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August 30, 2002

To: Members of the Executive Board

From: The Secretary

Subject: **Macao Special Administrative Region of the People's Republic of
China—Publication of Offshore Financial Center Assessment**

Attached for the information of the Executive Directors is the staff's assessment of the offshore financial sector of Macao SAR. The Managing Director has consented to a request by the authorities of Macao SAR to publish the assessment in accordance with the practices and procedures described in SM/01/228 (7/16/01). The posting of the assessment on the Fund's external website will be coordinated with its simultaneous release in Macao SAR.

Questions may be referred to Mr. M. Moore (ext. 38631), Ms. B. Baldwin (ext. 39454), and Mr. Grant (ext. 39910) in MAE.

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INTERNATIONAL MONETARY FUND

Monetary and Exchange Affairs Department



MACAO SAR

SPECIAL ADMINISTRATIVE REGION OF THE PEOPLE'S REPUBLIC OF CHINA

**ASSESSMENT OF THE REGULATION AND SUPERVISION
OF THE FINANCIAL SECTOR**

August 2002

Assessment of the Regulation and Supervision
of the Financial Sector

MACAO SAR Special Administrative
Region of the People's Republic of China

AUGUST 2002

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PREFACE

In July 2000, the Executive Board approved a program of assessments on the basis of the paper “Offshore Financial Centers—The Role of the IMF” published in July 2000. In this context, the Government and the Monetary Authority of Macau (AMCM)¹ and the Government of the People’s Republic of China, which is responsible for Macao SAR’s relationship with the IMF, invited the IMF to carry out an assessment in December 2001, of the extent to which the regulatory and supervisory arrangements for the financial sector complied with certain internationally accepted standards. The Macao SAR (Special Administrative Region of the People’s Republic of China) authorities indicated at the beginning of the assessment that they make no distinction in regulation and supervision between onshore and offshore activities. This assessment therefore covers both sectors. The assessment was carried out on the basis of the “Module 2” approach, as described in the above-mentioned paper of July 2000.

A team led by Mr. Neville Grant and which included Ms. Yuri Kawakami (both Monetary and Exchange Affairs Department of the IMF), Ms. Nadia Rendak (IMF’s Legal Department), Ms. Susan Hopkins (banking expert, US Office of the Controller of the Currency), and Mr. John Darwood (insurance expert, formerly Guernsey Financial Services Commission) carried out the assessment. Ms. Mariela Moreno (Monetary and Exchange Affairs Department) prepared the report. The team is most grateful for the excellent cooperation and hospitality received from the staff of the AMCM, other authorities, and a number of private sector bodies.

¹ The office of the Executive Director informed the Fund that the official name of Macao has been changed to “Macao Special Administrative Region of the People’s Republic of China.” Accordingly, in the title of this report, and elsewhere in the text, including the tables, Macao SAR will be used (see Secretary’s Circular No. 00/8 as of January 14, 2000 concerning Macao’s change of official name). The AMCM, the Portuguese abbreviation of the Monetary Authority of Macau, is widely used.

I. EXECUTIVE SUMMARY

The economy of Macao SAR is heavily dependent on tourism and gambling. The gaming industry accounted for 60 percent of government revenue and grants in 2001 and 30 percent of GDP in 2000. Following the rebound of a 4.6 percent increase in 2000, after four years of negative growth, the economy grew by 2.1 percent in 2001. The growth in 2001 was led by a surge in gambling receipts and visitors' expenditures, albeit with a decline in merchandise exports to the United States and the European Union. However, domestic demand remained weak, as a result of the sluggish construction and real estate markets.

The financial system of Macao SAR includes two types of institutions, namely deposit-taking institutions—mostly banks—and non-deposit-taking institutions such as insurance companies and finance companies. The deposit-taking institutions occupy a predominant position, accounting for more than 98 percent of total assets of the formal financial sector.

The Macao SAR financial sector, with assets of US\$18.2 billion, is small relative to that of some other offshore jurisdictions and does not create significant risk for the international financial system. For example, assets of banks in the Cayman Islands amount to more than US\$600 billion. Moreover, the offshore sector of Macao SAR is tiny—the assets of offshore banks amounted to only 0.2 percent of all banks assets, there were no offshore insurance companies and about 12 active international business companies.

The contribution of the financial sector to employment and to the economy, however, is important. It is estimated that the financial sector, both onshore and offshore, accounts for roughly 12 percent of GDP or somewhat less than the tourism's sector 30 percent.

At the end of November 2001, there were 23 financial institutions in Macao SAR—21 commercial banks; a government run postal bank and an offshore bank. The banking sector is relatively concentrated with two large banks, the Bank of China, Macao Branch and Tai Fung Bank Limited, together accounting for half of total assets and deposits of the entire system.

Macao SAR has 24 insurance companies, all engaged in domestic activities only, whose total gross premiums are about US\$138 million. Other financial institutions supervised by the AMCM include one finance company, with restrictive banking activities, ten moneychangers and two remittance companies. All of these financial institutions are authorized by the Chief Executive of the Macao SAR, on the recommendation of the AMCM.

Macao SAR does not host any investment banks and fund management companies. However, banks do service client accounts by taking orders for securities transactions in overseas markets.

At the end of November 2001, 31 non-financial companies were approved to conduct offshore business—16 have been incorporated, but only 12 were active—involving “back office” activities for their Hong Kong parents. While the offshore law provides for trusts and asset management, no such activities are currently being undertaken in Macao SAR.

Current policy is that all financial sector activities should be carried out in physical premises in Macao SAR, with accounting records and management available for inspection in the territory. Except for lower initial capital requirements for offshore compared with onshore,

there is no significant difference in the regulation and supervision of financial sector activities. This assessment will therefore cover both sectors.

The mission undertook a Module 2 assessment in accordance with the procedures agreed upon by the IMF's Executive Board in July 2000. This comprised a Basel Core Principles assessment of the supervision of the banking sector, an assessment of the insurance sector based on the International Association of Insurance Supervisors' (IAIS's) principles of insurance supervision, and a review of the registration and monitoring of international business companies' (IBC) activities.

With respect to the review of IBC's, which are usually privately held trading or holding companies that are typical in offshore jurisdictions, no agreed upon international standards are in place as yet. The review, therefore, is based on certain developing 'good practices' which have been applied in the Edwards Report on Crown Dependencies and the KPMG Review of Financial Regulation in Caribbean Overseas Territories and Bermuda.

The results of our assessments indicate that supervision is generally effective and thorough. It meets most of the international standards with respect to banking and insurance and is following 'good practices' with respect to the incorporating and monitoring of IBC's. Macao SAR is making considerable progress with respect to those principles with which it is not yet fully compliant or observant.

There is a high level of compliance with the Basel Core Principles for Effective Banking Supervision. Macao SAR is compliant with 16 of the principles, largely compliant with eight others and materially non-compliant with one—that is money laundering.

Insurance is also supervised to a good standard. Macao SAR is observant of eight of the Core Principles promulgated by the IAIS, largely observant of six others, and materially non-observant of one—that is on-site inspections. Two principles are not applicable.

The AMCM is the sole regulatory and supervisory authority for all financial institutions in Macao SAR. The AMCM carries out its duties diligently and has an intimate knowledge of the institutions under its supervision. There is some scarcity of resources, resulting in insufficient on-site supervision in the insurance sector. The AMCM is aware of these shortcomings and is making efforts to resolve them. The AMCM's activities are supported by a well-developed information technology (IT) system that provides a wide range of timely management information. This facilitates peer group analysis, trends and exception reports.

Current anti-money laundering measures as they relate to the Basel Core Principles, and the IAIS Principles need strengthening. The AMCM complies with accepted international standards of cooperation with foreign supervisory agencies with regards to the exchange of information and allows foreign home supervisors to conduct on-site reviews in Macao SAR.

Recommendations

Resources

The staff complement of the AMCM should be reviewed in light of current unfilled and the additional responsibilities and procedures manuals and training should be implemented so that these programs can be introduced and managed effectively.

Prudential aspects of anti-money laundering

The mission recommends that the government set up an FIU as soon as possible.

The revision of the anti-money laundering guidelines for financial institutions should be completed without undue delay. The revised AML guidelines should establish detailed rules on customer identification, the implementation of the “know your customer” rule, detection of suspicious transactions and training of staff. In the revision of the AML guidelines, account should be taken of the recent developments on the revision of the FATF 40 recommendations.

The AML regime applicable to banks and finance companies should be extended to other financial institutions, i.e., moneychangers, cash remittance companies, foreign exchange companies and other institutions supervised by the AMCM. It is important to make such other financial institutions subject to the anti-money laundering regime, as persons seeking to launder illicit proceeds may use those entities.

Mandatory reporting of cash transactions exceeding a specified threshold should be introduced.

The legal framework for the detection and reporting of suspicious transactions should be enhanced. For example, the legislation should be amended (i) to expressly prohibit warning (tipping off) customers when information relating to them has been reported to the Judicial Police or other competent authorities; and (ii) to require financial institutions to file a suspicious transactions report when a prospective client has refused to provide proper identification and the institution turns down the customer.

The publicity and training related to AML should be increased to enhance awareness of institutions, their staff and customers and the general public of the authorities’ AML’s efforts. Training should be organized for institutions’ staff on AML rules and procedures.

Currently, the AMCM does not have the resources to organize the necessary training. It does, however, recognize the importance of taking measures to make such training available for all interested parties.

Banking

The AMCM should be granted final prudential decision-making power under general policy guidelines set by the government. An amendment to the legislation to provide for operational independence for the AMCM should be enacted.

Additional staff should be added to ensure that banking risks are identified and supervision guidelines are developed and implemented in a timely manner. In addition, supervision manuals and handbooks (for example, internal controls, credit risk management, anti-money laundering) should be developed. They are useful in communicating the practices and standards expected of the banks, enhancing transparency to the supervisory processes, promoting consistency, and serving as a training tool.

Market risk should be included in the Basel capital adequacy ratio calculation and the AMCM should issue guidelines to banks regarding the circumstances where such risk should be included.

The identification and monitoring of concentration risk should be instituted by the AMCM, and an aggregate limit should be established on the amount of investment by financial institutions in shares, which are not financial holdings. Formal guidelines on the type (for example, government versus corporate) and quality (for example, investment rating) and amount of investments should also be put in place.

Country risk exposures should be classified and monitored on an individual country or cross-border basis, and an appropriate minimum provisioning policy should be introduced.

The AMCM should conduct formal assessments of market risk.

The AMCM should issue guidelines on, and conduct formal assessments of, interest rate risk.

The AMCM should complete the revisions to the circular relating to banks' anti-money laundering responsibilities, expeditiously. As a part of the effort to heighten public awareness, it may be useful for the bankers' association to issue a statement to show the industry's commitment to anti-money laundering.

The AMCM's examiners should continue to participate in anti-money laundering training, including workshops sponsored by the Asia Pacific Group on Anti-Money Laundering, to further develop expertise.

Legislation on mandatory reporting of suspicious transactions should be improved. Existing legislation should be amended to expressly prohibit "tipping-off".

Enforcement of existing legislation should be tightened, including a more vigorous application by the AMCM of sanctions for failure to report suspicious transactions.

Until the mistrust of the Judicial Police is overcome, the level of suspicious transaction reporting is not likely to see much change and the effort to combat money laundering will remain ineffective. The AMCM must continue to work with the banks, the bankers'

association, and appropriate law enforcement agencies with a view to building trust in the Judicial Police.

The introduction of mandatory reporting of cash transactions exceeding a specified threshold should be considered.

Insurance

Some further consideration should be given to the independence issue. The principle will only be seen to be fully observed when the AMCM is granted final prudential decision-making power under general policy guidelines set down by the government. An amendment to the legislation to provide for operational independence for the AMCM should be enacted.

The staff complement of the AMCM should be reviewed in light of the additional responsibilities of agents' examinations and on-site visits. Procedures manuals and training should be implemented so that those programs can be introduced and managed effectively.

The legal department should be encouraged to develop insurance expertise and to respond more readily to requests for assistance.

The supervisor should consider publishing guidance notes to clarify the legal framework for insurers and intermediaries.

The introduction of a procedures manual would be beneficial; this should include specimen application forms and check lists, and the specimen business plan should be expanded to include details of investments and sources of capital funds.

Where applications from foreign insurers are received, enquiry should be made of the insurer's home regulator as to his satisfaction with the proposal.

A practical approach to becoming more closely involved with corporate governance might be for the supervisor to write to all licensed insurers requesting a description of their corporate governance principles and the way in which they are followed through. Once this information has been received and digested further action could be formulated; this could range from recommending changes to the Macau Insurance Ordinance (MIO) to bring corporate governance within its ambit, to issuing guidelines as to regulatory expectations, to simply checking that satisfactory arrangements continue to operate. The latter should then be a permanent element of the on-site inspection process. New applicants should be asked to address the issue at time of application.

The supervisor should review the essential criteria to determine which elements might be best picked up within the previously recommended application form and those best dealt with at the time of annual reporting or of the periodic on-site visits. Check lists should be introduced to ensure all requisite aspects are covered at each of these points. The Guidance Notes on Prevention of Money Laundering should also be circulated to the intermediary sector.

The on-site inspection program should review the appropriateness of insurers investment and risk management policies.

In view of the increased regulatory involvement in market conduct, the supervisor has expressed a desire for more regular meetings with the industry associations that could only be beneficial. He has also raised the issue of public education regarding life insurance and those classes of compulsory insurance, for example automobile insurance. The mission recommends the continued development of these initiatives.

Checklists should be introduced for the annual review process for financial and statistical reports.

The mission recommends the implementation of the on-site inspection program that will contribute to the full observance of the standard for financial and statistical reporting.

The new program of on-site inspections should have a formal procedure, with checklists for both the visits and the subsequent review work in office. New staff should be added if necessary.

The AMCM might try to address the issue of coordination and cooperation among domestic regulatory and law enforcement agencies at the highest level. Some form of feedback to the insurance supervisor from domestic regulatory and law enforcement agencies would be very helpful.

No attempt should be made to further develop captive insurance business until an appropriate legal and supervisory support framework is in place.

Investments and securities

The legislation should be amended to provide more explicitly for the core objectives of the AMCM, including (i) protecting investors by preventing market manipulation and fraud and preserving markets' integrity, (ii) ensuring that markets are fair, efficient and transparent, and (iii) preserving the financial soundness of the supervised institutions and reducing systemic risk.

To ensure compliance with the principle relating to independence, the legislation should be amended to specify more precisely the scope of operational independence of the AMCM.

The AMCM should add staff to give it capacity to perform supervisory functions over companies acting as financial intermediaries or providing other securities or investment services.

SROs can be a valuable complement to regulatory oversight in achieving the objectives of securities regulation. As the securities industry in Macao SAR develops, it is recommended that the legislation be amended to allow and authorize SROs. The AMCM should then be encouraged to take into account Macao SAR 's unique circumstances, and the manner in which SROs could augment its own efforts in securities regulation.

The legislation should be amended to grant comprehensive powers to the AMCM in the investments and securities sector. Also, the investment funds legislation should be clarified as to what actions constitute offenses under the law and should provide for sanctions for such violations.

The legislation should be amended to provide the AMCM with inspection, investigation, surveillance and enforcement powers with respect to investment funds or financial intermediaries that are not banks.

The legislation should be amended to grant the AMCM the powers to share information with other regulators in Macao SAR and in other jurisdictions, provided that such information is requested for a specified purpose and that confidentiality of information is ensured. The AMCM should be able to share information with other regulators at its own initiative if such exchange of information is judged to be in Macao SAR's public interest and provided that the necessary safeguards are in place.

Companies

Current practice in a number of jurisdictions is either to forbid the use of bearer shares or to introduce provisions for their immobilization. Macao SAR should consider one of those options.

Legislation should be amended to permit the Macao Trade and Investment Promotion Institute (IPIM) to operate under general guidelines and thereby achieve operational independence.

II. BACKGROUND

A. Macroeconomic Developments²

Macao SAR, a former dependent territory under Portuguese administration, has become a Special Administrative Region (SAR) of the People's Republic of China (PRC) since December 20, 1999 under a joint declaration signed between Portugal and the PRC in 1987, similar to that for Hong Kong SAR. The Basic Law on Macao SAR preserves the social and economic system for 50 years following the transition in 1999 until 2049, within the Chinese formula of "one country, two systems." The jurisdiction remains a free port and a separate customs territory. There are few import tariffs or restrictions and no foreign exchange controls on current or capital international transactions. Insignificant in size (only 25.4 square kilometers) Macao SAR runs its own independent public finance and is self-governing except for foreign and defense affairs. The population census for 2001 put the number of residents at 435,235.

Macao SAR's economy is heavily dependent on tourism, (including gambling) and light manufacturing (mainly textiles and garments) and is closely related to the economies of Hong Kong SAR, the southern part of the PRC, and Taiwan Province of China. The gambling industry accounted for about 30 percent of the GDP in 2000, and for 60.1 percent

² With technical assistance from the Fund's statistical department, the Macao SAR authorities have made progress in improving major statistical data, including GDP, balance of payments, public finance, and monetary and financial statistics. The Fund's *International Financial Statistics* is expected to include some data on Macao SAR from 2002.

of the government revenue and grants, and 7.1 percent of employment in 2001.³ The manufacturing industry accounted for 9.7 percent of GDP in 2000, and 22 percent of employment in 2001.⁴ Manufactured goods are mainly exported to the United States (48.2 percent in 2001), the European Union (26.6 percent), and the PRC (11.7 percent). Compared to tourism and light manufacturing, the Macao SAR financial sector is small, and accounted for about 12 percent of the GDP in 2000, and only 3 percent of employment in 2001. The government is focusing on economic diversification, and is promoting the territory as a gateway to and from the PRC as well as a service center for foreign investors.

