Banking Sector Stress Testing Matrix (STeM) (continued)			
Domain		**Assumptions**	
		Bottom-Up Tests by Banks	**Top-down Tests by FSAP Team**
3. Shocks:	Scenarios developed in consultation with the CBS.	Scenario Analysis – moderate shock : single class 4 cyclone Severe Shock: dual class 4 cyclones (a year apart) combined with a recession for two leading trading partners. Wide ranging macro-economic impacts designed to stress the bank sector. Accentuation of moderate shock impacts through (i) reductions in remittances and export demand due to recessions in Australia and New Zealand; (ii) presence of already stressed balance sheets.	Baseline: using WEO forecasts. Moderate shock: single class 4 cyclone with diverse sector GDP impacts (including agriculture, tourism, construction and public sector). Severe Shock: dual class 4 cyclones (a year apart) combined with a recession for two leading trading partners. Accentuation of moderate shock impacts through (i) reductions in remittances and export demand due to recessions in Australia and New Zealand; (ii) presence of already stressed balance sheets.
	Sensitivity analysis:	Interest rate shocks of parallel increases in rates of 200, 300 and 400bp (2 SD is 2.6 percent) FX shocks of 10 and 20 percent depreciation of the Tala against the USD.	Interest rate shocks: (i) a 300 bps parallel move and a structured 300 bps non-parallel move in borrowing and lending rates across the applicable yield curve; (ii) 300bps contraction in interest margins in across the applicable yield curve. FX shock: 20 percent depreciation and appreciation of the Tala against the USD. Concentration risk: Failure of the largest counterparties (asset side credit loss and liabilities side reliance on non-bank depositors– see also Liquidity) with 20 percent haircut on collateral, and Instantaneous increase in NPLs on industry exposures factored by levels of existing NPLs.

Appendix Table 4. Banking Sector Stress Testing Matrix (STeM) (continued)

Domain		Assumptions: Bottom-Up Tests by Banks	Assumptions: Top-down Tests by FSAP Team
4.Risks and Buffers:	Risks/factors assessed:	Credit losses, profitability, funding costs, market risk, operational risk, exchange rate, taxes.	Change in credit aggregates, credit losses, profitability, funding costs (incorporating fixed / floating mix and spread contraction), market risk, non-interest income and expenses, operational risk, exchange rate, taxes.
	Behavioral adjustments:	Maturing exposures replaced with same asset class New assets originated proportionally across the portfolio. Maturity / tenor assumed to remain unchanged. No policy responses. No management action other than already included in strategy (capital raising, cost cutting, asset sales etc.).	Maturing exposures replaced with same asset class. New assets originated proportionally across the portfolio. Maturity / tenor assumed to remain unchanged. No policy responses. No management action other than already included in strategy (capital raising, cost cutting, asset sales etc.).
5. Regulatory and Market-Based Standards and Parameters:	Calibration of risk parameters:	Point in time parameters for credit risk for both credit losses; Historical P&L and Balance sheet performance.	Point in time parameters for credit risk for both credit losses and stressed RWA calculations. Historical P&L and Balance sheet performance.
	Regulatory / Accounting and Market-Based Standards:	Capital metrics per local regulatory requirements: CAR minimum of 15 percent Tier 1 minimum of 7.5 percent Tier 2 < 100 percent of core capital RWA metrics per local regulatory requirements, which do not have separate risk ratings for retail residential, and corporate and commercial as in Basel II.	Capital metrics per regulatory requirements: CAR minimum of 15 percent Tier 1 minimum of 7.5 percent Tier 2 < 100 percent of core capital RWA metrics per local regulatory requirements (based on Basel II standardized). RWA metrics per Quasi Internally Rated Bank (QIRB) assessment – per Schmieder et al.

