



# SAMOA

## FINANCIAL SECTOR ASSESSMENT PROGRAM

### BANKING SUPERVISION AND REGULATION— TECHNICAL NOTE

August 2015

This Technical Note on Banking Supervision and Regulation 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 July 2015.

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# SAMOA

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July 2015

## TECHNICAL NOTE

BANKING SUPERVISION AND REGULATION

Prepared By Keith Bell  
**Monetary and Capital Markets  
Department**

This Technical Note was prepared by IMF staff in the context of the Financial Sector Assessment Program in Samoa. It contains technical analysis and detailed information underpinning the FSAP's findings and recommendations. Further information on the FSAP can be found at <http://www.imf.org/external/np/fsap/fssa.aspx>

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## Glossary

|         |   |
|---------|---|
| AML/CFT | Anti-Money Laundering/ Combating the Financing of Terrorism |
| BCP     | Basel Core Principles For Effective Banking Supervision     |
| CBS     | Central Bank of Samoa                                       |
| CBA     | Central Bank of Samoa Act                                   |
| DBS     | Development Bank of Samoa                                   |
| FIA     | Financial Institutions Act                                  |
| FI      | Financial Institution                                       |
| FSD     | Financial Supervision Department                            |
| IFSA    | International Financial Services Act                        |
| LLP     | Loan Loss Provision   |
| MCIL    | Ministry of Commerce, Industry and Labor                    |
| MFI     | Microfinance Institution                                    |
| MOF     | Minister of Finance   |
| NPL     | Non Performing Loan   |
| PFI     | Public Financial Institution                                |
| 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                               |
| UTOS    | Unit Trust of Samoa   |

## EXECUTIVE SUMMARY<sup>1</sup>

**The main findings and recommendations here are based on selected Basel Core Principles.**

Given Samoa's small and simple banking sector, the assessment has identified BCPs for which further development of procedures and practices would be constructive and a priority. As such, the focus is on supervisory powers, resourcing levels, and the need for greater guidance from the supervisor to the industry on risk and its management.

**Little progress has been achieved towards implementing the recommendations of the 2007 BCP assessment.** Initiatives by the Central Bank of Samoa (CBS) to deal with weaknesses identified in supervision and regulation of domestic banks in 2007 were disrupted by a series of natural disasters and the use of limited supervisory resources on other priorities. That said, progress was achieved in issues related to Anti-Money Laundering and Combating Financing of Terrorism (AML-CFT), with Samoa upgraded to a "normal reporting" regime by the Asia Pacific Group on Money Laundering ("APGML") in 2014, from its previous status of "enhanced reporting." Recommendations regarding the international banking sector, regulated and supervised by Samoa International Financial Authority (SIFA), still remain to be implemented. Over time, supervision and regulation of all financial intermediaries, including offshore banks, should be unified under the CBS.

**As a result, there are significant weaknesses in banking supervision and regulation in Samoa (Table 1):**

- Prudential data reporting (including quality of data) needs to be upgraded, requiring a new set of data returns in electronic format to automate transposition of data for analysis.
- A planned program of targeted on-site inspections of domestic banks on a two-year cycle was not fully developed and delivered. Onsite inspections should be a priority and the CBS should give near term priority to the locally-owned banks.
- The CBS's Financial Supervision Department appropriately aims to conduct Risk-Based Supervision, but there are still apparent gaps in implementation.
- Supervisory Guidance to the domestic banks remains confined to the nine "Prudential Statements," which lack the detailed, prescriptive guidance that has become the international supervisory standard over time, and powers for enforcement should be strengthened.
- The FIA requires amendment, including regarding: (i) specific powers for the CBS to grant "waivers" on the large exposure limit only where robust analysis indicates this to be appropriate; (ii) CBS' authority to effect change in a bank's Board and senior management; (iii) provisions regulating "significant shareholder" and related parties; and (iv) the role of the Court in certain administrative remedial measures, which has potential to obstruct the application of such measures.

<sup>1</sup> This Technical Note has been prepared by Keith Bell, IMF external expert, in the context of the IMF and a World Bank first FSAP to Samoa. The team visited Apia during October 20–November 3, 2014.

**Table 1. Key Recommendations**

| <b>Recommendation</b>   | <b>Time*</b> |
|---|--------------|
| <b>Domestic Banking</b>   |              |
| CBS to hire additional staff for financial oversight according to Four Year Plan (¶15)  | ST           |
| CBS to improve the quality and coverage of data (¶16)   | ST           |
| CBS to conduct in-depth assessment of balance sheets, including an asset quality review, of potentially vulnerable banks (¶34)  | ST           |
| CBS to implement risk based supervision in full and conduct regular on-site inspections (¶32, 39)   | ST           |
| CBS to require banks to report all single exposures which exceed 10 per cent of regulatory capital (¶37)  | ST           |
| CBS to require half-yearly certification by a bank's external auditor of the accuracy of prudential returns submitted to CSB (¶38)  | ST           |
| CBS to require immediate delivery from each bank of a copy of the external auditor's "Internal Control Memorandum"/ "Management Letter" provided to management at the conclusion of the bank's annual audit (¶38) | ST           |
| CBS to activate regularly the provisions of MOUs with "home" regulators (¶40)   | ST           |
| CBS to upgrade supervisory guidance to banks, especially in regard to risk management and NPL write-offs (¶41, 11)  | MT           |
| CBS to source and install a current, standard package for the filing of prudential returns electronically and with analytical functionality (¶36)   | MT           |
| CBS to seek amendments to the FIA and CBA to support more efficient bank oversight through a set of prompt corrective actions and bank resolution tools (¶30)   | MT           |
| <b>International Banking</b>  |              |
| Enhance operational independence of SIFA to supervise international banks and remove potential for conflict between SIFA's promotional and supervisory roles (¶27)  | ST           |
| Over time the CBS should assume supervision and regulation of all financial intermediaries (¶14)  | MT           |
| SIFA to publish data on the international banking sector (¶34)  | ST           |
| SIFA to introduce individual capital requirements based on risk profile and to provide guidance (¶27)   | ST           |
| SIFA to introduce supervisory guidance to international banks (¶40)   | ST           |
| SIFA to introduce on-site inspections with an emphasis on asset quality and classification (¶34)  | ST           |
| *Short-term (ST), Medium-term (MT)  |              |