Following the rebound of a 4.6 percent increase in 2000, after four years of negative growth,⁵ the economy grew by 2.1 percent in 2001 (Table 1). The growth in 2001 was led by a surge in gambling receipts and visitors' expenditures,⁶ albeit with a decline in merchandise exports to the United States and the European Union. However, domestic demand remained weak, mainly as a result of the sluggish construction and real estate market.⁷ Reflecting weak domestic demand, consumer prices have continued to fall in recent years, while unemployment has hovered at 6–7 percent.

The government has traditionally conducted a prudent fiscal policy and has no public debt. Owing to a contractionary public expenditures policy pursued in recent years, the overall fiscal balance has improved.⁸

³ The monopoly of the gambling industry started in 1934, and has been held by the Sociedade de Turismo e Diversões de Macao (STDM) since 1962, whose latest contract expires at end-2001. The government has opened a public tender and the three concessionaires were announced on February 8, 2002.

⁴ Local textile manufacturers are expanding their production base in the PRC in view of the phasing out of the quota system by January 1, 2005, capitalizing on less expensive labor cost.

⁵ A burst of a bubble in the construction sector in 1996 was aggravated by the Asian financial crisis of 1997–98, which hit the economy hard, in particular, tourism including gambling.

⁶ Visitors' arrivals in 2001 reached a record high of over 10 million, increasing by 12.2 percent from 2000. In 2001, 50.6 percent of the visitors arrived from Hong Kong SAR, 29.2 percent from the PRC, and 14.1 percent from Taiwan Province of China. The increase of visitors was attributed to the region's recovery from the Asian crisis as well as to the improved security situation in Macao.

⁷ The number of buildings initiated, more than halved to 34 in 2000 from 74 in 1998, and further declined to 22 in 2001. The construction of both residential units and commercial offices has plummeted during this period.

⁸ The Macao SAR authorities have recently commenced compiling government finance statistics (GFS) in accordance with international standards. Fiscal data in Table 1 are based on the GFS's standards.

The local currency in Macao SAR, the pataca, has been pegged to the Hong Kong dollar under a currency board arrangement (CBA). The Hong Kong dollar widely circulates in Macao SAR. As the Hong Kong dollar is pegged to the U.S. dollar, the interest rates in Macao SAR are largely in line with those of the U.S. dollar. Credit to the private sector has kept shrinking since 1998, owing mainly to the decline in construction and real estate.

While the external balance of goods and services deteriorated in 1999, it recovered significantly in 2000, owing mainly to a surge in gambling receipts, and an increase in textile and garment exports.⁹ The growth of gambling receipts remained strong in 2001, but growth of the external balance of goods and services moderated greatly as a result of the decline in merchandise exports.

⁹ The Macao SAR authorities are planning to compile the balance of payments data in accordance with international standards.

Table 1. Macao SAR: Selected Macroeconomic Indicators, 1997-2001

Nominal GDP (2001)	US\$6.2 billion				
Average population (2001)	434,096				
GDP per capita (2001)	US\$14,281				
	1997	1998	1999	2000	2001
(Annual percentage changes, unless otherwise indicated)					
Real GDP/	-0.3	-4.6	-3.0	4.6	2.1
<i>Of which:</i> contribution of domestic demand	0.5	-3.2	1.1	-6.3	0.2
contribution of net external demand	-0.8	-1.4	-4.2	11.0	1.9
Composite consumer price index (period average) 1/	-3.2	-1.6	-2.0
Unemployment (in percent)	3.2	4.6	6.4	6.8	6.4
(In percent of nominal GDP)					
Overall fiscal balance 2/	1.7	-0.9	-1.0	1.6	3.6
Total revenue and grants	19.1	18.8	21.3	19.2	21.7
<i>Of which:</i> direct taxes from gambling	12.3	10.4	10.2	11.9	13.1
Total expenditure and lending minus repayments	17.5	19.8	22.3	17.6	18.2
(12-month percentage change, unless otherwise indicated)					
Money and banking					
Credit to the private sector	9.9	-12.5	-1.7	-7.1	-7.0
Broad money	4.8	3.0	6.3	-1.8	8.3
Interest rate (3-month interbank offered rate; end of period)	9.4	5.3	5.9	5.9	2.1
(In percent of nominal GDP, unless otherwise indicated)					
External balance of goods and services 3/	30.8	30.0	26.7	35.1	35.8
Exports of goods	30.6	32.9	35.9	41.0	37.1
<i>Of which:</i> textiles and garment	26.1	27.8	30.0	33.8	31.1
Imports of goods (f.o.b.)	36.0	36.9	41.5	45.4	47.8
Exports of services	45.1	43.7	44.2	52.9	60.7
<i>Of which:</i> gambling	30.8	28.2	26.8	32.1	36.5
Imports of services	9.0	9.7	11.9	13.4	14.1
Official reserves at AMCM (in millions of US dollars)	2,534.9	2,462.9	2,862.1	3,325.6	3,507.5
(In months of imports of good and nonfactor services)	9.6	9.7	10.5	11.0	11.0
(Nominal values)					
Real GDP (in millions of MOP)	55139.1	52618.8	51021.4	53380.6	54519
Nominal GDP (in millions of MOP)	55,894	51,902	49,021	49,742	49,802
GDP deflator	101	99	96	93	91.3
Annual change of GDP deflator	1.37	-2.70	-2.59	-3.01	-1.97
Annual change of composite CPI			-3.20	-1.61	-1.98
Composite					
CPI (Oct 1999-Sep 2000=100)		104	101	99	98
CPI (July/95-June/96)=100		102	99		
Visitor arrivals		6,949	7,444	9,162	
Overall fiscal balance	927	-485	-495	820	1,768
Total revenue and grants	10,697	9,781	10,447	9,557	10,813
<i>Of which:</i> direct taxes from gambling	6,869	5,414	5,008	5,936	6,502
Total expenditure and lending minus repayment	9,770	10,266	10,942	8,737	9,045
External balance of goods and services (MOP million)	17,216	15,592	13,095	17,473	17,848
Exports of goods (fob)	17,129	17,084	17,580	20,380	18,473
<i>Of which:</i> textiles and garment	14,566	14,441	14,728	16,804	15,504
Imports of goods (fob)	20,126	19,132	20,330	22,594	23,784
Exports of services	25,226	22,696	21,657	26,328	30,206
<i>Of which:</i> gambling	17,202	14,630	13,122	15,971	18,156
Imports of services	5,013	5,056	5,812	6,642	7,047
Imports of goods (cif)	16,603	15,596	16,300	18,098	19,170

Source: Macao SAR authorities.

1/ Owing to a change in the CPI basket, data prior to 1998 are not comparable.

2/ Presentation is based on the Government Finance Statistics (GFS) Standard. For year 2001, the figures are estimates.

3/ The authorities are planning to conform to the standard balance of payments statistics.

B. Domestic Sector

Banking

Twenty-two banks are licensed to conduct business in Macao SAR and one bank has an offshore license (a branch of a credit institution incorporated in Portugal), making a total of 23 banks. Of the 22 banks, 12 are locally incorporated (most of which are subsidiaries of overseas banks), including one postal savings bank, while 10 banks are branches of overseas banks. The banking sector is relatively concentrated with the two large banks (the Bank of China Macao Branch and the Tai Fung Bank Limited) together accounting for about half of the total assets and total deposits of the banking system. The total assets in September 2001 amounted to US\$17.8 billion (295 percent of GDP) and total deposits reached US\$13.3 billion (220 percent of GDP). In terms of capital origin, the share of Chinese capital was 57 percent, Portuguese capital was 16 percent, and local capital was 12 percent. (See Section IV for further details on banking)

Insurance

There are 24 insurance companies licensed to operate in Macao SAR. All conduct domestic business only. Nine are life companies while the remaining 15 are involved in non-life business. In terms of origin, 7 are local insurance companies and the remaining 17 are branches of overseas companies. In 2000, there were 1,467 insurance intermediaries, most of which were individual agents.

Gross premiums of non-life companies have kept declining in recent years reflecting the sluggish domestic economy, in particular, the construction and real estate market. However, the gross premiums of life companies have more than offset the decline in non-life companies' gross premiums, and the total gross premiums in 2000 reached US\$138 million (2.2 percent of GDP). (See Section V for further details on insurance).

Other financial institutions

The other financial institutions supervised by the AMCM include one finance company with restrictive banking activities, ten moneychangers, and two remittance companies. There is no primary securities market in Macao SAR. While banks take orders for securities transactions in overseas markets, they only do so on the client's account.

C. Offshore Sector

Compared with other offshore banking centers, Macao SAR has a short history of offshore banking development. Under the Modern Banking Ordinance (Decree-Law No. 35/82/M) in 1982, offshore banks were officially defined as one type of financial institutions for the first time. However, it was not until the Offshore Banking Ordinance (Decree-Law No. 25/87/M) of May 4, 1987 that licensing requirements, business scope, and the regulatory regime were specified. Repealing this Ordinance of 1987, the Decree-Law No. 58/99/M known as the Offshore Law was passed in October 1999 and became effective on November 1, 1999. The Offshore Law of 1999 defines the legal regime governing both financial and non-financial offshore activities.

The offshore financial business is regulated and supervised by the AMCM, while the offshore non-financial business is regulated and supervised by the IPIM.

The offshore sector of Macao SAR is very small and its development is still in an embryonic stage. Only one bank has been licensed as an offshore bank,¹⁰ and there are only 12 non-financial offshore companies, conducting largely back-office activities, operating as of December 2001.¹¹ While the Offshore Law provides for trusts and asset management, there are currently no such activities taking place in Macao SAR. There are also no offshore insurance companies operating in the jurisdiction.

D. Regulatory and Supervisory Framework of the Financial Sector

The AMCM¹² is the sole regulatory and supervisory authority for all financial institutions in Macao SAR, including banks, insurance companies, insurance intermediaries, a finance company, cash remittance houses, moneychangers, and other financial institutions. (The AMCM was established in mid-1989 as the successor institution to the Instituto Emissor de Macau or IEM) with the functions of a quasi-central bank and with the power to regulate and supervise the financial sector. The functions are set out in the Financial Systems Act of 1993, which consolidated all previous rules and regulations relating to the financial system.

Laws governing the financial sector

The general legal framework for the financial sector is set out in laws and decree-laws. In addition, the AMCM has issued notices and circulars as supplementary rules and regulations to maintain effective supervision. These regulations are readily available from the web site of the AMCM. Major legislation concerning the financial sector include the Financial Systems Act of 1993 (Decree-Law No.32/93/M, July 5, 1993), the law known as the Offshore Service Regime Law (Decree-Law No.58/99/M, October 18, 1999), the Macau Insurance Ordinance (June 1997) and the Insurance Agents and Brokers Ordinance.

Macao SAR has enacted three laws that deal with anti-money laundering (AML), including the Financial System Act of 1993, the Law on Organized Crime (July 30, 1997), and the Macao SAR Ordinance on Money Laundering (June 1998). (See Section III for further details on AML framework).

¹⁰ This offshore bank was licensed in 1993 under the Offshore Banking Ordinance of 1987.

¹¹ The first non-financial offshore company started operating in April 2001.

¹² The AMCM is governed by a Board of Directors, which reports to the Chief Executive of the Macao SAR, who appoints the members of the Board.

E. Prior Assessments of the Financial Sector

Macao SAR has received two assessments of its financial sector in recent years. The main findings of these assessments are summarized below.¹³

Financial Stability Forum

Subsequent to publication of its report on Offshore Financial Centers (OFCs) in relation to global financial stability (April 5, 2000), the Financial Stability Forum (FSF) published in May 26, 2000 a categorization of OFCs “reflecting their perceived quality of supervision and perceived degree of cooperation.” The FSF included Macao SAR in Group II, comprising “jurisdictions generally perceived as having legal infrastructures and supervisory practices, and/or a level of resources devoted to supervision and cooperation relative to the size of their financial activities and/or a level of cooperation that were largely of a higher quality than Group III but lower than Group I.”¹⁴

Joint APG/OGBS mutual evaluation report

The Asia Pacific Group on Money Laundering/Offshore Group of Banking Supervisors conducted a joint mutual evaluation on Macao SAR in April 2001. The report, issued in May 2001, made recommendations to strengthen the AML system. The recommendations are being actively considered and followed up by the SAR government.

III. ASSESSMENT OF GENERAL ISSUES

A. Responsibilities, Independence, and Resources

This chapter reviews issues that cut across all financial sectors, and therefore are assessed separately.

Responsibilities and independence

The responsibilities of the AMCM are to carry out the functions set out in Article 5 of its Charter, which came into force in 1996.

¹³ Neither the report by the Financial Action Task Force (FATF) on Money Laundering, June 22, 2000 nor the OECD List of Tax Havens June 26, 2000 mention Macao SAR.

¹⁴ The FSF stated in its press release of May 26, 2000: “it is important to stress that the categorization of Offs into these three groupings is based on responses of OFC supervisors and the impressions of a wide range of onshore supervisors at a particular point in time. The categorization does not constitute judgments about any jurisdiction’s adherence to international standards.”

The AMCM is charged with carrying out the responsibilities usually associated with a central bank. The responsibilities most relevant for the purpose of this assessment include:

- Advise and support the chief executive in the formulation and conduct of the monetary, financial, exchange rate, and insurance policies, by reporting and issuing opinions on the matters referred for its consideration;
- Study and propose the measures required for the execution of the monetary, financial, exchange rate and insurance policies and provide for their enforcement;
- Guide, coordinate and inspect the money, financial and foreign exchange and insurance markets, providing for their smooth operation and supervising the relevant operators, in accordance with these rules and with regulations applying to those activities;
- Act as intermediary in the monetary and financial external relations of the Macao SAR;
- Provide for the stability of the financial system, performing for this purpose the duty of lender of last resort;
- Act as a central depository for foreign reserves; and promoting the use of the local currency, the pataca. The AMCM provides for the minting of metal circulating and commemorative coins and does not issue notes. This latter function is undertaken by two commercial banks acting as agents of the Macao SAR Government according to article 108 of the Basic Law.

The mission understands that no marketing of Macao SAR as a financial center is currently being undertaken and that no such role is being contemplated for the AMCM.

Under the Act, all licenses for carrying out financial activities are granted by the Chief Executive of Macao SAR based on the advice from the AMCM.

The Chief Executive of Macao SAR appoints the chairman of the board of the AMCM—as well as all the other members of the board.¹⁵ The board comprises a minimum of three and a maximum of five members. Articles 14 and 15 of the AMCM's Charter also provide for a Supervisory Board (essentially an Audit Committee) and an Advisory Board.¹⁶

¹⁵ Members of the board of directors are all executives of AMCM and the chairman is the chief executive officer. Board meetings are held at least once a week.

¹⁶ The Advisory Board, according to Article 19 of the AMCM's Charter consists of the following members: Chairman and members of the Board of Directors of AMCM; Chairman of the Supervisory Board of AMCM; Chairman of the Macao Association of Banks; Chairman of the Macao Insurers' Association; and General Managers of the two note issuing banks, Bank of China Macao Branch and Banco Nacional Ultramarino S.A.

The functions of the Advisory Board are to give its opinion of the broad guidelines of the money, financial and exchange rate policy and of supervision of the money, financial, foreign exchange and insurance markets, as well as on the annual business strategy of the AMCM. The Advisory Board meets at least once every six months, when convened by its chairman or on a proposal of the majority of its members. Whenever he deems it convenient, the chairman may invite experts to participate in the meetings. The opinions of the Advisory Board are not binding on the AMCM.

As indicated above, the AMCM is not fully independent of the government of Macao SAR as decisions on licensing are the prerogative of the Chief Executive of Macao SAR. Nevertheless, in practice, the AMCM's daily supervision is fully discharged by its staff. We understand from the AMCM's senior staff that, despite the legal status, which appears to imply considerable dependence on government, there has not been any instance where the recommendations of the AMCM have not been accepted by government. The mission nevertheless has recommended, later in this report, that the AMCM be granted final prudential decision-making powers.

The AMCM liaises well with the government and consults with industry and government when making changes to broad regulatory and supervisory policy, or changes that have significant implications for industry.

Resources

As indicated earlier, the responsibilities of the AMCM include licensing and supervision of financial institutions; development of laws, regulations, and policies for the financial sector; as well as liaison with foreign supervisors and international and regional supervisory groups.

The AMCM is considering enhanced responsibilities in 2002. For example, it plans to introduce an on-site insurance program. This will result in each insurer being visited once every three years. It also intends to undertake greater responsibility for agents' examinations.

The AMCM has established an Institute of Financial Services (IFS), which was officially set up on March 8, 2002. The training provided by the IFS is intended to help to increase the operational efficiency of financial institutions. The founding members are, in addition to the AMCM, the Macao SAR Association of Banks, the Macao SAR Insurers' Association, the Macao SAR Insurance Agents and Brokers Association and the Macao SAR Federation of Professional Insurance Intermediaries.

