

# ***10 Year Review of the Development of the Financial Sector of the Macao SAR***

## **Prologue**

*The Macao financial system has emerged from the adverse conditions arising from the Asian financial crisis since the establishment of the Macao Special Administrative Region on 20 December 1999. It has grasped the opportunity provided by the opening-up of gaming franchise initiated by the MSAR Government. The financial sector has also benefited much from the policies adopted by the Central Government, such as the “Closer Economic Partnership Arrangement (the “CEPA”)”, the liberalization of tourism under “individual visit scheme” and the “Pan Pearl River Delta Region Economic Cooperation Forum” which formed a regional cooperative mechanism involving 9 provinces and 2 special administrative regions. The buoyant economy, under the locomotive effect of the pillar industry, has enabled the local financial business to make a turn around and resume its rapid growth again. The financial industry, which provides leverage effect in economic development, plays an important role in overall economic development.*

## **The Banking Sector**

*The banking industry accounts for the lion’s share in the financial system. It has made full use of the burgeoning economy in the past 10 years to expand and grow. The practitioners in the banking sector have successfully resolved the non-performing credits accumulated before 1999. On one hand, internal management relating to credit vetting has been strengthened which ensures the safety of traditional loan/deposit business. On the other hand, banks have endeavoured to develop non-traditional business to expand the spectrum of financial services. Such innovations have greatly improved operating results. Profits made by banks have increased many years in a row, from which banks have been able to build up a higher capital which can withstand*

*financial impacts generated externally or internally. In the recently erupted international financial tsunami, our local banking sector has emerged unscathed, thanks to its enhanced risk control, management and resistance. Simultaneously, the sector has been able to maintain its level of business operation.*

*The number of licensed banks has increased from 23 in 1999 to 27 of which 16 are foreign capital banks. The source of capital comes from China, Portugal, the US, France, Chinese Taiwan, Hong Kong and local. In the past 10 years, bank assets have increased by more than twofold, from MOP139 billion to MOP428.1 billion; deposits have increased from MOP100.6 billion to MOP289.6 billion as per September this year; loans have increased from MOP53 billion to MOP170.3 billion. Besides, there has been a marked improvement in the quality of bank assets. Non-performing ratio was 20% in 1999 which has dropped to less than 1% as per end September this year. Profitability has risen in tandem with economic growth, after tax profit of the banking sector in 2008 was MOP3.39 billion. The banking system has ample capital, CAR (capital adequacy ratio) has been maintaining at a level of around 15% in the past 10 years.*

### **The Insurance Sector**

*Since Macao's return to China, the insurance industry has been faring well. Mandatory insurance relating to motor vehicles, employees' compensation and professional liability protects our citizens. Insurance products have diversified to meet market demand. Strict supervisory measures coupled with efficient prosecution procedures have been able to repress malpractices. Licensed life insurance companies have increased from 9 to 11; general insurance companies have reduced from 16 to 13. Capital of our insurance sector comes from China, Portugal, Canada, Bermuda, Australia, Hong Kong and Macao. Total assets of this sector have increased from MOP2.95 billion in 1999 to MOP18.5 billion as per end June 2009; total annual*

*premiums have increased from MOP1.03 billion (MOP670 million from life) to MOP3.46 billion (MOP2.55 billion from life) as per end 2008. The sector made a profit of MOP112 million in 2008, a sharp contrast to its losing position 10 years ago.*

*The implementation of law relating to private pension funds promulgated in 1999 has plugged the loophole in labour security in Macao by protecting the well beings of the working population after retirement. Up-to-date, there are 7 insurance companies and 1 pension fund management company operating in the market. There are 36 pension funds established (5 closed and 31 open) involving 587 pension schemes established by individual and institutional entities. There are 79505 beneficiaries covered by the pension funds which have aggregate assets valued at MOP4.6 billion in trust.*

### **Financial Supervision**

*In the process of development of the financial industry, financial stability forms the bedrock. The financial authorities insist to adopt a stern and prudent supervisory principle. The indigenous features of local markets have been taken into consideration in formulating timely, reasonable and effective supervisory regulations and policies. The authorities follow supervisory principles of international organizations, based on “risk based” principle, incessantly enforce regular supervision on banks, insurance companies and other authorized institutions. It includes onsite inspections, offsite surveillances and communications at regular intervals. In the course of supervision, the relevant regulations are being perfected. Timely and swift punitive measures are adopted. Under the proactive cooperation of financial institutions, effective supervision has been made possible. In this way, the target of maintaining steady development of the markets can be realized.*