## INTRODUCTION

1. **This note discusses the current status of banking supervision and regulation in Samoa based on selected Basel Core Principles (BCP).** The progress towards implementing the main recommendations from a full BCP assessment in 2007 is also reviewed. Only the most critical principles from a financial stability perspective for Samoa are discussed, taking into account the significance of existing deficiencies and the conclusions of the 2007 assessment.
2. **The note focuses on domestic commercial banks.** The international (offshore) banking industry is small—with less than 10 percent of the assets of the domestic banking system—and stagnant. Furthermore, as the recommendations from the 2007 assessment have not been implemented by the Samoa International Financial Authority (SIFA), they remain valid and are highlighted in the text and in the table of recommendations. Other financial institutions, such as Public Financial Institutions (PFIs), insurance companies, and credit unions are excluded from the scope of the work, although it is underlined that their existence has impacted supervision of domestic banks due to the use of supervisory resources on matters related to several of them.
3. **The note is organized as follows:** the first section provides a brief overview of the financial system structure and bank vulnerabilities. Section two reviews the current status of financial oversight, discussing briefly the regulatory and supervisory frameworks. Section three reviews the main areas of concern identified in the 2007 full BCP assessment and the continued applicability of its recommendations in light of the limited progress achieved since then. Section four presents the main findings and recommendations of the current assessment.

## FINANCIAL SYSTEM PROFILE

### A. Financial Sector Structure

4. **Banks account for more than half of all assets, but the active role of the PFIs is reflected in a significant share of non-banks in the structure of the financial sector.** 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 1).
5. **Two Australian banking groups hold almost 2/3 of the domestic banking sector assets.** The sector comprises four banks. Australia and New Zealand Banking Group Ltd (ANZ) and Westpac Banking Corporation (Westpac), are subsidiaries of the third and fourth largest Australian banks, ranked by assets, and hold 45 percent and 21 percent of total banking assets, respectively.<sup>2,3</sup> The

<sup>2</sup> Data as at September 2014. ANZ and Westpac also rank as first and second largest Australian banks by Basel III regulatory capital requirements. See “Innovating for Growth”—Major Banks Analysis by PWC November, 2014 ([www.pwc.com.au/banking-capital-markets/assets/Major-Banks-Analysis-Nov14.pdf](http://www.pwc.com.au/banking-capital-markets/assets/Major-Banks-Analysis-Nov14.pdf)).

<sup>3</sup> On 28 January 2015, Westpac announced the sale—subject to regulatory and other approvals—of certain of its Pacific operations, including its Samoan subsidiary, to Bank of South Pacific Ltd. The sale is to be concluded in the first half of 2015.

two locally-owned banks, Samoa Commercial Bank and National Bank of Samoa, have market shares of 18 percent and 16 percent, respectively. Assets are concentrated in lending products with most of the lending targeting construction, trade and tourism sectors (Figures 1 and 2). 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.

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

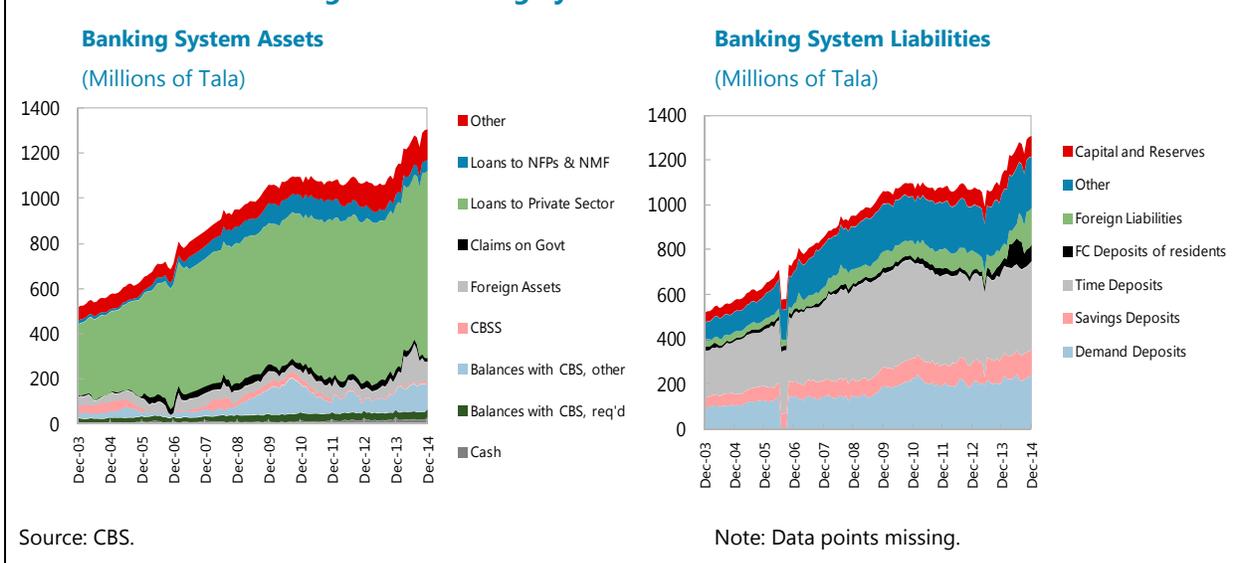
|  | 2008/09      | 2009/10      | 2010/11      | 2011/12      | 2012/13      | 2013/14      | Dec. 2014    |
|--|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| <b>Commercial banks</b>                    | <b>59.9</b>  | <b>60.4</b>  | <b>59.7</b>  | <b>58.7</b>  | <b>57.9</b>  | <b>57.0</b>  | <b>57.2</b>  |
| 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         |
| <b>Non monetary financial institutions</b> | <b>40.1</b>  | <b>39.6</b>  | <b>40.3</b>  | <b>41.3</b>  | <b>42.1</b>  | <b>43.0</b>  | <b>42.8</b>  |
| 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          |
| <b>Total Financial System</b>              | <b>100.0</b> |
| 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.