The banking and insurance departments of AMCM currently employ 34 people, 24 are professional staff members, with 13 professionals and five support staff dedicated to banking supervision and 11 professionals and five support staff in insurance supervision. In banking supervision, all professional staff members are degree holders and 10 are qualified accountants. In the insurance sector, two examiners are actuaries, and most of the others hold professional qualifications or university degrees.

Currently, there is some scarcity of resources, and this has meant, for example, that the amount of on-site supervision of banks has been somewhat less than desirable. In addition, there is a general need for additional capacity for analytical and enforcement staff. The

demands of the various duties have also constrained the Department's ability to write on-site and off-site supervision manuals and to develop supervisory handbooks or guidelines.

Additional resources should be added to ensure that risks are identified and supervision guidelines are developed and implemented in a timely manner. In this regard, supervision manuals and guidelines should be developed. They are useful in communicating the practices and standards expected of the financial sector, enhancing transparency to the supervisory processes, promoting consistency, and serving as a training tool.

The AMCM should add staff to give it capacity to perform supervisory functions over companies acting as financial intermediaries or providing other securities or investment services. Resources should also be added to increase the publicity and training related to AML so as to enhance the awareness of institutions, their staff and the general public about AML matters. Training should be organized for institutions' staff on AML rules and procedures.

In addition, the mission understands that the legal department needs to develop insurance expertise so that it can respond more readily to requests for assistance.

The AMCM has already recognized the need for additional resources, noting that it would be an asset to have at least three more professionals to assist in all the supervisory areas.

The AMCM's sources of income for all of its operations, including regulation and supervision, are set out in Article 26 of its Charter. The sources are:

- The return on its assets and the proceeds of their disposal;
- The earnings from its operations and investments;
- The fees paid by the entities subject to its supervision;
- The earnings from the marketing of commemorative coins;
- The fines enforced in proceedings of infringement to the legal provisions and regulations governing the areas falling under its competence;
- The gifts, endowments, bequests or legacies that it may come to receive;
- Other income payable or assigned to it by law, regulation, contract, court or Chief Executive's decision.

The AMCM's budget is subject to overall guidelines that are applicable to all government departments. The Secretary for Economy and Finance issues guidelines that are applicable to all government departments and agencies. With those guidelines in mind, the Board of the AMCM draws up its budget to be approved by the Chief Executive.

In recent years, however, there has been pressure on the AMCM's budget, owing mainly to rising overhead costs to recruit, develop, and retain staff. Efforts to fill outstanding vacancies

have to some extent had to be postponed because of budget considerations, and also by the desire to find candidates with appropriate education and experience.

Many jurisdictions face this problem of requiring additional personnel since the increased levels of supervisory performance generally demand more supervisors.

Recommendation

The staff complement of the AMCM should be reviewed in the light of current unfilled and the additional responsibilities and procedures manuals and training should be implemented so that these programs can be introduced and managed effectively.

On the banking side, there is a fairly extensive training program and several members of staff have attended training programs organized by the Bank for International Settlements, the Financial Stability Institute, the Federal Reserve Bank of New York, the South East Asian Central Banks (SEACEN), and the South East Asia New Zealand Banking Supervisors Forum (SENZA). The average experience of staff engaged in banking supervision is about seven years.

On the insurance side, there is also a fairly extensive training program. Members of staff have attended courses given by the Insurance School of Japan, the IAIS, and the OECD. The average experience of the staff in this area is about seven years.

The AMCM's activities are supported by a well-developed Information Technology (IT) system that provides a wide range of timely management information. This facilitates peer group analysis, trends and exception reports.

B. Cross-Border Cooperation

The AMCM complies with accepted international standards for cooperation with foreign supervisory agencies with regards to the exchange of information. For example, the AMCM exchanges information with foreign supervisors in the framework of the licensing procedure, as well as during ongoing supervision. When an institution in a foreign country applies for a license to establish a subsidiary or branch in Macao SAR, the AMCM contacts the home supervisor asking for its views on the applicant and its approval of the establishment. With respect to branches and subsidiaries of foreign banks operating in Macao SAR, the AMCM may provide the supervisory authority of the home country with information, which in the opinion of the AMCM enables the home supervisor to exercise its consolidated supervisory functions.

The exchange of information between the AMCM and foreign supervisors is provided for in the legislation. Supervisory authorities that do not have an MOU with Macao SAR will only be able to obtain publicly available information. However, according to the AMCM supervisory authorities that have an MOU with Macao SAR can obtain customer account information, provided that the information remains confidential and is not used for any purpose other than supervision.

The AMCM frequently exchanges information with countries that have a memorandum of understanding (MOU) with Macao SAR, (see following paragraph) and seeks assistance

through formal and informal arrangements. Macao SAR has made two requests from countries with which it does not have an MOU and has received positive responses from the relevant home supervisory authorities.

Macao SAR has also signed MOUs with the People's Bank of China, the Hong Kong Monetary Authority, the Securities and Futures Commission of Hong Kong, the Bank of Portugal, the Insurance Commission of Hong Kong, and the Insurance Commission of Portugal. In 1999, an MOU was signed between AMCM and the Bank of Cape Verde. These MOUs describe the scope of, and procedures for, information sharing along with its confidentiality. It is estimated that more than 80 percent of the business conducted in Macao SAR would be covered under those MOUs.

The AMCM allows foreign home supervisors to conduct on-site reviews in Macao SAR and one such review has been conducted by banking supervisors.

The AMCM is a member of international groups including, the South East Asia New Zealand Banking Supervision Forum (SEANZA), the International Association of Insurance Supervisors (IAIS), the Offshore Group of Insurance Supervisors (OGIS), and the Offshore Group of Banking Supervisors (OGBS). In addition, Macao SAR is also a member of the Asia Pacific Group on Money Laundering (APG). The AMCM sends its staff to international seminars in which supervisory issues are discussed, and has particularly close contacts with the Hong Kong Monetary Authority, the Hong Kong Insurance Commission and the Hong Kong Securities and Futures Trading Commission, the People's Bank of China, the Bank of Portugal, the Portuguese Insurance Institute, and the International Association of Insurance Fraud Agencies.

C. Enforcement Remedies

The mission discussed with the AMCM the matter of enforcement remedies. The Financial System Act of Macao SAR (FSAM) provides the AMCM with a range of sanctions. These remedies are adequate for most purposes. The mission pointed out that, as a general rule, regulators are well served when they have the broadest possible array of enforcement tools at their disposal—even if some of the more robust remedies are most often held in reserve, or are used only in special cases. The availability of certain remedies is often sufficient to deter wrongdoers. In addition, to be fully effective in dealing with unexpected problems, the enforcement remedies must be in place before the need for them arises. One issue that was explored was that of civil money penalties.

Article 6 of the FSAM provides the AMCM with a wide array of regulatory powers, including the power to issue directives and regulations with respect to a wide variety of matters. In addition, Article 7 affords very broad powers to compel any public or private entity (and not limited to those under its regulatory and supervisory ambit) to provide the AMCM directly with information necessary to carry out its functions. Moreover, the AMCM can inspect any entity to determine if it is involved in activities exclusively reserved for financial institutions and this extends to any group to which a financial institution belongs. The AMCM can also confiscate any documents or valuables which constitute the subject of the offense or which are deemed necessary for legal proceedings.

The Act also requires the disclosure to the AMCM of all information on an institution and its subsidiaries (Article 10) and prior to launching a new financial product institutions must inform the AMCM of their respective nature and conditions. In Article 35, the Act includes powers of revocation in regard to a wide variety of matters and institutions must also obtain approval from the AMCM for significant changes in shareholdings. Although the Act deals with the relationship between external auditors and the AMCM, it makes no provision for the AMCM to change auditors in the event of failure of the latter to carry out their duties satisfactorily. The AMCM stated, however, that external auditors of financial institutions must be approved by the AMCM, and that in general audit contracts are usually for one year. The AMCM can refuse to sanction a renewal in the event that the previous year's work of the external auditors was unsatisfactory.

Sections II and III of the Act set out a fairly comprehensive set of special measures to deal with difficulties encountered by institutions and for remedies in the event of violations of provisions of the legislation or any regulations, instructions or guidelines issued by the supervisory authority.

The sanctions for violation of the provisions of the Act include:

- Fines, which can vary between MOP10,000 (US\$1,300) and MOP5 million (US\$700,000). In the case of an offense repeated within a period of one year the fine is twice the original;
- Suspension of voting rights of any shareholder for a period of one to five years;
- Prohibition from holding any board position or carrying out management or directorship duties in any institution under the AMCM's supervision for a period of six months to five years;
- Imprisonment of up to two years;
- Restrictions on the activities of institutions;
- Imposing higher capital ratios;
- Intervention in the management of the institution;
- Revocation or suspension of the authorization granted for carrying on business.

When the offense committed can be remedied and has not resulted in significant damage to Macao SAR's economy or its financial and monetary system, the AMCM may decide to issue a simple warning to the offender instructing him to rectify the offense within a period of time fixed by AMCM.

All cases must be submitted to the Chief Executive with an opinion issued by the AMCM recommending sanctions. The Basic Law of the Judicial Organization No. 91/1999, Article 36 provides that any decision that requires the Chief Executive's approval can be appealed to the courts.

D. Prudential Aspects of Anti-Money Laundering

Introduction

The assessment of Macao SAR's anti-money laundering regime in this report relates primarily to those standards contained in the Basel Core Principles, the IAIS Principles and the IOSCO Principles. While a legal framework for AML is generally in place in Macao SAR, improvements in several areas are recommended. These include, enhancing the framework for implementing the "know your customer" rule and suspicious transaction reporting for financial and other institutions subject to supervision by the AMCM; strengthening the general enforcement of the AML legislation, and enhancing cooperation between various agencies in charge of enforcement of the AML regime in Macao SAR and their cooperation with the authorities in other jurisdictions on AML matters.

Institutional framework

Several official agencies play a role in implementing anti-money laundering measures in Macao SAR. The AMCM is responsible for implementing the AML legislation with respect to the sectors it supervises, that is, the financial sector, including banks, insurance companies, and financial intermediaries. There is no special department within the AMCM overseeing the AML efforts. The staffs of the banking supervision department and insurance supervision department of the AMCM are in charge of supervising compliance of the credit institutions and insurance companies, respectively, with the AML legislation.

The Prosecutor's office is responsible for leading the detection and investigation of criminal activities, including money laundering, proceeding with criminal prosecution, and facilitating the processing of criminal cases, and the Judicial Police is the agency that receives suspicious transactions reports and has primary responsibility for investigating money laundering. Within the Judicial Police departments of financial crimes and serious crimes primarily handle money-laundering cases. Regionally, Macao SAR is a member of the Asia Pacific Group on Money Laundering (APG).

Macao SAR currently has no Financial Intelligence Unit (FIU). However, following a recent report on anti-money laundering efforts in Macao SAR by the APG, the Macao SAR authorities—recognizing that the police efforts need to be very much reinforced—have set up a working group. The members are as follows:

- Unitary Police Service of the MSAR;
- Customs Services of the MSAR;
- International Law Office;
- Public Prosecutions Office of the MSAR;
- Gaming Inspection and Co-ordination Office;
- Macao SAR Trade and Investment Promotion Institute;

- Department of Financial Services;
- Department of Economic Services;
- The Monetary Authority of Macau.

The AMCM stated that the authorities are considering the eventual establishment of an FIU. In this regard, they have already sought the assistance of a number of organizations, including the U.S. consular office in Hong Kong.

The AMCM noted that the Judicial Police are planning to set up a special unit staffed with persons with accounting and other financial skills to assist in the investigation of money laundering matters. The AMCM have agreed to give lectures, commencing in January 2002, to police officers on anti-money laundering issues. In addition, the AMCM has been in contact with the Hong Kong police regarding a training session for Macao SAR financial institutions to be held in May 2002, as well as participation in future seminars or training courses. The AMCM is also considering additional anti-money laundering training courses offered by the International Law Enforcement Academy in Bangkok and the US consulate in Hong Kong.

Recommendation

The mission recommends that the government set up an FIU as soon as possible.

Legislation

The legal provisions governing financial supervisory AML measures in Macao SAR are built on international treaties and the domestic legislation. The *Organized Crime Law* (Article 10) makes conversion, transfers or dissemination of illicit properties or proceeds, or facilitating any of the above-mentioned actions, while knowing that the properties or proceeds are derived from criminal activities, a criminal offense.

The *Macao SAR Ordinance on Money Laundering Decree-Law No. 24/98/M of June 1, 1998* (hereinafter, "Law No. 24/98") establishes that as a preventive measure against crimes of conversion, transfer or dissemination of illicit properties or proceeds referred to in Article 10 of the Organized Crimes Law, any operations suspected of involving conversion, transfer or dissimulation of illicit properties or proceeds are subject to mandatory reporting. The Law applies to entities subject to the supervision of the AMCM and the Inspectorate of Gaming, pawnbrokers, and entities engaged in trade of antiques, works of art, precious stones and real estate intermediaries.

The law requires that suspicious transactions be reported before, if possible, or immediately after their occurrence. In practice, suspicious transactions are reported to the Judicial Police in writing with a copy to the AMCM. The supervisory authorities must inform the Judicial Police immediately of any cases of money laundering which come to their knowledge in the course of their supervisory duties or otherwise. The law has an indemnity provision for those who report suspicious transactions.

Anti-money laundering guidance notes

The AMCM has issued AML guidelines for banking and insurance institutions. The *AMCM Circular No. 001/A/96-DSB/AMCM* of June 17, 1996 (hereinafter the “AMCM Circular”) establishes procedures for identification of customers for certain types of transactions, namely those without opening of a bank account that involved the amount exceeding 100,000 patacas. The AMCM Circular applies only to (i) credit institutions and financial companies with headquarters in Macao SAR; and (ii) branches of credit institutions in Macao SAR with headquarters abroad. The AMCM Circular does not currently apply to moneychangers and remittance companies.¹⁷ The AMCM Circular specifies procedures for customer identification for individuals and legal entities, establishes rules for record keeping and requires the institutions to establish a mechanism of internal control and provide training to the staff designated to deal with the issues covered in the circular.

In March 2001, the AMCM also issued a *Guidance Note on Prevention of Money Laundering in Insurance Business*. The Guidance Note provides detailed rules that the insurance companies should follow to prevent money laundering, including the “know your customer” principle and customer identification requirements, record keeping procedures, training requirements for the personnel of insurance companies, and some other aspects of the implementation of anti-money laundering measures.

The AML guidelines for financial institutions are currently undergoing a revision. The new guidelines will provide more detailed requirements for implementing the “know your customer” rule and will establish more detailed rules of record keeping, internal compliance and identification of suspicious transactions. The new guidelines will take account of the recent developments in the AML area, including the FATF 40 recommendations.

Recommendations

The revision of the anti-money laundering guidelines for financial institution should be completed without undue delay. The revised AML guidelines should establish detailed rules on customer identification, the implementation of the “know your customer” rule, detection of suspicious transactions, and training of staff. In the revision of the AML guidelines, account should be taken of the recent developments on the revision of the FATF 40 recommendations.

The AML regime applicable to banks and finance companies should be extended to other financial institutions, including moneychangers, cash remittance companies, foreign exchange companies and other institutions supervised by the AMCM. It is important to make

¹⁷ The AML guidelines for financial institutions are currently being revised. The new guidelines will apply to all financial institutions, including cash remittance companies and moneychangers, as well as to financial intermediaries. The new guidelines will introduce more detailed rules for reporting suspicious transactions. It is our understanding, however, that the new guidelines will not introduce mandatory reporting of cash transactions above a specified threshold. In preparing the new guidelines the authorities take account of recent developments in the international AML framework, including the FATF 40 recommendations.

such other financial institutions subject to the anti-money laundering regime, since persons seeking to launder illicit proceeds may use those entities.

Mandatory reporting of cash transactions exceeding a specified threshold should be introduced.

Suspicious activity monitoring and reporting

As noted earlier, suspicious transactions must be reported to the Judicial Police, as required by Law No. 24/98. In addition, the AMCM Circular and the AML Guidelines for insurance companies establish criteria for detecting suspicious transactions and provide examples of such transactions.

Nevertheless, the level of suspicious transactions reported in Macao SAR is very low. Since the introduction of the mandatory reporting in mid-1998, banks have filed only eight reports and insurance companies have filed the same number. According to the authorities, the low level of reporting may be attributed to several factors, the most important of which are historical mistrust of law enforcement agencies and low anti-money laundering awareness within financial institutions and among the general population in Macao SAR.

Recommendation

The legal framework for the detection and reporting of suspicious transactions should be enhanced across all sectors. For example, the legislation should be amended (i) to expressly prohibit warning (tipping off) customers when information relating to them has been reported to the Judicial Police or other competent authorities; and (ii) to require financial institutions to file a suspicious transaction report when a prospective client has refused to provide proper identification and the institution turns down the customer.

Training

Both the AMCM Circular and the AML Guidelines require that training and information be provided to the personnel on anti-money laundering issues. The guidelines for insurance companies are more detailed, setting out in Annex D recommendations on training to be provided to different categories of staff (for example, new employees, sales/advisory staff, processing staff, administration/operations supervisors and managers). The regulations also require ongoing training and suggest annual or semi-annual refresher courses on AML issues.

The AMCM has established an institute of financial training aimed at improving the operational efficiency of financial institutions. The founding members are listed on page 19.

Recommendations

The publicity and training related to AML should be increased to enhance awareness of institutions, their staff and customers and the general public of the authorities' AML's efforts. Training should be organized for institutions' staff on AML rules and procedures.