Appendix Table 4. Banking Sector Stress Testing Matrix (STeM) (continued)

Domain		Assumptions	
		Bottom-Up Tests by Banks	**Top-down Tests by FSAP Team**
6. Reporting Format for Results:	Output presentation:	4 year P&L and Balance sheet under each scenario. Loan classification under each scenario. Industry sector impact under each scenario. Capital /Capital shortfall.	Process and methodology 4 year P&L and Balance Sheet by bank Industry sector impacts (10 sectors). Capital/Capital shortfall, by bank and by sector. Dispersion of capital ratios: min, avg, max; percentage of assets that fail. Capital shortfall, system wide. Pass or fail; percentage of assets that fail. For each hurdle rate, share in whole system by asset.). Industry sector concentrations. Multiple Financial Soundness Indicators
Banking Sector: Liquidity Risk			
1. Institutional Perimeter:	Institutions included:	NA *(Liquidity Tests were not undertaken by the banks)*	As for Solvency Risk
	Data and baseline date:	NA	Institutions' data as provided by institutions (questionnaires); Selected current data (as at 30 June 2014). CBS data per regulatory reports by institutions; Selected current data (at 30 June 2014). Institutions to be assessed on a standalone basis.
2. Channels of Risk Propagation:	Methodology:	NA	Implied cash flow tests (30 day). (Increase in funding costs are covered separately in multi-period solvency tests).
3.Risks and Buffers:	Risks:	NA	Rapid withdrawal or non-rollover of deposits (including from foreign parent). Concentration of funding/loss of funding by Govt. and SOEs. Closure of funding markets. Discounts on realization of liquid assets and haircuts on saleable non liquid assets.
	Buffers:	NA	Counterbalancing capacity (saleable assets. Central bank facilities. Possible reduction in Minimum Reserve Requirement

Appendix Table 4. Banking Sector Stress Testing Matrix (STeM) (continued)			
Domain		**Assumptions**	
		Bottom-Up Tests by Banks	**Top-down Tests by FSAP Team**
4. Tail shocks:	Size of the shock:	NA	Bank run and dry up of traditional sources of funding, loss of key sources of funding. Rising discounts on realization of liquid assets and haircuts on disposal of non liquid but saleable assets. In a very severe "general run" the assumption is consecutive daily withdrawals of: (i) 7.5 percent and 5 percent, respectively, of domestic and foreign currency demand deposits; (ii) 2.5 percent and 1.5 percent, respectively, of domestic and foreign currency savings deposits; and (iii) 1.5 percent and 0.5 percent, respectively, of domestic and foreign term deposits. This scenario also assumes a haircut of 30 percent on disposal of saleable assets.
5. Regulatory and Market-Based Standards and Parameters:	Regulatory standards:	NA	No regulatory metrics (ie self-regulated).
	Market based Standards:	NA	Basel III Liquidity Coverage Ratio Liquidity shortfall per day as percentage of Total Assets (TA)
6. Reporting Format for Results:	Output Presentation:	NA	Assumptions Survival period in days by bank. Number of banks that still can meet their obligations. Liquidity shortfall as percent of TA
Banking Sector: Contagion/Spillover Risk			
1. Institutional Perimeter:	Institutions included:	NA *(Contingency/Spillover tests were not undertaken by the banks)*	As for Solvency Risk.
	Market share:	NA	As for Solvency Risk.
	Data and baseline date:	NA	Institutions' data as provided by institutions (questionnaire templates): Selected current data (as of 30 June 2014)

Appendix Table 4. Banking Sector Stress Testing Matrix (STeM) (concluded)			
Domain		Assumptions	
		Bottom-Up Tests by Banks	Top-down Tests by FSAP Team
			CBS data as reported by institutions: Selected current data (as of 30 June 2014) Institutions to be assessed on a standalone basis.
2. Risks:		NA	Potential insolvency (technical or actual) on failure of a local banking sector participant. Currently there is only limited interbank lending between resident-banks. The risk of insolvency due to the failure of another resident bank is considered to be low.
3.Methodology:		NA	Inter financial institution contagion/spillover risk model. Assumed default of selected borrower and subsequent domino effect.
4.Shock assumption:		NA	Single and multiple default (pre and post severe-scenario solvency test): (i) each resident bank failed in turn; (ii) all resident banks failed at the same time; and (iii) each resident bank failed in turn, in which case the assessment was undertaken assuming the creditor bank in each case was at the lowest level of capital adequacy induced by the severe solvency scenario (see Severe Solvency Test).
5.Type of test:		NA	Iterative simulations of single and multiple resident-bank defaults