**6. 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. Dollarization is limited due to capital controls and almost all foreign currency assets and liabilities are concentrated in the foreign banks.<sup>4</sup>

<sup>4</sup> Foreign currency loans account for about 4 percent of total assets, and all foreign currency deposits account for about 8 percent of total deposits.

**Figure 1. Banking System Balance Sheet Structure**

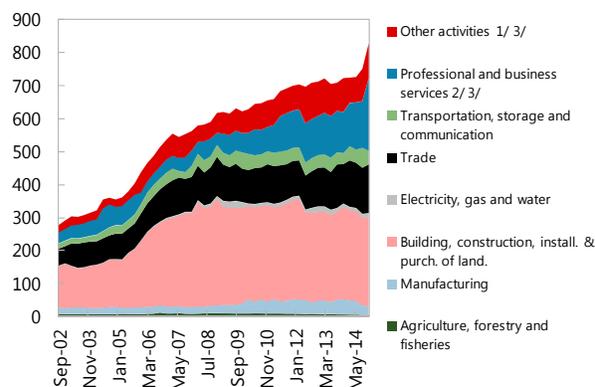


**7. Non-banks are important providers of credit.** The main non-bank institutions are the Samoa National Provident Fund (SNPF), a social security fund; the Development Bank of Samoa (DBS); the Samoa Housing Corporation (SHC); and the investment fund Unit Trust of Samoa (UTOS) (Box 1). The SNPF and DBS 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. The financial position of these PFIs could have systemic implications due to macro and fiscal linkages, although the direct linkages of PFIs to the banking sector nevertheless appear to be limited.

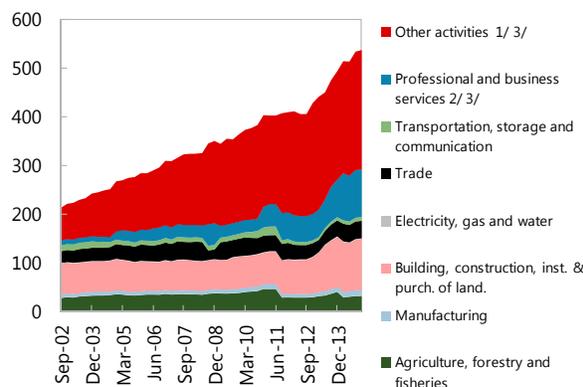
**8. In addition, there is one microfinance institution (MFI) and several credit unions which are not effectively supervised despite having capacity to take deposits from the public.** Samoa Pacific Business Development (SPBD) is the only MFI in Samoa with SAT 10 million in assets, SAT 6 million in loans and SAT 780,000 in deposits across 18,000 clients. A total of 13 credit unions are licensed to operate by the Ministry of Commerce, Industry and Labor (MCIL) but it is estimated that more are in operation. Supervision of the MFI and credit unions by MCIL is virtually non-existent, and financial information is not collected systematically or shared with the CBS. Based on limited data available, total assets of credit unions are estimated to be about SAT 20 million.

**Figure 2. Loan Placements by Sector****Distribution of Loans: Banks**

(In millions of Tala)

**Distribution of Loans: Non-Banks**

(In millions of Tala)



Source: CBS.

1/ Including personal loans not classified 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.

**9. The international financial sector is limited in size and scope.** There are seven international banks currently licensed in Samoa with total assets declining from US\$112 million in 2005 down to US\$ 54.4 million mid-2014, i.e., about one tenth of the domestic banking sector, and which are well capitalized. The operations of two of the seven licensees are restricted to serving exclusively members of their own groups, while the remaining five - being affiliates of investment advisers - deal with those advisers' clients at arms' length. There are no linkages between the domestic and international financial sectors.

## B. Vulnerabilities

**10. Bank portfolios have recently become smaller and more concentrated.** Bank credit to the economy has been stagnant for several years, with a recent jump due to a few larger projects. The loan portfolios have furthermore become more concentrated to the top ten borrowers, and concentration limits of 25 percent of capital, while appropriate, have limited new bankable projects, especially so for the two locally-owned banks that have smaller capital bases.