Currently, the AMCM does not have the resources to organize the necessary training. It does, however, recognize the importance of taking measures to make such training available for all interested parties.

Cooperation with other supervisors and competent authorities

The AMCM currently exchanges information with the Institute for Promotion of Investment, which is the regulatory agency for international (offshore) business companies. It also exchanges information about suspicious transactions with the Judicial Police - as expressly mandated by Law No. 24/98. However, the exchange of information with other law enforcement authorities is limited by the provision of Article 80 which provides that the confidentiality of information concerning relations between the institution and its customers may only be waived upon the customer's consent or by court order under the terms provided for in criminal law or in criminal procedure law.

The FSAM Article 78.6 expressly provides that information provided by the AMCM to foreign supervisory authorities is also protected by bank secrecy and cannot be revealed or used for any purpose other than the assessment of the conditions to grant an authorization to, or the carrying out of the supervision of financial institutions. If information is requested for purposes other than supervision, disclosure has to be authorized by a Macao SAR court. These rules apply to the exchange of information provided to foreign supervisors by the AMCM with whom it has signed memoranda of understanding. This includes the Hong Kong Monetary Authority, the Hong Kong Securities and Futures Commission, the Insurance Commission of Hong Kong, the People's Bank of China, the Insurance Commission of Portugal, and the Bank of Portugal.

The gaming sector

Given the importance of the gaming industry to the economy of Macao SAR, it is important to ensure that a proper AML framework for this sector be put in place. While entities subject to the supervision of the Inspectorate of Gaming (particularly casinos) are subject to mandatory reporting of suspicious transactions pursuant to Law No. 24/98 (Articles 2 and 3), enforcement of these provisions has been weak. Casinos have not filed any suspicious transaction reports since the introduction of the mandatory reporting.

IV. ASSESSMENT OF BANKING STANDARDS

A. Introduction

The banking sector is comprised of a total of 23 banks, including one bank with an offshore license. Branches and subsidiaries of foreign banks, accounting for 88 percent of total banking assets at end-September 2001, dominate the sector. The offshore bank, a branch of a foreign bank, only has a 0.2 percent share of total banking assets. The banks operating in Macao SAR are engaged in traditional banking activities. Due to the economic slowdown, bank loan-to-deposit ratio has declined steadily from a peak at about 64 percent in 1997 to 47 percent at end-September 2001. Trading activities are small in scope, are generally focused on foreign currencies, and are mainly transacted for the banks' customers. Insurance and securities activities are confined to agency capacity.

The 1993 Financial System Act of Macao SAR (FSAM) is the primary statute covering the banking sector. The FSAM gives the AMCM the authority to supervise and ensure stability of the financial system. Under FSAM, all financial institutions are subject to an annual supervision fee based on size and the number of branches.

The AMCM is governed by a board of directors, which is currently comprised of four members, including the chairman of the board. A board member has oversight of the Banking Supervision Department, which is headed by two deputy directors and assisted by 11 technical and five support staff.

The Banking Supervision Department is responsible for licensing, ongoing supervision, and policy development. Also, the department has responsibility for developing laws and regulations, as well as liaising with international and regional supervisory groups. Except for lower capital requirements for offshore banks, the licensing and supervision of domestic and offshore banks is the same.

The licensing procedures follow best international practices. They include the submission of an application from the prospective bank, its shareholders, directors, management, and external auditor. The requirement also includes a business plan, an assessment of impact to local economy and financial policies, and discussions with the applicant. The fit and proper test is applied to shareholders, directors, and managers, as are requirements relating to experience and expertise, the group structure in which the applicant belongs to, financial resources, and operational controls. Where applicable, assurance of consolidated supervision by the home country supervisor and evaluation of reciprocity treatment are applied.

The ongoing supervision regime embraces both on-site visit and off-site reviews. On-site supervision is based on a two-year cycle, applying the CAMEL concept. Also, internal audit and anti-money laundering are included in the scope of the review. Prudential meetings are held once a year with senior management of all banks. The subjects discussed at these meetings include matters outstanding, organization and operations, strategies, and general banking issues. Tripartite meetings are held following receipt of the external auditor's report. The AMCM requires an annual external audit of the financial statements of the bank. The law also enables the AMCM to conduct special audits of financial institutions whenever it is considered necessary and some of these have been conducted.

In off-site reviews, banks submit reports that are analyzed and discussions are held with management when necessary. Reports required to be submitted include:

- Weekly: Liquidity report
- Monthly: Solvency report
 - Monetary statistical return (asset/liability and income accounts)
- Quarterly: Large exposure report
 - Bad and doubtful loans report
 - Calculation of own funds (CAR)—local bank report
 - Weighted exposure—foreign bank branches report
- Annually: Income statement and balance sheet (to be published)

B. Assessment

In general, there is a high level of compliance with the Basel Core Principles for Effective Supervision of Banking in Macao SAR. Macao SAR is compliant with 18 of the principles, largely compliant with six of the principles, and materially non-compliant with only one principle. There are no instances of noncompliance. This assessment is summarized in the attached table.

The assessors noted that the nature of business undertaken is relatively traditional and straightforward. The AMCM has the necessary legislative base to undertake effective supervision, and carries out its functions in a professional and dedicated manner. The mission found that the AMCM carried out its duties diligently, and had an intimate knowledge of the banks under its supervision. Its approach appeared informal but this is a characteristic of small jurisdictions, where the regulators and principals of regulated entities are well known to each other. During the course of the review, the assessors visited a number of banks and noted that there was general acknowledgement of the AMCM's professional approach.

Areas where improvements would be beneficial

Independence and Resources (BCP 1.2)

Macao SAR is largely compliant with this principle. The assessment took into account the legal structure as well as implementation. The FSAM provides that final decisions involving supervision fees, licensing, special (credit exposure) limits, special (supervisory) measures, and intervention rest with the Chief Executive of Macao SAR, on advice from the AMCM. This structure could allow government to interfere in the operational independence of the AMCM. However, there is no evidence that such interference has occurred so far.

The responsibilities of the Banking Supervision Department include licensing and supervision of financial institutions; development of laws, regulations, and policies for the

financial sector; as well as liaison with foreign supervisors and international and regional supervisory groups. The demands of the various duties have constrained the Department's ability to write on-site and off-site supervision manuals and to develop supervisory handbooks or guidelines.

Recommendations

The AMCM should be granted final prudential decision-making power under general policy guidelines set by the government. An amendment to the legislation to provide for operational independence for the AMCM should be enacted.

Additional staff should be added to ensure that banking risks are identified and supervision guidelines are developed and implemented in a timely manner. Another consideration is that supervision manuals and handbooks, for example, internal controls, credit risk management, anti-money laundering should be developed. They are useful in communicating the practices and standards expected of the banks, enhancing transparency to the supervisory processes, promoting consistency, and serving as a training tool.

Capital (BCP 6)

Macao SAR is largely compliant with this principle. The AMCM has not addressed market risk in its capital adequacy ratio calculation on the grounds that except for two banks with local capital, Seng Heng Bank Ltd. and Delta Asia Bank Ltd., all the others are branches or subsidiaries of overseas banks. The AMCM plans to address market risk by 2004 when the new Basel capital guidelines are expected to become effective.

Recommendation

Market risk should be addressed in the Basel capital adequacy ratio calculation and the AMCM should issue guidelines to the banks regarding the circumstances where such risks should be included.

Loan Principles (BCP 7)

Macao SAR is largely compliant with this principle. The AMCM monitors each bank's loans that are greater than 15 percent of capital. Concentration risks to industry sectors are monitored by the AMCM through monthly and quarterly reports. However, there is no specified aggregate limit on investment in shares that are not financial holdings and there is no formal supervisory guideline on investments in debt securities.

Recommendation

The identification and monitoring of concentration risk should be instituted by the AMCM, and an aggregate limit should be established on the amount of investment by financial institutions in shares, which are not financial holdings. Formal guidelines on the type and quality (for example, government versus corporate or for example, investment rating) and amount of investments should also be put in place.

Country Risk (BCP 11)

Macao SAR is largely compliant with this principle. Exposures are not formally identified and monitored on an individual country or cross-border basis, nor have requirements been set on provisioning against transfer risk. The banks have low levels of international lending and investment activities outside China. But, Mainland China has a separate and different political, economic, social, and foreign exchange control structure and conditions. Events in Mainland China could adversely affect the banks' financial interests. In addition, Hong Kong SAR is a separate jurisdiction from Macao SAR.

The AMCM indicated that it informally monitors exposures to Mainland China and other countries. Moreover, a high proportion of banks are branches or subsidiaries of banks whose parent is located in a well-regulated jurisdiction overseas. The parent banks establish country and transfer limits based on the parent's capital and the supervisory authorities in the parent's home jurisdiction monitor operations on a consolidated basis. There are two banks with local capital and they have low exposure to Mainland China.

Recommendation

Country risk exposures should be classified and monitored on an individual country or cross-border basis, and an appropriate minimum provisioning policy should be introduced.

Market Risk (BCP 12)

Macao SAR is largely compliant with this principle. There is no formal requirement on assessment of market risk. However market risk is low. There is some intra day trading in foreign exchange and a few banks invest in equities for their own portfolio. As indicated, above the banks are also operating on the basis of guidelines from their parent banks.

Recommendation

The AMCM should conduct formal assessments of market risk.

Other Material Risk (BCP 13)

Macao SAR is largely compliant with this principle. There is no formal requirement on assessment of interest rate risk. The AMCM has, however, issued guidelines on liquidity. They also review internal auditors' reports during on-site visits and external auditors are required to report to the AMCM. Any matters that come to their attention during the course of their audit that will jeopardize the soundness of the bank.

Recommendation

The AMCM should issue guidelines on, and conduct formal assessments of, interest rate risk.

Money Laundering (BCP 15)

Macao SAR is materially non-compliant with this principle. Under Circular No. 001/A/96-DSB/AMCM, the banks are required to obtain identification of customers at account opening, and on cash transactions over MOP 100,000 with non-bank customers. In addition, the Circular requires the banks to designate a compliance officer and to establish training for appropriate personnel. Under Decree Law No. 24/98/M, the banks are required to report suspicious transactions to the Judicial Police and the AMCM. The investigation of suspicious transactions is conducted by the Judicial Police. There is no supervisory requirement on reporting cash transactions over a specific threshold amount. Since the decree law on suspicious transaction reporting was passed in 1998, banks have filed only eight suspicious reports.

The AMCM noted that, in practice, the banks have established internal thresholds to monitor large cash transactions. The transactions are analyzed and reported when determined to be suspicious. However, it appears that there is a distrust of the Judicial Police, and the banks have chosen to close the accounts rather than report the transactions.

The AMCM is revising Circular No. 001/A/96-DSB/AMCM. The revisions being made include broadening the type of financial institutions to be covered; standardizing the suspicious reporting format; specifying the information to be obtained for remittances and money exchanges, lowering the identification requirement for cash transactions non-bank customers to MOP20,000; specifying the penalties for noncompliance with suspicious reporting requirement; regular reporting of high risk accounts to management and the compliance officer, and requiring independent testing by internal auditors.

Recommendations

The AMCM should complete the revisions to the circular relating to banks' anti-money laundering responsibilities, expeditiously. As a part of the effort to heighten public awareness, it may be useful for the Bankers' Association to issue a statement to show the industry's commitment to anti-money laundering.

The AMCM examiners should continue to participate in anti-money laundering training, including workshops sponsored by the Asia Pacific Group on Anti-Money Laundering, to further develop expertise.

Legislation on mandatory reporting of suspicious transactions should be improved. Existing legislation should be amended to expressly prohibit “tipping-off”

Enforcement of existing legislation should be tightened, including a more vigorous application by the AMCM of sanctions for failure to report suspicious transactions.

Until the mistrust of the Judicial Police is overcome, the level of suspicious transaction reporting is not likely to see much change and the effort to combat money laundering will remain ineffective. The AMCM must continue to work with the banks, the bankers’ association, and appropriate law enforcement agencies to build trust in the Judicial Police. (See also the section on Anti-Money Laundering Guidance Notes).

The introduction of mandatory reporting of cash transactions exceeding a specified threshold should be considered.

Table 2. Compliance with Basel Core Principles

Core Principle (CP)	Principle	Degree of Compliance				Comments including improvements underway
		Compliant	Largely Compliant	Materially Non Compliant	Non Compliant	Not Applicable
1.1	Clear supervisory responsibilities	X				
1.2	Independence and resource		X			The AMCM is not fully independent of the Government of Macao SAR. The demands of the various duties on the Banking Supervision Department have constrained the Department's ability to write supervision manuals and develop supervisory guidelines and handbooks.
1.3	Legal framework	X				
1.4	Supervisory powers	X				
1.5	Legal protection	X				
1.6	Information sharing	X				
2	Permissible activities	X				
3	Licensing	X				
4	Transfer of ownership	X				
5	Acquisitions and investments	X				
6	Capital requirements		X			Market risk has not been incorporated into the Basel capital adequacy ratio calculation. The AMCM plans to address market risk by 2004 when the new Basel capital guidelines become effective.
7	Loan and investment principles		X			Concentration risk needs to be more rigorously monitored. There is no regulatory aggregate limit on investments in shares that are not financial holdings. There is no formal supervisory guideline on investments in debt securities.
8	Loan classification	X				
9	Large exposures	X				
10	Connected lending	X				
11	Country risk		X			Exposures are not formally identified and monitored on an individual country or cross-border basis. Also, requirements have not been set on provisioning against cross-border risk and transfer risk.
12	Market risk		X			There is no formal requirement on assessment of market risk.
13	Other material risks		X			There is no formal requirement on assessment of interest rate risk.
14	Internal controls	X				
15	Money laundering			X		Supervisory guidelines have been issued on anti-money laundering, but a very small number of suspicious transaction reports have been filed. It appears that there is a distrust of the Judicial Police, a separate Macao SAR government agency that receives suspicious transaction reports, and has primary responsibility for investigating money laundering, and the banks have chosen to close the accounts rather than report the transactions.
16	On-site-off-site supervision	X				

Core Principle (CP)	Principle	Degree of Compliance					Comments including improvements underway
		Compliant	Largely Compliant	Materially Non Compliant	Non Compliant	Not Applicable	
17	Understanding banks' operations	X					
18	Consolidated reporting	X					
19	Independent validation	X					
20	Consolidated supervision	X					
21	Accounting and disclosure	X					
22	Corrective action	X					
23	Global supervision	X					
24	Cooperation with foreign supervisors	X					
25	Foreign banks' branches	X					

V. ASSESSMENT OF INSURANCE STANDARDS

A. Introduction

There are 24 insurance companies that operate in Macao SAR and all serve the domestic market. Fifteen companies transact non-life business and nine transact only life business. Composite both life and non-life insurers are not permitted. Seven of the companies are local and the remaining 15 are branches of overseas companies from eight different countries, including Japan, United States, United Kingdom and Bermuda. There is a large intermediary sector with almost 1800 agents, salesman, and brokers. Gross premiums in 2000 were P 348 million non-life and P 755 million life. Non-life has declined from a peak of P 413 million in 1996, due to the general economic downturn during those years; the non-life business has, nevertheless, remained profitable.

There are three representative bodies: the Macao SAR Insurers Association, the Insurance Agents and Brokers Association, and the Federation of Insurance Intermediaries.

At the time of writing there are no captive insurance companies in Macao SAR. This assessment is conducted with the understanding that no captive insurance business will be carried on from, or within, Macao SAR until an appropriate supervisory system is put in place (see further discussion at end of this section).

The ultimate authority for the supervision of the insurance market rests with the chief executive of Macao SAR while the day-to-day supervisory functions are the responsibility of the AMCM through its Insurance Supervision Department. This department is sixteen persons strong, with collectively a great deal of experience. Legal assistance is available through the legal department.

The current insurance laws comprise the Macau Insurance Ordinance (MIO), which covers insurers, and the Insurance Agents and Brokers Ordinance (IABO), which covers intermediaries. The latter was updated during 2001.

The Insurance Supervision Department takes a lively interest in international insurance affairs; Macao SAR is a member of the International Association of Insurance Supervisors, the International Association of Insurance Fraud Agencies, and the Offshore Group of Insurance Supervisors, of which it became a full member this year. A further example of international activity is found in the hosting, in November of this year, of the conference "Challenges and Opportunities for Insurance in Asia in the New Millennium" which drew 461 attendees. The Insurance Supervision Department also offers training assistance to jurisdictions such as Cape Verde and Sao Tome and Principe, and has a Memorandum of Understanding with the Insurance Commissioner in Hong Kong (six Macao SAR insurers have head offices there) the Portuguese Insurance Supervisory Authority (ISP) and the Bank of Cape Verde.

The significance of these agreements to the development of the Macao SAR insurance supervisory regime should not be overlooked. Recently Hong Kong has assisted with the preparation of the new Agents Examination Program while the ISP has assisted, among other things, with the Private Pensions Funds legislation, which the AMCM has been responsible for since March 1999.

B. Assessment

The standards and practices of insurance supervision were reviewed in comparison with the Insurance Core Principles Methodology promulgated by the International Association of Insurance Supervisors (IAIS). The mission considers that to date the supervisory office has operated quite effectively within its regulatory framework; has recognized the need for updating certain areas, including agents examinations, and on-site visits for instance, and is taking steps to deal with them.