*One thing worth mentioning is that our financial system has been impacted by a few financial incidents during the aforementioned period. We have experienced bank runs,*

*improper marketing of financial products and violation of sales of insurance, the supervisory authorities have followed up and treated the cases, effectively maintained operating order of the markets.*

*On the other hand, the financial authorities have been assiduously prompting financial institution to implement anti-money laundering and combating financing of terrorism measures. In 2001, the MSAR joined anti-money laundering organizations in Asia-Pacific region. In 2002, 2006 and 2008, guidelines relating to anti-money laundering and combating financing of terrorism were revised. The scope was extended to cover finance companies, financial intermediaries, money changers and remittance companies. These measures have effectively prevented and bashed money laundering which has enable the Macao financial sector to align with international standards in the requirements and practices in anti-money laundering. In view of the endeavours aforementioned, the results of our supervisory efforts on financial system have had the approval of international organizations. In the 2008 offshore financial centre appraisal conducted by the IMF, Macao was recognized to be basically in conformity with international standards and alignment with best practices.*

### **Monetary Policy and Management**

*The orderly circulation of currency and continued stable exchange rate safeguard macro-economic stability. All along, the financial authorities have strictly adhered to currency board system, firmly guarded an exchange rate policy which links the Pataca to Hong Kong Dollar, and actively promoted the circulation of the Pataca in neighbouring regions, especially the Guangdong Province. In 2004, the State Council sanctioned RMB business in Macao. The MSAR Government made use of the opportunity to facilitate the quoting of Pataca on foreign exchange centre in China, which no doubt enhanced the reputation and circulation of the Pataca. Empirical evidence has proven that the link between the Pataca and Hong Kong Dollar has*

*facilitated economic development of Macao and is beneficial to the Macao financial, economic and social stability.*

*The broader defined money supply (M2) increased from MOP90.1 billion in 1999 to MOP208.4 billion as per end September 2009. During this period, in order to facilitate circulation of our local currency and to mop up excess liquidity in the banking system, in addition to allowing interbank market to balance demand and supply of liquidity, the authorities continued to issue monetary bills which serve as an investment instrument and, at the same time, balance the supply and demand of liquidity.*

*In tandem with increased economic activities, the demand for currency in circulation has increased. The financial authorities ensure the supply of coins on one hand, and act through the 2 notes issuing banks on the other hand to ensure supply of notes of various denominations to satisfy the need of our citizens in this respect. Simultaneously, to alleviate the disputes arising from counterfeit notes, the financial authorities have paid special attention to the issue of counterfeit prevention. New notes are being issued on a timely basis with enhanced features against counterfeiting. The move ensures normal and orderly circulation of currency.*

### **Financial Infrastructure**

*With the continued perfection of financial infrastructure facilities, capital flow has been stimulated which strengthens economic activities. In August 2007 and June 2008, cross border clearing mechanisms with Hong Kong for HKD cheques and USD cheques were established. Macao has built up swifter and more secure cross border payment channel. Besides, under the auspices of the People's Bank of China, Macao has been able to work with Shenzhen and other neighbouring regions in promoting the use of multi-purpose debit cards. At the same time, the financial authorities have been mooting with related institutions of neighbouring regions on the establishment of a common platform*

*for fund clearing. At the moment, the Macao real time payment and clearing system under construction hopefully will interface with the real time clearing systems of the Mainland and Hong Kong. It will no doubt enhance efficiency in clearing cross border funds between Guangdong, Hong Kong and Macao, reduce settlement risks, promote deepened financial and economic cooperation and integration between the three regions.*

*RMB business in Macao started in November 2004. The initial stage includes deposits, exchange, remittance and bank cards. In line with financial cooperation between the two regions, it is hopeful that the scope will expand which will facilitate further advance in economic and trade relationship between the two regions. As per September 2009, deposits denominated in RMB amounted to 1.73 billion yuan. There are 7707RMB credit cards issued as per end September 2009. In 2008, exchange and remittance involving RMB amounted to 5.38 billion yuan and 260 million yuan respectively. During January to September 2009, the figures showed a sluggish trend.*