**11. Banks' asset quality was hit, in turn, by the global financial crisis, the tsunami in late 2009, and cyclone Evan in 2012.** System NPLs are high at 8.3 percent of total loans, with all banks above 4 percent, and are growing. The system is partial to high NPL coverage instead of write-offs and some banks are carrying NPLs that have accumulated over time and are not written off, making NPLs persistently high. The high NPLs reflect 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 at the locally-owned banks.

**12. Reported capitalization has remained strong.** As banks have remained profitable with flat or declining portfolios, capital metrics are strong, although there are uncertainties about problem loans being fully accounted and provisioned for. In particular, the Australian bank subsidiaries' capital has increased. This has pushed total and Tier 1 capital adequacy ratios, computed on a Basel 1 basis by CBS, to high levels. The system CAR as a whole is around 30 percent and most capital is high quality Tier 1.

## FINANCIAL REGULATION AND SUPERVISION

### A. Supervisory Agencies

**13. The principal domestic financial sector supervisor is the CBS, but its current resources are not commensurate to the mandate.** The CBS' mandate is derived from the CBA, 1984 (Section 4(f) and (g)) and the Financial Institutions Act, 1996 (Section 3) which, taken together, make the CBS responsible for the supervision and regulation of domestic commercial banks and, following legislative amendments, also for domestic nonbank financial services, including insurance companies, PFIs, Money Transfer Operators, and foreign exchange dealers.<sup>5</sup> It is, furthermore, intended that supervision and regulation of credit unions will be added to CBS's responsibilities in the future. Over time, the CBS should supervise all lending, deposit taking, and other financial intermediary institutions (including offshore banks).

**14. The SIFA is responsible for the supervision and regulation of international financial services.** SIFA was established in 2005 under its own Act and supervision of the seven international banks is subject to the International Banking Act, 2005. Supervision and regulation of offshore banks should eventually be moved to the CBS.

**15. The CBS program of supervision and regulation is delivered through the Financial Supervision Department (FSD) of its Financial Soundness Group (FSG).** The FSG was established following a senior management review of the CBS' supervisory responsibilities and available resources, in the context of the development of the CBS' Strategic Plan (2014–2018). The FSG is headed by an Assistant Governor and, in addition to the supervision and regulation unit, includes Samoa's Financial Intelligence Unit (FIU), responsible for AML and CFT issues, and a Financial System Development Unit, responsible for financial inclusion initiatives and development of a national payment and settlement system. The FSD currently has a staff of six persons after adding two in early 2014. Further additions are envisaged in the Department's Plan for the Year 2014–2015 to deal with expansion of supervisory responsibilities. Two senior supervisors use a portfolio approach to supervision, being allocated institutions in each of the categories (commercial banks, insurance companies, PFIs).

<sup>5</sup> The FIA reads, in Part II, paragraph 3, section (1): "The Central Bank in accordance with this Act may issue licenses to financial institutions and shall undertake prudential supervision of licensed financial institutions." The 2001 FIA amendment introduced the concept of "non-bank person or institution," meaning "any person or body [...] which provides financial services to the public."

## B. Supervision of Domestic Banks

**16. Supervisory processes are primarily off-site, although staff maintains frequent contact with counterparts at banks.** Senior executives are met on an “as viewed necessary” basis rather than on a scheduled format and banks file a suite of weekly, monthly and quarterly returns in “hard copy” and PDF format, originally designed for the monetary survey purposes. Portions of the data are subsequently re-cast on spreadsheets used for analysis of banks’ performance and adherence to prudential standards found in the FIA and in the CBS’ “Prudential Statements.” Data quality is uneven. The CBS does not, as a matter of course, obtain a copy of the external auditors’ “Internal Control Memorandum”/“Management Letter” provided to bank management at the conclusion of the annual audit.

**17. Supervisory Guidance to domestic banks is not in accordance with current international standards.** Guidance remains confined to the nine “Prudential Statements” issued by the CBS between 1995 and 1999 and lacks the detailed, prescriptive quality that has become the international supervisory standard over time. This has been recognized by the FSG and the FSD’s Plan for the Year 2014–2015 incorporates as an objective “Updated Prudential Standards in line with international requirements and global developments.”

**18. A plan initially drawn up in 2007 for a program of targeted on-site inspections of domestic banks on a two-year cycle has not been fully developed and delivered.** On-site inspections were conducted in 2010 at the two locally-owned banks, albeit with a strict focus on AML/CFT. In mid-2013, on-site inspections were conducted at the four domestic banks on credit and liquidity (based on the CBS’ 2000 On-Site Manual) and AML/CFT. The FSG plans to conduct on-site inspections of all four domestic banks by June 2015 (the end of the fiscal year), notwithstanding the modest staffing complement of the FSD.

**19. There are important factors partially offsetting the CBS’ infrequent on-site inspections of ANZ and Westpac in Samoa.**<sup>6</sup> Internal audit services of both banks’ parents assess Samoan operations on-site annually (one has the practice of visiting the CSB’ Governor immediately upon arrival and providing a briefing of findings before departure); and control reporting to regional headquarters (located in Fiji for both) is extensive. Both ANZ and Westpac enjoy identical high credit ratings,<sup>7</sup> are listed on the Australian Securities Exchange (ASX), comply with the ASX Corporate Governance Principles and Recommendations published by the ASX Limited’s Corporate Governance Council, and both must comply with governance requirements prescribed by the Australian Prudential Regulation Authority (APRA) under its Prudential Standards CPS 510 (Governance). (In the context of the FSAP Update for Australia, it was noted that “Australia has a very high level of compliance with the BCPs” and that “APRA meets the requirements for effective consolidated

<sup>6</sup> On 28 January 2015, Westpac announced the sale—subject to regulatory and other approvals—of certain of its Pacific operations, including its Samoan subsidiary, to Bank of South Pacific Ltd., the sale to be concluded in the first half of 2015.