The mission considers Macao SAR to be observant of eight of the 17 Core Principles of Supervision, largely observant of six, materially non-observant of one, and two principles of supervision, those dealing with corporate governance and derivatives, are not applicable. In fact, the updating referred to above should, when implemented, improve the situation to the point of 13 fully observant principles, two largely observant, and two not applicable.

Areas where improvements would be beneficial

The following paragraphs contain the main recommendations of the mission, mainly applicable to those principles of which Macao SAR was either largely or materially non-observant.

Organization (IAIS 1)

Macao SAR is largely observant of the principle, the main issue being, somewhat arguably, that of independence. The insurance supervisor is to all intents and purposes operationally independent; although all significant decisions need ratification by the Chief Executive of Macao SAR, we are informed that there have been no instances where ratification has been disallowed over the last 20 years.

Financial support comes from the income of the AMCM. The staff comprises 11 involved in line supervision and five support staff, two of the examiners being actuaries. Whilst the current workload is manageable, there is likely to be a need for expansion next year to deal with the introduction of the pending agent examination system and the proposed increase in regular on-site inspections.

Recent updates to the insurance legislation have provided the supervisor with the requisite powers and responsibilities to carry out his functions more effectively; this is not to say that the past has been ineffective but that industry developments and international supervisory expectations have prompted up-dating. Activity over the past year has included the revision of the insurance laws (all after discussions with industry associations); the production of Guidance Notes on the Prevention of Money Laundering, and cooperation and assistance in training and regulation (including staff exchanges) extended to other former Portuguese colonies.

Legal assistance may be requested from the AMCM legal department, but the Supervisor finds that there can be a lack of availability, and, more important, a lack of insurance expertise. Currently the Supervisor is obliged to fall back on the Portuguese supervisory office (ISP) for assistance on insurance related legal issues.

There are several laws that affect the operation of an insurance entity, the basic ones being the Macau Insurance Ordinance and the Insurance Agents and Brokers Ordinance. The Commercial Code (which contains, among other things, the Insurance Contract Law) also deals with rights and duties of board members, and the Civil Code deals with agent/principle relationships. The Insurance association has expressed some concern over this slightly confusing situation and the supervisor agrees that some guidance notes might be helpful.

Recommendations

Some further consideration should be given to the independence issue. The principle will only be seen to be fully observed when the AMCM is granted final prudential decision-making power under general policy guidelines set down by the government. An amendment to the legislation to provide for operational independence for the AMCM should be enacted.

The staff complement of the AMCM should be reviewed in light of the additional responsibilities of agents' examinations and on-site visits. Procedures manuals and training should be implemented so that agents' examinations and on-site visits can be introduced and managed effectively.

The legal department should be encouraged to develop insurance expertise and to respond more readily to requests for assistance.

The supervisor should consider publishing guidance notes to clarify the legal framework for insurers and intermediaries.

Licensing (IAIS 2)

Macao SAR is observant of the licensing principle. Chapter III of the MIO specifies the conditions of access to insurance activities, which are set out in such a way that applicants and supervisors alike can use them in the application and checking processes. All the usual tests such as integrity, professional experience and adequacy of business plans including reinsurance assessment are involved. Applications from re-insurers are treated in exactly the same way as those for insurers.

Because the existing supervisory staff are all experienced and familiar with the due processes in reviewing new applications, it has not been considered necessary to use manuals or check lists as well. The business plan is not required to show details of investments or sources of capital funds, although it is believed these are checked out in practice. For applications from foreign insurers no check is made with the home regulator to determine whether there is satisfaction with the proposal, which, given that such insurers are all major international players, has not been a significant issue to date.

The licensing of intermediaries is covered by the recently up-dated IABO which now provides for an examination system to be effective January 1, 2002, which it is anticipated will result in both an upgrading of standards and a reduction in the total agency force.

Recommendations

The introduction of a procedures manual would be beneficial; this should include specimen application forms and check lists, and the specimen business plan should be expanded to include details of investments and sources of capital funds.

Where applications from foreign insurers are received, enquiry should be made of the insurer's home regulator as to his satisfaction with the proposal.

Corporate Governance (IAIS 4)

Technically this principle is not applicable since it applies only where the supervisor has responsibility for setting requirements for corporate governance, which is not so in the present case. The MIO does not address the issue as such but some aspects of directors' and officers' responsibilities are dealt with under the Commercial Code. It is recognized that only a few of the currently licensed companies are independent local entities and that the majority are branches of major insurers with head offices in well supervised jurisdictions whose own corporate governance practices should flow down to the local branch operation, and that due to the size of the marketplace the supervisor must have some familiarity with these issues. However, given that there may be a possibility of the principle becoming all embracing in the future, and that it can be argued that a supervisor cannot be totally effective without having a reasonable awareness of corporate governance within his licensees, it is suggested that the issue should be included in the assessment.

Recommendation

A practical approach to becoming more closely involved with corporate governance might be for the supervisor to write to all licensed insurers requesting a description of their corporate governance principles and the way in which they are followed through. Once this information has been received and digested further action could be formulated; this could range from recommending changes to the MIO bringing corporate governance within its ambit, to issuing guidelines as to regulatory expectations, to simply checking that satisfactory arrangements continue to operate. The latter should then be a permanent element of the on-site inspection process. New applicants should be asked to address the issue at time of application.

Internal Controls (IAIS 5)

Macao SAR is largely observant of this principle inasmuch as the supervisor, given the small number of licensees, has been able to develop a reasonable familiarity with their internal controls and has the authority to take a much closer interest if necessary. However the essential criteria as set out under Principle 5 call for a much more proactive supervisory approach that involves an awareness of a great deal of detail regarding all aspects of a

company's internal workings and controls. This will be accomplished in the main through the new on-site inspection program, but more attention to some aspects will need to be given at the time of license application and as part of the annual review process.

Money laundering also comes within this standard; in this respect the supervisor issued newly published Guidance Notes on the Prevention of Money Laundering in March 2001, which have already produced results by way of suspicious transaction reports by insurers. The Notes were issued only to insurers; a wider circulation might be advisable.

Recommendation

The supervisor should review the essential criteria to determine which elements might be best picked up within the previously recommended application form and those best dealt with at the time of annual reporting or of the periodic on-site visits. Check lists should be introduced to ensure all requisite aspects are covered at each of these points. The Guidance Notes on Prevention of Money Laundering should also be circulated to the intermediary sector.

Assets (IAIS 6)

Macao SAR is largely observant of the principle, which essentially is one that seeks to ensure that the supervisor has powers to require insurers to have proper investment and risk management policies in place, and to check that they are being carried through. The powers are available but the checking element will only be fully observed when the on-site inspection program comes on stream. It is worth mentioning that investment opportunities in Macao SAR are very limited and that most are to be found in bank deposits, money market instruments or real estate. Furthermore all insurers have to pledge all assets covering technical reserves to the AMCM (which also determines which assets may be admitted) that can only be withdrawn or sold on the written approval of the AMCM. Significantly the claims reserves have to be calculated on a gross (before reinsurance) basis.

Recommendation

The on-site inspection program should review the appropriateness of insurers investment and risk management policies.

Derivatives (IAIS 9)

This principle is not applicable since there are no dealings in derivatives in the insurance industry in Macao SAR.

Market Conduct (IAIS 11)

Macao SAR is largely observant of this principle; the supervisor takes a lively interest in his market and is working steadily to improve its conduct. Measures already taken include the establishment of an Arbitration Panel for dealing with small claims disputes, a Customer

Protection Declaration to be included in every policy issued, and the proposed Agent Examination system to ensure that they are fit and proper. An optional Cooling Off period is also planned for next year. The introduction of the Agent Examination system will contribute to Macao SAR being fully observant of the principle.

Recommendation

In view of the increased regulatory involvement in market conduct, the supervisor has expressed a desire for more frequent meetings with the industry associations, which could only be beneficial. He has also raised the issue of public education regarding life insurance and those classes of compulsory insurance, for example, auto insurance. The mission recommends the continued development of these initiatives.

Financial Reporting (IAIS 12)

Macao SAR is largely observant of this principle, which deals with the filing, processing and analyzing of financial and statistical reports supported by on-site inspections. The annual returns are comprehensive and analyzed in a timely fashion; although as mentioned earlier no checklists are used, which the mission believes would be helpful. Since on-site inspections are not yet the norm full observance is not yet possible.

Recommendations

Checklists should be introduced for the annual review process for financial and statistical reports.

The mission recommends the implementation of the on-site inspection program that will contribute to the full observance of the standard for financial and statistical reporting.

On-Site Inspections (IAIS 13)

Macao SAR is materially non-observant of this principle. When such inspections have been carried out in the past they have been prompted by special circumstances, such as the Y2K issue. However the supervisor has adequate powers to conduct regular inspections and is to introduce such a program in 2002, which will result in each insurer being visited once every three years. This is a commendable initiative but may well place a strain on current staff resources.

Recommendation

The new program of on-site inspections should have a formal procedure, with checklists for both the visits and the subsequent review work in office. New staff should be added if necessary.

Coordination and Cooperation (IAIS 16)

Macao SAR is largely observant of this principle; the MIO gives the supervisor all the powers he needs to satisfy his part, but the principle also involves “other bodies” when it states “the supervisor should be informed of findings or investigations where power to investigate fraud, money laundering and other such activities rests with a body other than the insurance supervisor”. The supervisor does not have law enforcement powers, and has concerns that those that do are not inclined to share information in respect of cases that have been referred to them.

Recommendation

The AMCM might try to address the issue of coordination and cooperation among domestic law enforcement and regulatory agencies at the highest level. Some form of feedback to the insurance supervisor from other domestic regulatory agencies would be very helpful.

C. Captive Insurance Business

Some offshore centers choose to have an entirely separate captive insurance law while others roll the specific provisions into the domestic insurance law. Either way, the important issue is that the distinct nature of captive business should be recognized and a proper regulatory base established. The law should therefore include, among other things, different capital provisions, different solvency provisions, and the licensing of captive insurance management companies (and their on-site inspections). The supervisory body should have sufficient experience in captive insurance business to be able to adequately assess applications (which often involve complicated business plans with unusual financial structures) and the subsequent development of the business once licensed. Equally important would be the ability to determine the integrity of the applicant parties, and the integrity of the on-going business, and to take prompt action in event of any problematical issues arising.

The AMCM has expressed interest in developing captive insurance business subsequent to the introduction of the Offshore Regime Decree Law of 1999. While that Law in a sense opens the door for captive business it provides no actual framework for its operation, either within itself or within the Macau Insurance Ordinance. It is understood that there is already more than one party interested in establishing a captive within the jurisdiction.

However, the development of a captive insurance center depends on many factors, the principle one being that the jurisdiction should provide a comfortable environment from which to operate, comfortable that is in the sense of reputation, services, ease of access, and, of course, the requisite legal framework, none of which exists in Macao SAR at the present time.

The difficult question is, if an appropriate legal framework is put into place, will an offshore industry follow? There are already other jurisdictions in the region providing captive facilities; Singapore is well established and Hong Kong and Labuan are also open for business, so whatever Macao SAR might be able to provide would need to be attractively competitive.

Since there is no existing expertise in this area the first step would be to catch the attention of one of the international insurance brokers, which already has captive insurance management facilities in several other jurisdictions. The broker would have to consider the cost of establishment, the likelihood of persuading experienced staff to relocate (housing, education, health care and similar expenses), and what benefits that broker could offer potential captive clients that were not already available from jurisdictions nearby. Once one such management operation was established others may well follow.

It has been suggested that the opening up of the China market might provide good opportunities for new business, which might be handled through Macao SAR.

Recommendation

No attempt should be made to further develop captive insurance business until an appropriate legal and supervisory support framework is in place.

Table 3. Observance of International Association of Insurance Supervisors (IAIS) Core Principles

Core Principle (CP)	Principle	Degree of Observance				Comments including improvements under way
		Observant (FO)	Largely Observant (LO)	Materially nonobservant (MNO)	Non observant (NO)	Not Applicable (NA)
	Organization of Insurance Supervisor					
1	Organization		X			Technically the final authority rests with the chief executive of the SAR; operationally the supervisor's decisions have not been reversed over the last 20 years. Experienced insurance in-house legal assistance is lacking.
	Licensing and Changes in Control					
2	Licensing	X				Suggest introduction of application forms for insurers with added details of investment/sources of capital funds.
3	Changes in control	X				
	Corporate Governance					
4	Corporate governance					X The supervisor does not have responsibility for corporate governance but the commercial code has some bearing. Recommend supervisor adopts standard as far as possible.
	Internal Controls					
5	Internal controls		X			Recommend procedural changes to elicit more information from insiders, making this aspect an integral part of the new on-site inspection program.
	Prudential Rules					
6	Assets		X			Will be dealt with as part of on-site inspection program.
7	Liabilities	X				
8	Capital adequacy and solvency	X				
9	Derivatives and off-balance sheet items					X No dealings in these items.
10	Reinsurance	X				
	Market Conduct					
11	Market conduct		X			Will be observant when agent examinations introduced in 2002.
	Monitoring, Inspection, and Sanctions					
12	Financial reporting		X			Will be observant when on-site inspection program implemented. Recommend greater use of check lists in due process.
13	On-site inspection			X		New on-site inspection program already planned and to be implemented in 2002.
14	Sanctions	X				
	Cross-Border Business Operations					
15	Cross-border business operations	X				
	Coordination, Cooperation, and Confidentiality					
16	Coordination and cooperation		X			Investigating bodies do not necessarily inform supervisor of findings of investigations.
17	Confidentiality	X				

VI. REVIEW OF THE INVESTMENT AND SECURITIES SECTOR

A. Introduction

The securities and investment industry in Macao SAR is in its early stage of development and does not currently play a significant role in the local economy. At present, investment and securities services are provided mostly by commercial banks. These services include securities trading on behalf of clients, portfolio and asset management and financial consulting. Three Hong Kong companies were licensed in 2000–01 to operate as financial intermediaries through Macao SAR branches, and 2 more applications are currently under consideration. Macao SAR has 29 registered and over 100 unregistered private pension funds. Aside from the pension funds, no collective investment schemes are established in Macao SAR or are operated from there. Over 350 investments funds (including sub-funds) authorized and operated from outside Macao SAR are marketed locally. There are no securities exchanges in Macao SAR and the primary securities market is virtually nonexistent. This section describes the legal and regulatory framework in the securities and investment sector in Macao SAR.

The provision of securities and investment services in Macao SAR is governed by the following legislation: the FSAM (Decree-Law No. 32/93/M), the Investment Funds Law (Decree-Law No. 83/99/M), the Offshore Activity Law (Decree-Law No. 58/99/M) and the Law on Private Pension Funds (Decree-Law No. 6/99/M of February 8, 1999).

Under the FSAM, both financial institutions and financial intermediaries are permitted to provide securities and financial services. A financial institution is defined as “an undertaking whose principal activity is to grant credit facilities, to acquire holdings, to engage in investment activities, or to act as intermediary in the money, financial or foreign exchange market.” A financial intermediary is “any individual or corporate body whose business is to buy and sell, on behalf of third parties, in a habitual form and with a view to profit, securities or other negotiable instruments transacted in the money, financial or foreign exchange markets, or to merely accept investors’ orders relating to the disposal of these instruments” FSAM Article 1(c).

The supervisory and regulatory powers over the financial markets are shared between the Chief Executive of Macao SAR and the AMCM.¹⁸ The Chief Executive has the power “to oversee, coordinate and supervise the money, financial and foreign exchange markets, as well as the business conducted by the respective authorized institutions.” While exercising his powers, the Chief Executive “may issue directives or adopt measures as he deems appropriate to the condition of the money, financial or foreign exchange markets” (FSAM Article 4). The AMCM has the powers “to supervise, coordinate and inspect” financial

¹⁸ Under the Basic Law of the Macao Special Administrative Region of the People’s Republic of China March 1993, the Chief Executive of Macao SAR is selected by election or through consultations held locally and is appointed by and accountable to the Government of the PRC (Articles 45 and 47). The Chief Executive is appointed for a five-year term (Article 48).

markets as well as credit institutions, financial intermediaries and other financial institutions (FSAM Article 5.1). In its capacity as the supervisor, the AMCM can issue notices and circulars of a regulatory nature, as well as directives regulating different aspects of activity of the participants of financial market (FSAM Article 6). In addition, the AMCM has the following powers:

- to conduct, using its own inspectors or a third party, inspections of the supervised entities and to examine the books, accounts, transactions and other relevant records and documents of financial institutions at any time, with or without prior notice (FSAM Article 8);
- to request from any public or private entity information necessary to carry out its functions (FSAM Article 7.2);
- to inspect any other entity operating in other sectors or economic activity whenever there are reasonable grounds to believe that it is involved in an activity exclusively reserved to financial institutions, whenever an inspection of its operations is indispensable for a clarification of the activity of a specific financial institution, or whenever it is deemed necessary to assess financial situation of the group to which a financial institution belongs (FSAM Article 8.2);
- to confiscate during the course of supervision any documents or valuables which constitute the subject of the offense or which are deemed necessary for legal proceedings (FSAM Article 8.4);
- to require the dissolution and judicial winding-up of any company or other corporate entity which, without authorization, is engaged in operations which are legally restricted to financial institutions (FSAM Article 2.2).

The legislation does not provide clear guidance concerning the degree of independence of the AMCM while performing its regulatory and supervisory functions. While the ultimate power to authorize financial and other institutions falling under the AMCM's supervision and to impose sanctions lies within the Chief Executive, the AMCM appears to enjoy a significant degree of operational independence. It would be useful, however, if this issue is clarified in the legislation, as it has a bearing on the ability of the AMCM to effectively regulate and supervise financial institutions.