### **Financial Statistics and Research**

*Financial statistics help in the appraisal of performance of financial industry and the formulation of policy. High quality research enhances credibility of policy and capability of risk supervision. In perfecting financial research and statistics of Macao, more transparency and increased volume of market information dissemination have been entailed in addition to actively participating in international financial statistics cooperation programmes. As a result, efficiency of local financial markets, international reputation and knowledge of risk prevention have been enhanced. In the past 10 years, there has been a marked increase in the volume of financial information dissemination. Regular dissemination of statistics has been increased from one item to 9 items, which include balance of payments, investment in securities, and international banking business. In 2007, under the auspices of the People's Bank of China, Macao*

*applied for accession to the IMF “General Data Dissemination System” which has made alignment with international statistics standards possible. Starting from August 2007, the MSAR was able to have an independent page in the Dissemination Standards Bulletin Board of the IMF for the purpose of publishing relevant information.*

*There are special research and analysis on the issue of the overall economy and policy of the MSAR. Such information has been made available to the general public via the “Macao Monetary Research Bulletin” which is a quarterly publication started in December 2001. Apart from theses on Macao financial system written by economic researchers of the financial authorities, papers are also presented by local and overseas economists by invitation. The periodical serves as communication platform with the general public. Starting from 2005, the half-yearly “Monetary and Financial Stability Review” became available. It analyses the risks, opportunities and challenges inherent in contemporary financial markets. There are related reports and papers which are available on the web which local and overseas readers can share and discuss.*

### *Management of Reserves*

*Benefited from rapid economic growth, coupled with the huge quantity of foreign exchange earned from exports of services, there has been a brisk increase in forex reserves. As per end 1999, Exchange Reserves amounted to MOP22.9 billion which increased to MOP142.2 billion as at 30 September 2009. In addition, there was a sum of MOP10.2 billion transferred from Land Fund to the MSAR and it became MSAR Reserve Fund. After 10 years of investment management, the sum increased to MOP12.730 billion in the third quarter of 2009. The financial authorities have been vested with the responsibility of managing Exchange Reserves of the MSAR. A prudent but positive management principle has been adopted. Through the adoption of diversified management strategy, effective and extensive deployment of financial*

*products, the long term investment results and efficient use of liquid funds have been secured.*

### **Cross Border Communication and Cooperation**

*Expanded and deepened external communication and cooperation in financial domain can more effectively lead to economic diversification. The financial authorities attach much weight to cooperation with regional and international regulatory authorities and organizations. Communication between local financial sector with overseas counterparts will enable Macao market participants to explore bigger market and cooperation leading to fresh business opportunities. After return to China, regular meeting mechanisms have been established with the People's Bank of China, China Banking Regulatory Commission, China Insurance Regulatory Commission, Hong Kong Monetary Authority, Office of Commissioner of Insurance of Hong Kong, and Hong Kong Securities and Futures Commission, which have enhanced cross border financial supervision and information exchange. Local market participants find more business opportunities which can be exemplified by the possible cooperation in finance and insurance under the "CEPA" and the "Outline of the Plan for the Reform and Development of the Pearl River Delta".*

*Recently, the financial authorities have actively played a part in the SAR's efforts in promoting the platform function of Macao in economic and commercial cooperation between China and Portuguese speaking countries, particularly cooperation in the realm of economics, commerce, finance and insurance. Through various memoranda of understanding concluded with Bank of Portugal, Insurance and Pension Fund Supervisory Authority of Portugal and other financial regulatory authorities of Portuguese speaking countries, stable and regular links have been established. At the same time, through organized study tours by delegates of our financial sector and various seminars and conferences held in Macao, closer financial cooperation and*

*development have been made possible. In 2008 and April 2009, we hosted conferences of central banks and regulatory authorities of Portuguese speaking territories. Delegates from financial institutions of Portuguese speaking countries in Europe, Asia and Africa and commercial attachés of the PRC in Lusophone countries were invited to attend with a view to building up a financial cooperation mechanism under the framework of the Economic and Commercial Cooperation Forum of China and Portuguese Speaking Countries.*

### **Work Review**

*Although the financial authorities have been, in the past 10 years, fulfilling candidly all the duties, from nurturing, motivating to perfecting the healthy and steady growth of the financial system and much experience has been accumulated during the process, some deficiency can still be identified as development sometimes has failed to catch up with rapid changes in the markets. For instance, although some relevant regulations have been appropriately revised, the amendments may not be able to fully cope with the most recent requirements or changes in the markets. Besides, the MSAR has an open economy and is easily affected by economic fluctuations beyond its border which have a strong bearing on the management of financial system operation. When a financial crisis persists and the real economy wanes, market practitioners will have difficulty in maintaining profitability which will weigh on the overall capability to maintain a low non-performing ratio.*