<sup>7</sup> Moody’s Short Term P-1 (Stable); Standard & Poor’s Short term A-1+ (Stable).

supervision.”<sup>8</sup> In the latter regard, CBS is already an active member of the APRA-sponsored College of Supervisors for ANZ.<sup>9</sup>

**20. The CBS appropriately aims to conduct Risk-Based Supervision (RBS), but there are still apparent gaps in implementation.** Full implementation of RBS requires, inter alia, that there be effective, and timely, follow-up to close out issues raised in the inspection cycle. However, review of the on-site inspections conducted in mid-2013 has revealed instances where this was not achieved, although a number of issues requiring attention had been identified.

**21. The CBS faces important limitations stemming from deficiencies in the legal framework.** The FIA, which together with the “Prudential Statements” underpins the entire domestic bank supervision framework, presents significant deficiencies, notably: (i) the statute sets out a large exposure limit which the CBS has, from time to time, “waived” without having legal capacity to do so; (ii) the CBS does not currently have authority to effect change in a bank’s Board and senior management; this is a serious omission where, for example, both on- and off-site supervision have revealed an instance of a Board member being an obligor for a large exposure chronically delinquent; (iii) the statute lacks a definition of “significant shareholder,” the capacity to deem parties to be related and the capacity to require deduction of related parties’ exposures from capital when assessing an institution’s capital adequacy; and (iv) the statute currently contemplates involvement of the Court in certain administrative remedial measures, which has potential to obstruct the application of such measures.

### C. Supervision of International Banks

**22. Supervision and regulation of the seven international banks is minimal.** There is still no Prudential Guidance from the SIFA and supervision is limited to SIFA’s receipt and filing of a quarterly report. SIFA also reviews the audited accounts prior to the grant of an annual license renewal to each international bank.

## THE 2007 ASSESSMENT AND SUBSEQUENT DEVELOPMENTS

**23. The 2007 BCP assessment found that compliance had improved since the previous assessment.** A full stand-alone BCP assessment was conducted in 2007 and covered procedures and practices for supervision of both domestic and international banks in the context of an IMF Assessment of Financial Sector Supervision and Regulation. The assessment was based on the entirety of the Twenty-Five BCPs first published in September 1997 by the Basel Committee on

<sup>8</sup> See Australia—Detailed Assessment of Observance of the BCPs (November 2012), paragraphs 1 and 39.

<sup>9</sup> 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.

Banking Supervision, but also included an evaluation of measures needed for compliance with the 2006 BCPs. For the domestic banking sector, the assessment showed seventeen BCPs as “Compliant” or “Largely Compliant,” with a further four as “Not Applicable.” The remaining four BCPs were assessed as “Materially Non-Compliant.” As regards the international banking sector, the assessment showed twelve BCPs as “Compliant” or “Largely Compliant,” with a further four as “Not Applicable.” Of the remaining nine BCPs, two were assessed as “Materially Non-Compliant” and seven were assessed as “Non-Compliant.”

**24. The 2007 assessment identified significant weaknesses in the supervision of domestic and international banks.** The main areas of concern related to various forms of risk and their management (Table 2), as addressed in Section IV: “Arrangements for Ongoing Banking Supervision” of the September 1997 BCPs’ publication, where Part A covers “Risks in Banking” and Part B covers “Development and Implementation of Prudential Regulations and Requirements.” Broad areas for improvement were identified with respect to the supervision of domestic banks’ credit policies, connected lending, large exposures, and corporate governance policies. As for international banks, recommendations included on-site inspections, minimum risk-based capital requirements, and guidance on risk management and corporate governance.

**25. Attempts by the CBS to address areas of concern were not completed.** Initiatives by the CBS to deal with weaknesses identified in the 2007 assessment were disrupted by a series of events. Firstly, Samoa suffered severe dislocation due to a sequence of major exogenous shocks (e.g., natural disasters such as the 2009 tsunami and tropical cyclone Evan in 2012) and, secondly, there was diversion of scarce supervisory resources within CBS, inter alia, to development of a supervisory regime for PFIs. Progress was achieved in regard to issues related to AML/CFT and was instrumental in having Samoa ultimately made subject to a “normal reporting” regime by the Asia Pacific Group on Money Laundering (“APGML”) in 2014, reduced from the “enhanced reporting” regime previously applied.