As mentioned above, most of the securities and investment services in Macao SAR are currently provided by commercial banks. Article 17 allows banks to engage in the following activities:

- trading for own account or for account of customers in money, financial and foreign exchange instruments, financial futures and options, and transactions involving foreign exchange or interest rates and transferable securities;
- participating in issues and placements of securities and provision of other services related to such issues;

- portfolio safekeeping, administration and management;
- management of other assets;
- financial consultancy; and
- investment in holdings in company capital.

All of the above-mentioned services, with the exception of those specified in (b) appear to be provided by Macao SAR banks. Although the data on assets under management is not available, the scope of portfolio/asset management services appears to be relatively insignificant.¹⁹

Securities and investment activities carried out by commercial banks are supervised by the AMCM in the course of the bank supervision process, including off-site and on-site inspections.

Besides banks, three branches of Hong Kong firms have been licensed as financial intermediaries. So far, no local company has applied for an authorization to act as financial intermediary. The general legal framework for financial intermediaries is set out in FSAM Articles 116–120. The FSAM limits the types of activity in which financial intermediaries may engage to (i) purchasing and selling securities and other instruments in money, financial or foreign exchange markets on behalf of third parties, and (ii) accepting investors' orders relating to the above-mentioned instruments. Financial intermediation requires an authorization from the Chief Executive, which is issued on advice of the AMCM (FSAM Article 118.1). According to the FSAM, the minimum share capital for Macao SAR-registered financial intermediaries must be specified in a special law or in the Executive Order granting the authorization. At present, the capital requirements for all licensees are set in the respective Executive Orders.

The general categories of information to be included in an application for financial intermediary's license are set out in FSAM Article 119 and further specified in the AMCM's internal guidelines. These guidelines, however, were issued as an interim measure, pending the adoption of new legislation on financial intermediaries. The present application procedures require, *inter alia*, that the applicant submit an opinion of the regulator in the home jurisdiction of the company seeking to establish a financial intermediary subsidiary or branch in Macao SAR. In the absence of a developed regulatory framework, the AMCM relies heavily on such recommendations.

The remaining legal framework for financial intermediaries is limited to the FSAM Article 120 which provide that certain provisions of the Act applicable to banks—such as registration with the AMCM; opening of branches and representative offices outside Macao SAR; requirements concerning shareholders, managers and members of the board of

¹⁹ According to the AMCM staff, only two banks currently provide asset management services, and 11 banks currently provide securities services.

directors (including the “fit and proper” requirement); minimum share capital, reserves and dividends; accounting and mandatory publications; confidentiality rules; customer identification requirements, as well some other provisions—shall be applied to financial intermediaries “on a supplementary basis, after the necessary modifications.” Currently, it is not clear how this provision would be applied in practice or how supervision of financial intermediaries is to be carried out by the regulator. The AMCM stated, however, that new legislation would clarify the matter.

The existing legislation does not establish a supervisory regime for financial intermediaries. Pending adoption of new legislation, the AMCM relies mostly on the fact that the existing licensees fall under the supervision of the Hong Kong Securities and Futures Commission (HK SFC) in accordance with Hong Kong’s rules concerning consolidated supervision. In carrying out its supervisory functions, the HK SFC can conduct, together with the overseas regulator, on-site inspections of the overseas subsidiaries and branches of entities supervised by the HK SFC. While the operations of the Macao SAR branches have not yet been reviewed, the HK SFC expects to conduct on-site inspections of these branches in 2002.

The Macao SAR authorities are committed to improving the legal and regulatory framework for financial service providers. A new law on financial intermediaries has been drafted and consultations with the industry are about to start. The new law will set forth a more comprehensive legal and regulatory framework for financial intermediaries. It is expected that the new legislation will be passed in 2002.

Other financial services currently available in Macao SAR include portfolio and asset management for companies and high net worth individuals. As mentioned above, such services are provided mostly by commercial banks pursuant to their general banking licenses. There is no special legislation governing the provision of these services.

While the Law on Investment Funds passed in November 1999 establishes the legal framework for investment funds, no such funds or fund management companies have been established in Macao SAR since the passage of this legislation. This is due in part to the deficiencies in the existing legal framework, although an unclear tax regime and lack of fund management expertise in Macao SAR also contribute to slow development of this sector. Macao SAR currently does not have any investor compensation scheme.

Investment funds organized and/or operated elsewhere must be authorized by the AMCM prior to being advertised or marketed in Macao SAR. Authorization will only be granted “if the investment funds have been duly authorized in their country of origin and the respective fund managers and custodians are subject to supervision by the competent authority” (Article 61 of the Investment Funds Law). The documents and information to be provided to obtain authorization is specified in the AMCM’s internal guidelines. As a matter of practice, the AMCM will only grant authorization to the funds that have been authorized by the HK SFC. The majority of the investment funds currently marketed in Macao SAR are established in and/or managed from Hong Kong. While the investment fund legislation of Hong Kong was not specifically reviewed for the purposes of this report, Hong Kong’s legal and regulatory framework for collective investments schemes is widely perceived to be comprehensive and largely consistent with the best international practices.

There are currently 29 registered and over 100 unregistered pension funds in Macao SAR. Major Macao SAR companies and banks established most of the funds, while others were set up by medium- and small-size companies. All of the existing pension funds were established prior to the handover of Macao SAR to China in 1999 and most of them are managed from outside Macao SAR. At present, private pension funds are not subject to any supervision and are only required to register with the tax authorities in order to obtain certain tax benefits. The new legislation on private pension funds passed in Macao SAR in February 1999 transferred the supervision over private pension funds to the AMCM. The law establishes a transition period, extended through December 2002, by which the existing funds must register with the AMCM.

The 1999 Law on Offshore Activities established a special “offshore” regime for certain activities, including banking and financial services. In particular, the law has provisions on offshore trust management (Articles 30–60). However, no such activities are currently taking place within Macao SAR.

To create a more attractive environment for investment funds and management companies, legislation will have to be improved and to be brought in compliance with the IOSCO principles²⁰ applicable to the establishment and operation of collective investment schemes. The tax regime for investment funds should be clarified. It is also important that fund management expertise be built within Macao SAR. The mission recommended that in their effort to improve the legal and regulatory framework for investment funds in Macao SAR the AMCM should continue to liaise closely with the HK SFC, building on the good working relationship that exist between the two regulators.

The cooperation arrangements between the AMCM and other securities regulators include formal and informal cooperation and information sharing. The AMCM maintains especially close relations with the HK SFC. A memorandum of understanding was signed between the AMCM and the HK SFC on July 14, 2000. The regulators meet at least twice a year to exchange information and to discuss supervisory matters. The AMCM staff maintains regular formal and informal contacts with the staff of the HK SFC. The HK SFC has provided training to the AMCM’s staff on supervision of the securities sector. The mission encouraged the authorities to continue to liaise closely with the HK SFC and to expand cooperation with the regulators in other jurisdictions.

The secrecy provisions of the FSAM limit information sharing between the AMCM and other securities regulators. (See the Annex on AML assessment for more detailed description of the legal provisions.) According to the existing legislation, the AMCM can share information with other regulators only for supervisory purposes. Information sharing for purposes other than supervision requires a court order. At present, the information exchange on securities supervision between the AMCM and regulators in other jurisdictions limited. It is expected, however, that the need for cooperation and information sharing will grow, as the securities industry develops. Therefore, the mission team recommends that the AMCM expands such cooperation.

²⁰ IOSCO principles 17–20 are applicable to collective investment schemes.

B. Review of Selected IOSCO Principles and Recommendations

Due to the fact that the securities sector in Macao SAR is still in its early stages of development, a full assessment of compliance with the IOSCO Objectives and Principles of Securities Regulation was not undertaken at this time. The review of some IOSCO principles, which the mission considers relevant for Macao SAR, and recommendations related to these principles are set out below.

Areas where improvements would be beneficial

Clear Responsibilities (IOSCO Principle no. 1)

IOSCO identifies certain core objectives of the principle, including (i) that markets are fair, efficient and transparent, and (ii) that systemic risk is reduced. These objectives and principles are not clearly set out in the Macao SAR legislation.

Recommendation

The legislation should be amended to provide more explicitly for the core objectives of the AMCM, including (i) protecting investors by preventing market manipulation and fraud and preserving markets' integrity; (ii) ensuring that markets are fair, efficient and transparent; and (iii) preserving the financial soundness of the supervised institutions and reducing systemic risk.

Independence (IOSCO Principle no. 2)

This principle requires that the regulator should be operationally independent and accountable in the exercise of its functions and powers. Under the existing framework, the powers of supervision over the financial markets in Macao SAR are shared between the Chief Executive and the AMCM.

Recommendation

To ensure compliance with the principle relating to independence, the legislation should be amended to specify more precisely the scope of operational independence of the AMCM.

Adequate Resources (IOSCO Principle no. 3)

This principle requires the regulator to have adequate powers, proper resources and the capacity to perform its functions and exercise its powers. At present, the AMCM appears to lack both resources and expertise to carry out effective supervision over the securities and financial services sector. The banking supervision staff, who have no special expertise in the securities area, currently carry out supervision over licensed financial intermediaries.

Recommendation

The AMCM should add staff to give it capacity to perform supervisory functions over companies acting as financial intermediaries or providing other securities or investment services.

Self-Regulatory Organizations (IOSCO Principles nos. 6, 7)

Under this principle, the regulatory regime should make appropriate use of self-regulatory organizations (SROs) that exercise some direct oversight responsibility for their respective areas of competence, to the extent appropriate to the size and complexity of the markets. At present, there are no SROs in Macao SAR.

Recommendation

SROs can be a valuable complement to regulatory oversight in achieving the objectives of securities regulation. As the securities industry in Macao SAR develops, it is recommended that the legislation be amended to allow and authorize SROs. The AMCM should then be encouraged to take into account Macao SAR 's unique circumstances and the manner in which SROs could augment its own efforts in securities regulation.

Comprehensive enforcement powers (IOSCO Principle no 9)

This principle requires the regulator to have comprehensive enforcement powers over the supervised entities. While the AMCM appears to have satisfactory enforcement powers over banks such as suspending their activity, imposition of administrative measures and use of fines, the legislation does not provide the regulator with sufficient enforcement powers with respect to financial intermediaries or investment funds.

Recommendation

The legislation should be amended to grant comprehensive enforcement powers to the AMCM in the investment and securities sector. Also, the investment funds legislation should be clarified as to what actions constitute offenses under the law and should provide for sanctions for such violations.

Information Sharing Mechanism and Assistance to Foreign Regulators (IOSCO Principles no. 12 and 13)

Under these principles regulators should establish information sharing mechanisms that set out when and how they will share both public and nonpublic information with their domestic and foreign counterparts. The regulatory system should allow for assistance to be provided to foreign regulators who need to make inquiries in the discharge of their functions and exercise of their powers.

Recommendation

The legislation should be amended to grant the AMCM the powers to share information with other regulators in Macao SAR and in other jurisdictions, provided that such information is requested for a specified purpose and that confidentiality of **information** is ensured. The AMCM should be able to share information with other regulators at its own initiative if such exchange of information is judged to be in Macao SAR's public interest and provided that the necessary safeguards are in place.

VII. REVIEW OF PRACTICES WITH RESPECT TO THE REGULATION OF COMPANIES

A. Introduction

There are, as yet, no internationally accepted standards for the assessment of practices concerning the regulation of companies.

The OECD publication, "Principles of Corporate Governance," focuses on the management of public companies. It includes principles relating to the rights of shareholders; equitable treatment of shareholders; disclosure and transparency; and responsibilities of the board of directors. These principles are not directly applicable to privately held trading or holding companies, which are typical of "international business entities," incorporated in offshore jurisdictions. Most of these entities are private and are formed by nonresident individuals so as to hold various kinds of business interests outside the jurisdiction.

Recently, the offshore companies sector has attracted attention in two well-publicized reviews of certain offshore financial centers. These are the Review of Financial Regulation in the Crown Dependencies—November 1998 (better known as the Edwards Report) and the more recent KPMG Review of Financial Regulation in the Caribbean Overseas Territories and Bermuda, October 2000. Both reports applied some broad general principles, explicitly and implicitly, as guides as to what can be considered good practices. The major issue in both studies can be summed up by stating that regulatory and law enforcement agencies must be able to obtain key information about companies in their jurisdiction. This implies that they should be able to obtain details of the ultimate beneficial owner and not simply the name of the person who set up the structure. There should also be gateways through which such information can be disseminated.

B. Structure

In Macao SAR, the Commercial Code deals with the registration and regulation of companies, and was not reviewed for this report. The mission relied on discussions with the registrar of companies for the description that is set out below.

There are approximately 10,000 active companies registered in Macao SAR, about 600 new registrations were made in the calendar year ending December 31, 2000. Any person can file an application for registration and although the registration process is relatively simple, lawyers file most applications on behalf of clients. The minimum number of shareholders required to form a company is one and the minimum number of directors is the same. Except for limited liability partnerships, bearer shares can be issued.

The registrar conducts no due diligence of shareholders or directors, but determines whether the proposed name of the company has already been registered or whether it is likely to be confused with that of an existing company. The registrar has a list of regulated activities, and if any of those activities is included in the proposed company's articles of incorporation, the registrar refers the applicant to the appropriate regulatory agency for approval. Only after approval by such agency will registration be completed. Such agencies include the AMCM for financial activities and the IPIM for offshore business. The commercial registry is also responsible for ships, aircrafts, and motor vehicles. The registrar has a staff of 20 persons.

The international business companies sector of Macao SAR is very small and its development is still in an embryonic stage. The Decree-Law No. 58/99/M known as the Offshore Law was passed in October 1999 and came into effect on November 1, 1999. The Offshore Law of 1999 defines the legal regime governing both financial and non-financial offshore activities. As was noted earlier, the offshore financial business is regulated and supervised by the AMCM. However, the IPIM regulates the offshore non-financial business.

To set up an offshore non-financial company, an investor is required to:

- submit an application form, an investment plan, and other documents including information on the ultimate ownership;
- obtain an approval letter from the IPIM;
- register with the commercial registry within six months of receiving the approval letter, and complete other procedures according to the commercial laws;
- receive a permit from the IPIM; and
- commence operations within six months of receiving the permit.

By December 2001, the IPIM had received 44 applications, approved 31 applications, and issued 16 permits. Three companies failed to register within six months of receiving the approval letter.

In order to operate an offshore service business, the investor is required—pursuant to the Offshore Law—to:

- use only non-Macao SAR currency in their activities;
- target only non-Macao SAR residents as customers, and
- focus only on non-Macao SAR markets.

In reviewing the applications, the IPIM requires investors to have a physical presence/offices in Macao SAR and to employ local staff. Companies are not permitted to issue bearer shares and must inform the IPIM of any changes in ownership.

There were only 16 non-financial offshore companies incorporated as of the end of November 2001. Most of these companies are operating as back offices²¹ and the ultimate owners are from Hong Kong SAR. The IPIM expects that based on their business plans over the next two years, the 16 offshore companies intend to employ about 159 people (115 local and 44 expatriates).

The Offshore Law provides for two types of companies, namely, offshore commercial services institutions [known as International Business Companies (IBCs)], which can provide services to any party, and offshore auxiliary services institutions, which can provide services only to the parent company/companies. Currently, all operating companies are IBCs.

Offshore companies are exempted from income tax, industrial tax, inheritance and donation tax, property-transfer tax and stamp duties in Macao SAR. In addition, their management staff and specialized technicians (non-Macao SAR residents), who are authorized to reside in Macao SAR, can be exempted from salary tax for the first three years of their employment at the offshore institution. As of December 2001, however, very few expatriates were registered.

Except for Portugal, Macao SAR has no double tax treaty with any jurisdiction. However, this has not posed a problem for investors from Hong Kong SAR, because only profits earned domestically in Hong Kong SAR are subject to income tax in that jurisdiction. This may suggest that investors from Hong Kong SAR setting up offshore companies in Macao SAR are not primarily driven by the tax incentives in Macao SAR, but by other factors including lower labor and office costs.

The IPIM collects financial statements and conducts random inspections to ascertain that the registered offshore companies are adhering to their registration requirements. The IPIM has four professionals responsible for registering and monitoring the activities of the offshore companies, and the number is expected to increase in 2002.

All offshore companies are required to have an annual audit and to file the auditor's report with the IPIM. As part of this audit, auditors must confirm that the company has complied with the requirements of its permit. In addition, the IPIM's staff conducts periodic visits to ascertain that the company's operations are in conformity with the requirements of its permit.

The IPIM stated that no agency or department of government promotes Macao SAR as an offshore financial center, as this implies a tax haven, which is not in accord with government policy.

²¹ The Despacho No.236/GM/99 has defined 20 categories of business that are appropriate for offshore investors and the investor can apply for one or more categories. So far, most of the applicants have opted for one or more of the following categories; back offices, commercial and service agents, overseas selling activities, documentation services, and call centers for customer support.

C. Assessment

Good practice

The authorities must have a means of establishing as necessary, who are the beneficial shareholders and directors of companies that are registered in their jurisdiction.

For offshore companies, there is upfront disclosure to the authorities at the incorporation stage together with the obligation to update such information when changes occur. However, for domestic companies, except for Limited Liability Partnerships, bearer shares are permitted.