*Second, globalization brings financial innovation which has tempted the practitioners to take high risk in pursuit of profit. Regulators are facing new challenges arising from risks inherent in securitization of financial products and application of derivatives. Thus, it is a prerequisite to enhance regulatory might and technical requirement. In addition, although guidelines relating to international money laundering and terrorism financing have been implemented, there is however room for improvement in this*

*respect for some institutions as revealed by onsite inspections. It purports that there is a need to strengthen training and law-abiding awareness in this respect.*

*In managing the Exchange Reserve and the MSAR Reserve Fund, it is pertinent to adopt a diversified management strategy to perfect investment risk management. Interest rate hedging has been applied to investment instruments of these funds, but overall investment risk hedging has yet to be implemented. At the same time, to gear away from over reliance on traditional fixed income investment instruments, a strategy to deepen diversification of investment products needs to be adopted.*

*In the endeavour relating to perfecting of financial infrastructure facilities, the construction work in respect of Pataca real time payment/settlement system appears a bit slow. In the course of appraisal, the interface of RMB clearing system with neighbouring financial system was not anticipated as scheduled and has thus left our financial infrastructure facilities behind. As a result we have failed to converge with the development of financial markets of neighbouring regions. After review, a visionary construction plan was formulated. Progress has been speeded up to coordinate with the future interface of the Pataca/HKD/RMB real time payment/settlement system which will have an impetus for the business development of local financial markets.*

*In compiling financial and economic research and data, deficiency and lack of systematic approach were found before the forming of SAR. At the same time, there were deviations from international standards in the methodology of compiling and processing procedure. After much effort, financial data were being consolidated and comprehensively treated up to a certain extent. However there are constraints relating to availability of facilities and professionals. As a result, there is still room for improvement while quality has yet to be enhanced.*

*After the return, AMCM proactively participated in many plans relating to statistics and research under the IMF. Our methodology in this respect has integrated into the modern international statistics compilation system and format. By taking into consideration local practical situation, financial statistics and reports aligned with international standards have been compiled and released. However, there exists some shortfall in terms of coverage, timeliness, in-depth study when compared to work of advanced countries. Thus, incessant review and correction is a continued task.*

### **Conclusion**

*The financial system of Macao has had a smooth sailing in the course of Macao's return to China. It was able to grasp new development opportunity when the SAR was founded. It has grown steadily from recovery. In coordinating the pace of market expansion and maintaining order of operation, the regulatory authority has rendered a positive function. The future may not be so rosy as the financial tsunami originated in the West has devastated the globe which exerts pressure on our economy. Benefited from numerous infrastructural items initiated by the SAR Government, we have started to see results of various economic stimulating policies. Coupled with the fact that the fundamental elements of the overall economy have been able to retain its vividity and the endeavour of all stakeholders in our financial system, the financial industry will certainly move forward to overcome all difficulties and threats, continue to co-ordinate in the allocation of social resources to produce an optimum result.*

*The financial authorities have been endeavouring to achieve the best result in carrying out the duties. Supports from the Central Government and the SAR Government have been secured. With the cooperation from relevant government agencies and participants, our financial system has been able to take on consecutive challenges and grow amid all these trials. It has greatly enhanced its ability to withstand risks. However, it is noted that erratic changes prevail in international markets which are rife*

*with challenges and crises. International financial upheavals erupt treacherously which give rise to unpredictability. There is an increase in illicit activities which emerge in different morph. Financial debacles occur frequently which pose greater challenge to governments and regulatory authorities.*

*The financial authorities play a key role in the construction work of an appropriate financial system. There is an opportunity when international financial regulatory bodies are starting to adjust their function in the present situation. We will find out an effective method to improve by referring to past experience and deficiencies identified. Regulatory authority is vested with the responsibility for financial affairs. It should be courageous in fulfilling its duties in accordance with legal framework. It should learn from experience, make up for any fallout in a timely manner to embody professionalism and accountability. At the same time, it should acquire support and cooperation from market participants in respect of regulatory work. It should earnestly listen and accept opinions and suggestions from practitioners and the community so as to make timely improvement, construct a better and appropriate regulatory body conducive to the sustainable and stable development of the financial system.*