**26. Recommendations from the 2007 assessment for the supervision of domestic banks remain largely unaddressed.** These include that the CBS: (i) issue more detailed guidance on the standards expected to be observed by banks in their credit policies and use those to evaluate effectiveness of banks’ systems and controls for managing credit risk; (ii) collect information on connected lending, and 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 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 which exceed 10 percent of capital for fully effective monitoring of concentration risk.<sup>10</sup> (detailed recommendations in Appendix Table 1)

**27. Likewise, recommendations for supervision and regulation of international banks by SIFA have not been implemented.** Those recommendations addressed, inter alia; (i) the lack of individual capital requirements based on risk profile; (ii) the lack of guidance on banks' risk management; and (iii) the need to expand on-site inspections with an emphasis on asset quality and classification. There is still no Prudential 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 international bank. The 2007 assessment also expressed concern regarding: (i) the potential for infringement of the operational independence of SIFA, given the legal powers of the MoF to grant licenses and to take other important supervisory measures; (ii) the potential conflict between the SIFA's promotional and supervisory roles; and (iii) the minimal published data on the international banking sector. All these issues are still unaddressed. (detailed recommendations in Appendix Table 2).

**Table 3. Core Principles Assessed "Materially Non-Compliant" or "Non-Compliant" in 2007**

| Domestic Banks—1997 CPs                  |            | International Banks—1997 CPs             |            |
|--|------------|--|------------|
| CP 6 Capital Adequacy                    |            | CP 6 Capital Adequacy                    | <b>NC</b>  |
| CP 7 Credit Policies                     | <b>MNC</b> | CP 7 Credit Policies                     | <b>NC</b>  |
| CP 8 Loan Evaluation and Loss Provisions |            | CP 8 Loan Evaluation and Loss Provisions | <b>NC</b>  |
| CP 9 Large Exposure Limits               |            | CP 9 Large Exposure Limits               | <b>NC</b>  |
| CP 10 Connected Lending                  | <b>MNC</b> | CP 10 Connected Lending                  | <b>MNC</b> |
| CP 11 Country Risk                       | <b>MNC</b> | CP 11 Country Risk                       | <b>NC</b>  |
| CP 12 Market Risk                        |            | CP 12 Market Risk                        | <b>NC</b>  |
| CP 13 Other Risks                        | <b>MNC</b> | CP 13 Other Risks                        | <b>NC</b>  |
| CP 14 Internal Control and Audit         |            | CP 14 Internal Control and Audit         | <b>MNC</b> |

Source: 2007 BCP Assessment

## MAIN FINDINGS AND RECOMMENDATIONS

**28. The compliance with the Basel Core Principles was assessed according to the September 2012 methodology and based on the following steps.** The current status of bank regulation and supervision was described in the authorities' detailed self-assessment of observance completed before the main mission. In addition, the relevant laws and regulations were reviewed and interviews were conducted with the management and staff of the CBS' Financial Supervision

<sup>10</sup> The 2007 assessment had viewed as a positive development the then recent introduction of on-site inspection and its forecast continuation on a two year cycle. However, no further on-site inspections were undertaken until mid-2013, exception made for one AML/CFT inspection at each of the two indigenous banks.

Department, senior officials of the SIFA, and representatives from the domestic banks, and private audit firms.<sup>11</sup>

**29. The findings and recommendations are based on selected principles.** Not presenting a full-assessment format is predicated on Samoa’s small and simple banking sector. As a result, the discussion below is focused on those BCPs for which further development of procedures and practices would be the most important. Emphasis is placed on the supervisor’s powers, resourcing levels (which have a clear impact on supervisory practices and procedures), and the need for greater guidance from the supervisor to the industry on risk and its management. The current recommendations – substantive and demanding as they are – reflect a focused assessment and thus should be regarded as the “first cut” in supervisory development, even if addressed effectively, since the 2012 BCP methodology is more demanding than the previous methodologies and requires many more supervisory elements to be in place. For instance, it incorporates 39 new assessment criteria, comprising 34 “Essential” criteria and 5 new “Additional” criteria. In addition, 34 “Additional” criteria from the 2006 BCPs were re-categorized as “Essential” criteria that represent minimum baseline requirements for all countries assessed.

➤ ***Responsibilities, objectives and powers (CP 1)***

Inter alia, this Core Principle requires that banking laws, regulations and prudential standards be updated as appropriate.

**30. The FIA is the cornerstone of Samoa’s supervisory architecture and some areas merit attention for improvement.** The FIA should be amended to provide: (a) the CBS with legal capacity to waive large exposure limits in appropriate circumstances based on robust analysis.; (b) the CBS with power to remove bank Board members and senior executives when warranted; (c) a clear definition of a “significant ownership” position by a bank shareholder, with capacity for CBS to deem parties to be related and to require deductions of related parties’ exposures from capital when assessing a bank’s capital adequacy; and (d) the CBS with power to use certain administrative remedial measures, by removing the prior involvement of the Court in the matter.

**31. Power provided in the FIA for the issuance of regulations “necessary or expedient for giving full effect to this Act” should be used.** This power has never been used and should be exercised to set out detailed, prescriptive requirements on matters now covered (or omitted coverage) by the nine “Prudential Statements” issued to domestic banks by CBS between 1995 and 1999.

**32. The “Prudential Statements” issued by the CBS do not contain the detailed, prescriptive guidance that has become the international supervisory standard over time.** The current Prudential Statements (PSs) date from 1995–1999 and, firstly, set out the CBS’ overall approach to supervision and then address separately : (i) licensing, ownership and management;

<sup>11</sup> Auditing firms are not subject to quality assurance reviews, which is a weakness that should be addressed.

(ii) capital adequacy; (iii) concentration of credit exposure; (iv) liquidity; (v) “connected” lending and direct ownership interests; (vi) asset quality, provision for losses and suspension of interest; and (vii) accounting and internal control systems; and (viii) foreign currency exposures. However, the PSs should be amended to include new or improved supervisory requirements with respect to policies for controlling credit risk, connected lending, operational risk, interest rate risk, corporate governance and liquidity and, although not currently material, market and country risks.