Recommendation

Current practice in a number of jurisdictions is either to forbid the use of bearer shares or to introduce provisions for their immobilization. Macao SAR should consider one of those options.

Good practice

A regulatory body should maintain independence from political and private sector influence.

Administratively, the IPIM reports to the Secretary for Economy, and the Chief Executive approves decisions on applications. The IPIM indicated that there has been no interference by government in its decisions.

Recommendation

Legislation should be amended to permit the IPIM to operate under general guidelines and thereby achieve operational independence.

ANTI-MONEY LAUNDERING ASSESSMENT BASED ON THE FUND/BANK DRAFT METHODOLOGY DOCUMENT

Information and Methodology Used for the Assessment

The Macao SAR anti-money laundering system was assessed for compliance with the criteria described in the Fund/Bank Draft Methodology Document for assessment of financial supervisory principles in the prevention of money laundering. The assessment is based on a partial review of the legislation and financial regulations, and interviews with staff of the financial supervisory agency, Monetary Authority of Macao (AMCM), the Prosecutor's office, the Judicial Police, and several financial institutions.

The AMCM and other organizations were very helpful, adjusting their schedules to provide information and hold discussions. However, assessors cannot fully evaluate how legislation and regulation are implemented because of time limitations. Also, due to the fact that the English translation of the relevant legislation was not always immediately available, some areas may require further clarification.

Anti-money laundering (AML) measures in Macao SAR are largely based on a legal and organizational framework which is common to the three financial sectors (banking, insurance, securities) reviewed, but legislation specific to each sector is also relevant. In order to avoid repetition, an overview of the rules and prudential practices common to all sectors is provided and references to that overview are made in the sectoral assessments.

This assessment forms part of the pilot phase of assessments using the Fund/Bank Draft Methodology Document.

Overview of measures to prevent money laundering

Institutional framework. Several official agencies play a role in implementing anti-money laundering measures in Macao SAR: the AMCM is responsible for implementing the AML legislation with respect to the sectors it supervises, i.e., financial sector, including banks, insurance companies and financial intermediaries. There is no special department within the AMCM overseeing the AML efforts. The staffs of the banking supervision department and insurance supervision department of the AMCM are in charge of supervising compliance of the credit institutions and insurance companies, respectively, with the AML legislation. The Prosecutor's office is responsible for leading the detection and investigation of criminal activities, including money laundering, proceeding with criminal prosecution, and facilitating the processing of criminal cases. The Prosecutor's office has a special department dealing with organized and serious crimes. The Judicial Police is the agency which, according to law, receives suspicious transactions reports and has primary responsibility for investigating money laundering. Within the Judicial Police the departments of financial crimes and serious crimes handle money-laundering cases.

There is currently no Financial Intelligence Unit (FIU) in Macao SAR, although the authorities are considering the setting up of such a unit.

Legislative and regulatory background. The legal provisions governing financial supervisory AML measures in Macao SAR are built on international treaties and the domestic legislation. Macao SAR is party to the *1988 Vienna Convention on drug trafficking*, which made all crimes a predicate offense for money laundering.

The *Organized Crime Law* (Article 10) makes conversion, transfer or dissemination of illicit properties or proceeds, or facilitating any of the above-mentioned actions, while knowing that the properties or proceeds are derived from criminal activities, a criminal offence. This provision is patterned after the 1988 Vienna Convention. The Law establishes the following sanctions:

- (a) conversion, transfer, helping or facilitating in one way or another conversion or transfer of the whole or part of those properties or proceeds directly or indirectly, with the purpose of concealing or disseminating their illicit source or helping a criminal escape without juridical punishment for his activities, is punishable by 5 to 12 years' imprisonment and a fine of value equivalent to 600 days;
- (b) concealing or disseminating the real nature, source, location, treatment, movement, ownership of those properties or proceeds or of the right entitled to the latter, is punishable by 2 to 10 years' imprisonment and a fine of value equivalent to 360 days;
- (c) acquiring or receiving by any title, utilizing, withholding or keeping those properties or proceeds, is punishable by one to 5 years' imprisonment and a fine of value equivalent to 240 days.

The law expressly provides that the crimes described above are punishable even if those properties or proceeds were derived from criminal offences committed outside Macao SAR (Article 10.2).

The *Organized Crimes Law* allows the liability for offences specified in Article 10 of the law to be imposed on legal entities. Article 14 provides as follows:

- Private collective entities even if not legally incorporated, and associations with no legal identity are liable for the offences and penalties described in Article 10, if offences are committed by their members, whether founders, board members, managers or chiefs in the course of duties, or by their representatives or proxies who act on their behalf or in their interests.
- The provisions of preceding paragraph are applicable even if the power to act on behalf of the entity is granted in a void or ineffective act.
- The liability of the entities referred to in paragraph 1 does not preclude the individual liability of respective agents under the terms of general penal law.
- Members, whether founders, board members, managers or chiefs in the course of their duties, representatives or attorneys acting on behalf of or in the interest of their entities referred to in paragraph 1 are jointly liable, under the terms of civil law, for the fine and indemnity to which the entities are condemned."

Section 2 of Article 14 exempts from liability the agent who acted contrary to the orders or explicit instructions of the one in power.

The *Ordinance on Money Laundering Decree-Law No. 24/98/M of June 1, 1998* (hereinafter, “Law No. 24/98”) establishes that as a preventive measure against crimes of conversion, transfer or dissemination of illicit properties or proceeds referred to in Article 10 of the Organized Crimes Law, any operations suspected of involving conversion, transfer or dissimulation of illicit properties or proceeds are subject to mandatory reporting. The law applies to the following institutions:

- entities subject to the supervision of the AMCM;
- entities subject to the supervision of the Inspectorate of Gaming;
- pawnbrokers;
- entities engaged in trade of antiques, works of art, metal works or precious stones, even if they are not conducting only such businesses; and
- real estate intermediaries or entities engaged in purchasing real estate or personal estate, which are subject to registration, for resale, even if they are not conducting only such businesses.

The above-mentioned entities must file reports with the Judicial Police with information (i.e., a copy of the report) also given to the respective supervisory authority. The law requires that suspicious transactions be reported before, if possible, or immediately after their occurrence (Article 3.2). While the law itself does not specify criteria for determining suspicious transactions, it provides that for reporting purposes supervisory authorities “shall systematize those operations classified as risky, namely due to the payment methods used, the amounts involved, their repetitions or other characteristics of the operations in question” (Article 4). Information on suspicious transactions shall be provided in the following manner:

- The supervisory authorities are required to keep all entities falling under their supervision informed about the procedures for detecting and reporting of suspicious transactions by means of direct notification or through publishing circulars and notices in the Government Gazette.

In practice, suspicious transactions are reported to the Judicial Police in writing, with a copy sent to the AMCM. **The above-mentioned provisions on the manner in which reports should be filed require clarification.**

The supervisory authorities must inform immediately the Judicial Police of any cases of suspected money laundering which have come to their knowledge in the course of their supervisory duties or otherwise (Article 6).

Law No. 24/98 has an indemnity provision for those who report suspicious transactions. Pursuant to Article 7, “disclosing information under the provision of Article 3 and preceding article neither is regarded as violation of any general or particular duty to maintain secrecy

nor imposes liability on the person who gives the information, with the sole exception of cases in bad faith.”

Unless considered a more serious infraction, failure to comply with the reporting requirements is considered an administrative violation punishable by a fine between 10,000 and 500,000 Macao patacas for an individual and a fine between 100,000 and 5,000,000 Macao patacas for legal entities. The supervisory agencies are responsible for investigating violations of the law and imposing fines. Appeal is available through the Administrative Court; filing an appeal suspends the imposed sanction.

In addition to and in the implementation of the anti-money laundering legislation, the AMCM has issued AML guidelines for banking and insurance institutions. The *AMCM Circular No. 001/A/96-DSB/AMCM* of June 17, 1996 (hereinafter the “AMCM Circular”) establishes procedures for identification of customers for certain types of transactions, namely transactions without opening of a bank account that involved the amount exceeding 100,000 Macao patacas. The AMCM Circular applies only to (i) credit institutions and financial companies with headquarters in Macao SAR, and (ii) branches of credit institutions in Macao SAR with headquarters abroad. **The AMCM Circular does not currently apply to moneychangers and remittance companies.**²² The Circular also sets out the rules for record keeping and requires the institutions to establish a mechanism of internal control and to provide training to the staff designated to deal with the issues covered in the circular.

In March 2001, the AMCM issued a *Guidance Note on Prevention of Money Laundering in Insurance Business* (hereinafter the “AML Guidelines for insurance companies” or the “Guidelines”). The Guidelines set out detailed rules to be followed by the insurance companies to prevent money laundering, including the “know your customer” principle and customer identification requirements, record keeping procedures, training requirements for the personnel of insurance companies, and some other aspects of the implementation of anti-money laundering measures.

Customer due diligence. The key provision on customer identification for credit institutions is Article 106 of the Financial System Act of Macao (FSAM). The customer identification requirements set forth in this article are two-fold. First, it provides that opening of accounts; deposits in cash or other valuables and the hiring of safe deposit boxes may only be done for customers identified by name, address and official proof identity. Second, it requires the credit institutions to verify the identity of the customers, and to record the identity of all customers who make significant transactions and refuse to serve those who decline to

²² The AML guidelines for financial institutions are currently being revised. The new guidelines will apply to all financial institutions, including cash remittance companies and moneychangers, as well as to financial intermediaries. The new guidelines will introduce special rules for reporting suspicious transactions. It is our understanding, however, that reporting of only those transactions that are suspicious will continue to be required and that no mandatory reporting for cash transactions over a specified limit is to be introduced. In preparing the new guidelines the authorities take account of recent developments in the international AML framework, including the FATF 40 recommendations.

provide evidence of their identity. Section 3 of Article 106 permits credit institutions to offer numbered accounts to customers whose identity shall only be known to a restricted number of employees but prohibits granting credit facilities to this type of account holders. The opening of a numbered account does not relieve the credit institution from complying with the customer identification requirements.

FSAM Article 106 applies only to credit institutions. Customer identification requirements for cash remittance companies are set out in *Cash Remittance Companies Decree-Law No. 15/97/M of May 5, 1997*. Article 16 of the law requires cash remittance companies to “record data related to the identification document and address of the applicant, as well as the identification and address of the beneficiary of the values.” No specific customer identification requirements currently apply to financial intermediaries, which are not banks.

The detailed rules for customer identification with respect to transactions by banks and finance companies with customers *who do not have an account with the institution* are set out in the AMCM Circular. **The Circular, however, does not expressly require that the same procedures for verifying the customer’s identity should be applied in case of opening a bank account.** According to the Circular, identity checks are mandatory for transactions in which the amount involved, either individually or collectively, reaches or exceeds 100,000 Macao patacas. For such transactions, the institutions are required to maintain a copy of the original identification document of the customers and/or their representatives.

The AMCM Circular provides for the identity check procedures for face-to-face operations as well as not face-to-face operations. In face-to-face operations, the following requirements apply to identification of individuals:

- (a) the identification documents should be valid in Macao SAR and with photo attached. In addition, information like the full name, date of birth, I.D. card number, date and place of issue should be duly registered; and
- (b) the customer’s address should be included in the respective transaction record and the financial institution should take adequate measures to verify the information if it deems necessary.

If any of the required information cannot be verified, the financial institution should request the customer to provide the name of another bank in which he maintains an account. Such bank should be located in Macao SAR, or in a country included in Annex 1,²³ or otherwise it should be an “international bank with recognized good reputation.” The financial institution should obtain the customer’s identity information from such other institution before proceeding with any operations.

For legal entities the following should be required prior to the transaction:

²³ Included in Annex 1 are: 15 countries of the European Union, Australia, Canada, South Korea, United States, Hong Kong SAR, Iceland, Japan, Norway, New Zealand, China, Singapore, Switzerland, Taiwan Province of China, and Turkey.

- the name of the firm or company, the main objective and place of headquarter should confirmed with the original document the certificate of incorporation issued by the Business Registrar or Finance Department, or the copy of the Charter (published in the official gazette); and
- the powers attributed to any natural persons to represent the legal entity to execute movement of funds in the name of the legal entity, through the financial entities, should be confirmed by the original document certificate of authorization issued by the relative entity, formal power of attorney or certificate (issued by the Business Registrar).

If any of the required information cannot be verified, the financial institution should adopt the procedure mentioned in section 2.1.1 (i.e., requesting copies of the identification documentation from another financial institution).

In the case of non-face-to-face transactions, the Circular requires that the identification documents required for face-to-face transactions should be sent to the financial institution by registered mail. Based on the information provided by the customer or his representative, the financial institution may consult a bank located in the country mentioned in Annex 1 to obtain the written certification for the genuineness of information.

Financial institutions are exempt from the mandatory identification requirements with respect to (i) customers “with necessary information available” (e.g., the existing customers), and (ii) institutions under the supervision of the AMCM (section 2.3 of the Circular).

The AML Guidelines for insurance companies are more comprehensive than the AML guidelines for banks. The general requirement for customer identification is set out in Section III.1 which provides as follows:

- Insurance companies should make reasonable efforts to determine the true identity of all customers requesting the companies' services. All insurance companies should institute effective procedures for obtaining identification from new customers. It should be an explicit policy that significant business transactions will not be conducted with customers who fail to provide evidence of their identities. Detailed procedures and policies on verification of customer identity are set out in Annex A.

More detailed rules for checking the customer's identity are specified in Annex A and require that positive identification should be obtained from documents issued by official or other reputable source, e.g., current valid passports or identity cards. In case of doubts whether the identity document is genuine, contact should be made with the Macao Immigration Department or the relevant consulates in Macao SAR to ascertain the details on the document are correct.

Sections 6 and 7 of Annex A provide that when applicant for insurance policy is acting on behalf of another person, appropriate steps should be taken to verify the identity of the applicant and the underlying principal. Insurance companies should not keep anonymous accounts or accounts in obviously fictitious names. They should identify and record the identity of their clients when establishing business relations.

A special warning is included regarding postal business. According to Section 8, “any mechanism which avoids face to face contact between a company, agent or broker and its client, or where mass selling techniques or coupon applications are involved, inevitably poses difficulties for client identification and produces a useful loophole that money launderers may wish to exploit.” The Guidelines advise that particular care should be taken when undertaking such business to ensure that the identity of the prospective client has been verified to the satisfaction of the company, agent or broker concerned.

Suspicious activity monitoring and reporting. Suspicious transactions must be reported to the Judicial Police, as required by Law No. 24/98. The AMCM Circular and the AML Guidelines for insurance companies establish criteria for detecting suspicious transactions and provide examples of such transactions.

The level of suspicious transactions reporting in Macao SAR is very low. Since the introduction of mandatory reporting in mid-1998, banks have filed only eight reports and insurance companies have filed eight reports. According to the authorities, the low level of reporting may be attributed to several factors, including historical mistrust of law enforcement agencies and low anti-money laundering awareness within financial institutions and among Macao SAR’s population.

Record keeping. According to Macao’s Commercial Code, records of transactions must be kept for a period of ten years. According to the AMCM Circular, calculation of the ten year period starts (i) on the effective date for the execution of an occasional transaction or of the last operation of a series of occasional transactions, or (ii) on the date of formal close of a banking deposit account by the customer or the date of cancellation of a banking deposit account by the financial institution based on the internally defined criteria; or (iii) on the initial date of the procedures for the recover of credit facility following insolvency or bankruptcy of the borrower. The AML Guidelines for insurance companies require the records, including customer identification documents, of the contracts that have been settled by maturity, claim or cancellation to be kept at least for six years. Insurance companies may keep records by way of original documents, stored on microfiche, or in computerized form provided that such forms are accepted as evidence. If records relate to ongoing investigations or transactions, which have been subject of a disclosure, they should be retained until it is confirmed that the case has been closed (section 7 of Annex B).

Compliance and audit. The AML guidelines for banks and insurance companies require each financial institution or insurance company to designate a responsible person (i.e., a compliance officer) to coordinate internal control procedures on preventing money laundering and for centralizing the information on suspicious activity. The name of the compliance officer must be communicated to the AMCM and that person should consult with the AMCM if in doubt. The AML Guidelines for insurance companies set forth general rules for the activity of compliance officers. The AMCM should be immediately informed in writing if the external auditor detects in the course of performing its duties that the financial institution, its representatives or employees has been involved in criminal activities or money laundering (FSAM Article 56). A similar provision of the *Insurance Ordinance Decree-Law No. 27/97/M of June 30, 1997* applies to external auditors of insurance companies (Article 90).

Training. Both the AMCM Circular and the AML Guidelines for insurance companies require that training and information be provided to staff on anti-money laundering issues. The guidelines for insurance companies are more detailed, setting out in Annex D recommendations on training to be provided to different categories of staff (e.g., new employees, sales/advisory staff, processing staff, administration/operations supervisors and managers). The regulations also require ongoing training and suggest annual or semi-annual refresher courses on AML issues.

Cooperation with other supervisors and competent authorities. The AMCM's ability to share information with domestic and foreign counterparts is subject to confidentiality provisions of the FSAM (Articles 78–81). The FSAM imposes on person currently or previously employed by the AMCM and any person who has at any time provided services to the AMCM an obligation to maintain secrecy of information obtained during the course of their employment or the provision of services, and prohibits such person from revealing or taking advantage of such information. The duty of secrecy applies, in particular, to “names and other information related to customers, deposit accounts and respective transactions, application of funds and other banking operations” (Article 78.2).