➤ ***Independence, accountability, resourcing and legal protection for supervisors (CP 2)***

**33. In view of the CBS’ increased responsibilities, a careful assessment of staffing should be conducted.** The CBS has taken additional mandates since the last assessment which, in effect, give it responsibility for the supervision of all domestic financial intermediaries. While there is merit in such a centralization of responsibilities, it should be accompanied by allotment of sufficient dedicated resources of the required standard. (It is recommended below that an annual program of on-site inspections be initiated, primarily targeting the locally-owned banks. For the fiscal year ending June, 2015, it would be appropriate only to conduct on-site inspections of the two locally-owned banks, given the limited staff of the FSD. In this context, the sufficiency and technical skills of the staffing now available for bank supervision should be evaluated and additional resources sought, if necessary.)

➤ ***Supervisory approach; Supervisory techniques and tools; Supervisory reporting; and Corrective and sanctioning powers of supervisors (CPs 8-11)***

**34. The CBS should engage in an annual program of on-site inspections guided by risk-based supervision.** It should also target the locally-owned banks based on their higher relative riskiness. As a general principle, the on-site inspections should also be used to verify supervisory reports and obtain more information on classified assets, connected lending, and country exposures. (To date, only one cycle of prudential inspections has been completed for domestic banks.) In addition, the CBS should conduct an in-depth assessment of balance sheets, including an asset quality review of potentially vulnerable banks, possibly through appointing an experienced external assessor. As for the international banks, which are supervised by SIFA, no prudential inspections have been performed and published data is insufficient.

**35. The single cycle of prudential inspections on domestic banks completed in 2013 did serve to highlight significant issues with supervisory reporting.** Weaknesses were identified especially regarding classified assets and connected lending, highlighting the need for a consistent inspection program to be put in place. Historically, the CBS’ bank supervisory processes have been almost exclusively off-site and focused on review of prudential returns and published financial statements. The CBS’ current suite of returns has components filed weekly (condensed balance sheet and foreign exchange position), monthly (detailed balance sheet with schedules and computation of the bank’s capital adequacy ratios), and quarterly (income statement; summary of past due and non-performing loans; together with a schedule of 10 largest borrowers; schedule of credit portfolio and deposits by residual maturity). Notably absent is a bank’s liquidity profile showing “gap” positions, an omission which should be rectified.

**36. Information processing from prudential returns needs to be modernized for supervisors to have access to adequate data.** Returns are filed in “hard copy” and PDF format and data are subsequently recast by the CBS’ staff on spreadsheets for analysis of banks’ performance and adherence to prudential standards found in the FIA and PSs. This is a time-consuming process and the CBS should investigate obtaining a standard package for the electronic filing of returns.

**37. Banks should be required to report all single exposures over 10 percent of capital.** This would include many exposures that fall below the current 25 percent ceiling under the FIA and not captured by the present quarterly return of each bank’s 10 largest borrowers. In addition, the reporting does not provide sufficient information for full and effective monitoring of concentration risk.

**38. Banks should be required to submit an external auditors’ certificate verifying accuracy of returns to the CBS.** This procedure is expressly contemplated by the FIA, but has not been implemented to date. Given past performance of some banks, and any further delay in implementing an on-site inspection program, serious consideration should be given to using this power. Relatedly, the CBS should require each bank to deliver a copy of the “Management Letter”/“Internal Control Memorandum” provided to management by the external auditor at the conclusion of the annual audit.

**39. The CBS should address deficiencies in the implementation of Risk-Based Supervision (RBS).** While the CBS supervision staff has drawn benefit from participation in RBS workshops, gaps in full implementation of the practice are apparent.<sup>12</sup> An Institutional Profile and a Supervisory Plan for each bank is not maintained and, as previously noted, on-site supervision is sporadic. Moreover, 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 has revealed instances where this was not achieved, although the inspections were instrumental in revealing inaccuracy in prudential returns, particularly as regards asset quality, provisions for loss and suspension of interest accrual. It is clear that on-site supervision should play a greater role in the fulfillment of the CBS mandate as bank supervisor. Adequate resources should be engaged for the purpose, including experienced inspection staff from other jurisdictions to act as mentors.

➤ ***Home/host relationships; (CP13)***

**40. The CBS should regularly activate the provisions of the 5 June 2014 Multilateral Memorandum of Understanding with the APRA regarding ANZ.** Typically, APRA organizes conference calls with all relevant host supervisors of Australian banks every three to six months and will provide host supervisors of subsidiaries incorporated in overseas jurisdictions with its assessment of the parent, if requested. Such requests should be made by the CBS. It is also APRA’s practice to invite a representative from the host supervisor to accompany APRA when undertaking an inspection of Australian banks operating in the host supervisor’s jurisdiction. In the event that

<sup>12</sup> The most recent workshop was held at CBS in October 2014.

APRA arranges to make such an inspection of ANZ's Samoan subsidiary, the CBS would draw benefit from accepting the standard invitation.

➤ ***Corporate governance; Risk and its Management; Internal Control and Audit; (CPs 14-26)***

**41. Banks should be provided with more detailed guidance on corporate governance and risk management.** The guidelines date from 1995–1999 and the CBS should seriously consider their revision to cover all of these risks and those areas currently omitted. Specifically, the CBS should issue more detailed guidance to domestic banks on the standards to be observed in individual credit policies. The CBS would then use them to evaluate the effectiveness of banks' systems and controls for managing credit risk. Banks should also be required to have in place comprehensive risk management policies, approved at Board level, to enable them effectively to identify, evaluate, monitor and control material non-credit risks, including interest rate, market, liquidity, country and operational risks. In this context, the CBS should assess the adequacy of these policies and procedures during on-going supervision. As for the international banks, SIFA should develop guidance on all of these standards for the sector. To this end, the CBS and SIFA could benefit from a coordinated review of Prudential Standards already in use by banking supervisors in other countries. A coordinated approach, underpinned by an appropriate Memorandum of Understanding between the CBS and SIFA, would help guard against development of inconsistent standards in common areas of supervisory practice.

## Appendix I. Summary of 2007 Detailed Assessment Recommendations

### Appendix Table 1. Domestic Banking Sector

| 1997 Core Principle     | 2007 Recommendations   |
|-------------------------|--|
| CP 7 Credit Policies    | <p>CBS should develop a PS setting minimum standards for banks' own credit policies and then review the adequacy of banks' policies in relation to these standards and verify by on-site inspection that banks adhere to their own approved policies.</p> <p><i>Inter alia</i>, banks' credit policies should contain internal limits for exposures to single counter-parties, groups of closely related borrowers, economic sectors and geographical areas; and, as well, procedures for approving exposures to persons connected with the bank and internal limits for such exposures.</p> |
| CP 10 Connected Lending | <p>Notwithstanding the breadth of the definition of connected parties in PS 6, the CBS should be given discretion to make judgments on the existence of connections between the bank and other parties, in special circumstances.</p> <p>The CBS has not validated compliance with the law or PS 6, either via periodic collection of individual or aggregate information on connected lending or via on-site inspection.</p> <p>The CBS does not require information systems in the banks to independently identify, monitor, and administer such exposures.</p>                            |
| CP 11 Country Risk      | <p>The CBS should consider:</p> <ul style="list-style-type: none"> <li>• amending PS 4 and PS 7 to specifically address the unique characteristics of country and transfer risk; and,</li> <li>• periodically collecting information on specific country and transfer risk exposures.</li> </ul>   |
| CP 13 Other Risks       | <p>The CBS should issue specific guidance to banks on its requirements and expectations for management and control of operational risk and interest rate risk. (NB: The October 2006 revision and update of the BCPs separated risks currently addressed in this CP into three separate CPs for: (a) operational; (b) interest rate; and (c) liquidity risk, respectively.)</p>  |

## Appendix Table 2. International Banking Sector

| 1997 Core Principle                              | 2007 Recommendations   |
|--|--|
| CP 6 : Capital Adequacy                          | The Minister to issue a regulatory code (s.6 IBA)  |
| CP 7: Credit Policies                            | The Minister and Inspector should develop a regulatory code which sets standards for international banks' credit policies.   |
| CP 8: Loan Evaluation and Loan Loss Provisioning | The Minister and Inspector should issue a regulatory code requiring international banks to have internal systems for regularly reviewing their loans and other exposures, classifying them and making necessary provisions for losses promptly.  |
| CP 9: Large Exposure Limits                      | The Minister and Inspector should issue a regulatory code requiring international bank to address concentration risk, to include, <i>inter alia</i> , a definition of closely related groups (to be treated as single borrowers), a requirement to report all individual exposures exceeding 10 percent of capital and a prohibition on incurring single exposures exceeding 25 percent of capital without obtaining prior permission from the Inspector.  |
| CP 10: Connected Lending                         | The Inspector should consider addressing the following issues: <ul style="list-style-type: none"> <li>• lack of specific prohibitions on granting extensions of credit to connected parties on more favorable terms than those for others; unconnected parties;</li> <li>• lack of a specific requirement that transactions with connected parties be approve by the bank's Board, or that persons benefiting from such transactions be excluded from the assessment and decision-making thereon; and,</li> <li>• the Inspector does not require banks' information systems to identify, monitor and administer such exposures independently.</li> </ul> |
| CP 11: Country Risk                              | After analysis of specific risk exposure issues in all banks, the Inspector should issue appropriate requirements for risk management, internal control, and information systems, including necessary provisioning requirements, and monitor and control of such exposures and verify implementation of those requirements through periodic collection and analysis of pertinent information and through on-site inspections.  |
| CP 12: Market Risk                               | After analysis of specific risk exposure issues in all banks, the Inspector should, as necessary, issue appropriate guidance for risk management, internal control, and information systems and monitor and control of such exposures and verify implementation of those requirements through periodic collection and analysis of pertinent information and through on-site inspections.   |
| CP 13: Other Risks                               | After analysis of the specific risk exposure issues in all banks, the Inspector should issue appropriate guidance for risk management, internal control, and information systems and monitor and control of such exposures and verify implementation of those requirements through periodic collection and analysis of pertinent information and through on-site inspections. (The recommendation noted that the October 2006 revision and update of the BCPs separated the risks currently addressed in this CP into three, allowing operational, interest rate and liquidity risk to be addressed independently.                                       |
| CP 14: Internal Control and Audit                | The Inspector should provide guidance to the banks on its requirements for risk management and internal controls and accounting systems.<br>The Inspector should issue guidance for the corporate governance responsibilities of bank directors and management.<br>The Inspector should fully implement its on-site examination program, including comprehensive coverage of risk management, internal control, and audit systems.   |