The general secrecy provisions of FSAM Article 78 do not preclude the AMCM from sharing information for limited purposes listed in Article 79.1. In particular, the AMCM can exchange information with other supervisory authorities provided that the information remains subject to secrecy and is not used for any purpose other than supervision. Disclosure of summarized or aggregate information, which does not permit individual identification of purposes or institutions for statistical purposes, is also permitted. Information can be disclosed for purposes other than those specified in Article 79.1 only if such disclosure is expressly required by law. FSAM Article 78.6 specifically provides that information provided by the AMCM to foreign supervisory authorities is also protected by bank secrecy and cannot be revealed or used for any purpose other than the assessment of the conditions to grant an authorization to, or the carrying out of the supervision of financial institutions.

In performing its supervisory functions, the AMCM exchanges information with other authorities in Macao SAR, as well as with foreign regulators. While certain general information may be and is shared by the AMCM with other Macao SAR authorities for various purposes on an informal basis, AMCM's ability to share information for purposes other than supervision (including information sharing in the context of an investigation or prosecution of money-laundering cases) is limited by the FSAM Article 80, according to which confidentiality of information concerning relations between the institution and its customers may only be waived upon the customer's consent or by court order under the terms provided for in criminal law or in criminal procedure law. The requirement to obtain a court order applies equally to agencies within Macao SAR (such as, for example, customs or tax authorities) and to foreign regulators, including those with whom the AMCM has signed formal cooperation agreements. According to AMCM, a court order authorizing disclosure of information can be obtained fairly quickly. The authorities indicated that there had been several cases of such disclosure in the past.

International cooperation may also be granted pursuant to the international treaties to which Macao is a party. Macao SAR may be a party to international conventions on judicial assistance with the authorization of the government of the People's Republic of China (PRC).

At present, the 1998 Vienna Convention on drug trafficking is force in Macao. The Palermo Convention was signed by the PRC and will come into force in Macao upon its ratification by the PRC. There is no domestic legislation in Macao SAR on international cooperation. Requests for international assistance in criminal matters, including money-laundering cases, are facilitated through the Macao Judicial Police Interpol office. The authorities advised that information is regularly shared with the overseas police organizations on an informal basis.

AML in financial services sector. Due to the small size of the securities and financial services sector in Macao SAR, no assessment of the AML measures in this sector has been conducted. The following, however, should be noted: although non-bank financial intermediaries fall within the provisions of Law No. 24/98 on mandatory reporting of suspicious transactions, no further regulations on the implementation of the law have been issued. In revising the legislation on financial intermediaries, the authorities should consider including explicit provisions on AML measures in such legislation and issuing additional guidance as to the implementation of those measures by financial intermediaries.

AML in the gaming sector. Given the importance of the gaming industry to the economy of Macao SAR, it is important to ensure that a proper AML framework for this sector be put in place. While entities subject to the supervision of the Inspectorate of Gaming (including casinos) are subject to mandatory reporting of suspicious transactions pursuant to Law No. 24/98 (Articles 2 and 3), enforcement of these provisions has been weak. Casinos have filed no suspicious transaction reports since the introduction of the mandatory reporting. The existing legal framework must be strengthened by (i) the body supervising the gaming industry issuing the implementing regulations on detecting and reporting suspicious transactions, and (ii) strengthening the enforcement of the AML measures provided for in the legislation.

Conclusions. While a legal framework for AML is generally in place in Macao SAR, improvements in several areas are recommended. The areas that should be strengthened include (i) enhancing the framework for implementing the “know your customer” rule and suspicious transaction reporting for financial and other institutions subject to supervision by the AMCM; (ii) strengthening the general enforcement of the AML legislation, and (iii) enhancing cooperation between various agencies in charge of enforcement of the AML regime in Macao SAR and their cooperation with the authorities in other jurisdictions on AML matters. More detailed recommendations are set out in sectoral assessments.

D. Banking Supervision

Detailed assessment

Table 1. Detailed Assessment of Compliance with the Banking Supervision AML Requirements

Organizational and administrative arrangements	
Description	See overview. Further, the licensing of banks requires that the major shareholders and the top management of the bank be evaluated for entry. In addition to technical skills and experience, the fit and proper criteria require that the individuals have been observant of commercial obligations and not convicted of a serious crime. Attempted acquisition of a qualified holding also triggers an evaluation by the AMCM with criteria similar to licensing criteria.
Assessment	Largely compliant
Comments	<p>At present, the AMCM does not have formal manuals for assessing banks' compliance with prudential standards during offsite or on-site inspections. It is recommended that if such manuals are prepared, a section on assessing compliance with AML procedures be included.</p> <p>The results of the Assessment of the Basel Core Principles (BCP) on licensing (BCP 3), internal controls (BCP 14), accounting and disclosure (BCP21), information sharing (BCP 1.6) and cooperation with foreign supervisors (BCP 24) should also be noted.</p>
Customer due diligence	
Description	<p>Legal obligations with regard to customer due diligence are described in the overview. The AMCM determines whether banks carry out customer due diligence by verifying, during on-site supervisory visits, the implementation by banks of the procedures set out in the Financial System Act of Macao and the AML guidelines issued by the AMCM. Banks indicate that their account opening procedures require the production of identification document such as passport or other valid ID. Sometimes, a prospective customer is asked to produce a bank statement or a utility bill to verify the customer's address. Failure to produce an acceptable form of identification results in the refusal to open an account.</p> <p>The existing guidelines for banks (the AMCM Circular) are not clear as to whether the rules for customer identification set out therein apply in all cases, i.e., whether they apply both to transactions which involve the opening of a bank account and transactions for which no bank account needs to be opened. Also, the existing rules appear to allow Macao banks to rely on customer identification records to be provided by other financial institutions (which are limited to banks located in the jurisdictions specified in the AMCM's guidelines) in the event of transactions that do not require opening an account.</p> <p>As mentioned in the Overview section, the existing guidelines for banks are currently being revised. The new guidelines should provide more comprehensive rules on customer identification.</p> <p>The existing guidelines concentrate on the procedures for verifying the customer's identity and do not stress the importance of knowing the nature of customer's business on a continuous basis as an important factor in preventing money laundering.</p>
Assessment	Largely compliant
Comments	The AML guidelines for banks issued by the AMCM should be amended to clearly set out the identification procedures that must be applied consistently to opening bank accounts and to

	<p>other operations (i.e., transactions that do not require opening a bank account), both in face-to-face and nonface-to-face transactions. The provision that allows reliance by Macao banks on documentation provided by other banks while conducting customer due diligence should be reconsidered. The regulations should stress close knowledge of the customer and the customer's business as an important control tool.</p> <p>On-site inspections by the AMCM should examine manuals, routines, and reporting structures implemented in commercial banks by, for example, questioning the tellers on their procedures.</p>
Monitoring and reporting of suspicious activities	
Description	<p>The Overview section describes the provision of the Law No. 24/98 and of the implementing regulations issued by the AMCM that banks have in place the procedures to detect and report suspicious activity. The AMCM guidelines provide banks with indicators for activities, which are to be considered suspicious. Compliance with the AML guidelines is checked during on-site inspections. The AMCM, however, has no written manuals to be used during bank inspections to check compliance with the AML measures. There have been no cases where sanctions were applied by the AMCM to banks for failure to comply with the suspicious transaction reporting requirements.</p> <p>Banks appear to have procedures in place for monitoring and reporting suspicious transactions. It is difficult, however, to evaluate the quality of the staff designated as compliance officers or to assess the overall effectiveness of these procedures. The very low level of reporting of suspicious transactions to the Judicial Police suggests that there is room for improvement in the implementation of the suspicious transactions reporting rules.</p>
Assessment	Materially noncompliant
Comments	<p>It is recommended that the legal framework governing detection and reporting of suspicious activity be enhanced. For example, consideration should be given to amending the legislation (i) to expressly prohibit warning ("tipping off") customers when information relating to them is being reported to the Judicial Police or other competent authorities; (ii) to require financial institutions to file a suspicious transaction report where a prospective client has refused to provide proper identification and the bank turns down such customer. Further, the AMCM should consider amending the AML guidelines by adding to the list of suspicious transactions operations involving the banks' correspondent accounts, and to require that the institutions reporting suspicious transactions to the Judicial Police must comply with instructions from the Judicial Police.</p> <p>It would be useful if the regulations establish a standard form that should be used for reporting of suspicious transactions.</p> <p>With respect to implementation, the AMCM should (i) require banks to adopt and circulate to their staff instructions/manuals for identifying suspicious transactions, record keeping and related matters; (ii) pay special attention to the implementation by banks of AML guidelines during its supervisory inspections by, for example, interviewing compliance officers or undertaking a more thorough review of the AML procedures in banks with especially low level of suspicious transactions reports; (iii) where necessary, apply sanctions for failure of a bank to file suspicious transaction reports; and (iv) increase general awareness of banks about AML requirements.</p>
Record keeping	
Description	See overview section above. The record keeping of banks is checked in the process of inspections. The records are generally maintained for 10 years.
Assessment	Compliant
Comments	It is advisable that during inspection it is specifically verified that institutions are indeed

	keeping copies of the identity cards used to open accounts, and of transactions in accordance with the AML guidelines.
Training and organizational dissemination of information.	
Description	<p>See overview of rules mandating training. While the AML legislation requires that ongoing training on AML issues be provided to the banks' staff, the training currently available is not sufficient. The volume of training on AML should be increased to enhance awareness of the banks' management and staff, customers and general public of the authorities' AML efforts. More training on AML matters should be available to the AMCM's staff supervising financial institutions. Regular training should be also organized for the banks' staff on AML rules and procedures.</p> <p>At present, the AMCM does not have sufficient resources to organize the necessary training. It does, however, recognize the importance of taking measures to make such training available for all interested parties.</p>
Assessment	Largely noncompliant
Comments	<p>The AMCM should take advantage of its membership in different international groups and organizations to keep its staff aware of the developments in the AML area. It should also be encouraged to seek assistance from the relevant international agencies and organizations as well as from the private sector for organizing training courses on AML for the AMCM's staff and for financial institutions.</p> <p>The AMCM should also consider posting the AML guidelines on its Internet site.</p>
Compliance and audit	
Description	Under the AML guidelines issued by the AMCM, banks should designate compliance officers to centralize information on suspicious transactions and to coordinate the AML efforts within the institution. Banks appear to have designated compliance officers, as required by the regulations. Compliance of banks with these requirements is assessed during AMCM's inspections during which it verifies that the provisions of the legislation and regulations are being observed.
Assessment	Largely compliant
Comments	It is important to ensure that once a compliance officer is designated, this person is provided with the necessary training on AML matters, including the rules for customer identification and criteria for suspicious transactions. Persons of high moral professional and moral standards should be designated as compliance officers.

E. Insurance Supervision

Detailed assessment

Table 2. Detailed Assessment of Compliance with the Insurance Supervision AML Requirements

Organizational and administrative arrangements	
Description	See overview section above. Compliance with the AML measures is assessed during on-site inspections. No such assessments have yet been conducted, as the AML guidelines were issued fairly recently. The authorities plan to include assessments of the AML measures in their future regular on-site visits to insurance companies.
Assessment	Largely compliant
Comments	The results of the Assessment of the IAIS Core Principles (ICP) on organization (ICP 1), corporate governance (ICP 4), internal controls (ICP 5), reinsurance (ICP 10), and coordination and cooperation (ICP 16) should also be noted.
Licensing and professional conduct tests	
Description	<p>The Insurance Ordinance provides that a license is required to carry out insurance business, and gives the Chief Executive the authority to issue licenses upon advice of the AMCM. The Financial System Act, the Insurance Ordinance and AMCM's By-Laws define the responsibilities of the AMCM. Detailed licensing requirements are set out in the Insurance Ordinance and regulations issued by the AMCM. A condition for the license is that the applicant satisfies the "fit and proper" test, as specified in the law and regulations. The "fit and proper" requirements apply to members of the supervisory board and the board of the general assembly of the insurer as well.</p> <p>Licensing requirements are described in greater detail in the assessment of observance of the IAIS Core Principles.</p>
Assessment	Compliant
Customer due diligence	
Description	The requirements for customer identification and identification of beneficial owners in the life insurance industry are those under the legislation referred to in the Overview.
Assessment	Compliant
Monitoring and reporting of suspicious activities	
Description	See legislation described in the overview above. Large insurance companies appear to have in place procedures for detecting and reporting suspicious transactions. Since the AML guidelines for insurance companies were issued only in March 2001, compliance with these guidelines have not yet been assessed by the AMCM during inspections.
Assessment	Largely compliant
Comments	Compliance with the procedures for monitoring and reporting suspicions activities should be verified during on-site inspections by the AMCM. Special attention should be paid to the implementation of these procedures in small companies.
Record keeping	

Description	As described above, both the Macao SAR's Commercial Code and the AMCM's guidelines specify the period for keeping of customer records. The minimum period established by the Commercial Code is ten years; the AMCM guidelines require that records be kept for at least six years.
Assessment	Compliant
Comments	It is desirable to verify whether companies, especially small insurance companies, indeed comply with the record keeping requirements.
Training and organizational dissemination of information.	
Description	Life insurance companies are subject to similar rules as banks. At present, there is lack of training both in banks and insurance companies on AML issues. See assessment of this principle under the banking sector assessment.
Assessment	Largely compliant
Comments	It is recommended that AMCM circulate its AML guidelines not only to the insurance companies but to insurance agents and brokers as well. The AMCM should also consider posting the AML guidelines on its Internet site. Subsequent to the assessment the AMCM informed us that guidelines are available on its internet site and that it has finalized the revision of the Insurance Intermediaries Qualifying Examinations, which requires knowledge of anti-laundering issues.
Compliance and audit	
Description	See overview and section on administrative arrangements.
Assessment	Largely compliant
Comments	The AMCM should verify during on-site inspection the extent to which companies comply with the legal requirements.

F. Summary of Recommendations

This section summarizes the major recommendations on strengthening the AML framework in Macao SAR. The recommendations set out in this section apply across all sectors that were reviewed during the OFC assessment of Macao SAR.

Improving the legal and institutional framework for suspicious transactions reporting.

The legislation on mandatory reporting of suspicious transactions should be improved. Consideration should be given to amending the existing legislation as follows: (i) to expressly prohibit warning ("tipping off") customers when information relating to them is being reported to the Judicial Police or other competent authorities; (ii) to require financial institutions to file a suspicious transaction report where a prospective client has refused to provide proper identification and the bank turns down such a customer. The AMCM should consider amending the AML guidelines by adding to the list of suspicious transactions operations involving the banks' correspondent accounts; (iii) to require that the institutions reporting suspicious transactions to the Judicial Police must comply with instructions from the Judicial Police; (iv) to clarify the manner in which suspicious transaction report should be filed; and (v) to provide for the liability for unauthorized disclosure of information related to suspicious transaction reports. Enforcement of the existing legislation should be tightened,

including through a more vigorous application by the AMCM of sanctions for failure to report suspicious transactions.

Revision of the AML guidelines for financial institutions. The revision of the anti-money laundering guidelines for financial institutions should be completed without undue delay. The revised AML guidelines should establish detailed rules on customer identification, the implementation of the “know your customer” rule, detection of suspicious transactions and training of staff. In the revision of the AML guidelines, account should be taken of the recent developments on the revision of the FATF 40 recommendations, including additional recommendations on the prevention of financing of terrorism. The requirements on customer identification should be tightened to reduce reliance on documentation provided by other financial institutions. The regulations should stress close knowledge of the customer and the customer’s business as an important control tool.

Extending the AML measures to non-banking financial institutions. It is recommended that the AML regime applicable to banks and finance companies, including the “know your customer” rule, apply to other financial institutions, i.e., money changers, cash remittance companies, forex companies and other institutions supervised by the AMCM. It is important to make such other financial institutions subject to the anti-money laundering measures, as there is a substantial risk that persons seeking to launder illicit proceeds may use those entities. Also, other institutions subject to supervision of the AMCM, e.g., financial intermediaries, should be made subject to the AML measures similar to those that apply to banks and other financial institutions.

Mandatory reporting of cash transactions. It is recommended that the introduction of mandatory reporting of cash transactions exceeding a specified threshold be considered.

Clarifying the AML framework in the gaming sector. Given the size of the gaming sector in Macao and its importance for Macao’s economy, a proper AML framework for this sector must be established and enforced. This should include, in the least, the following measures (i) clarifying the mandatory force of the provisions of the existing legislation on detecting and reporting of suspicious transactions by casinos and other supervised gaming establishments; (ii) issuing by the body supervising the gaming industry of the necessary implementing regulations; and (iii) strengthening the enforcement of the AML measures applicable to the gaming sector. Guidelines for the application of suspicious transaction reporting rules should be issued and implemented in other sectors as well (i.e., real estate businesses, businesses dealing in precious metals and stones, antique).

Establishment of a financial intelligence unit. The authorities should consider establishing a separate agency (e.g., an FIU) outside the law enforcement system that would be responsible for collecting and analyzing suspicious transaction reports and coordinating the investigation of money laundering cases. In the meanwhile, it is important that the Judicial Police be allocated sufficient resources to analyze the suspicious transaction reports and to investigate money-laundering cases. The staff of the Judicial Police should receive the necessary training on financial and other related matters.

Cooperation and information sharing. Efforts should be made to step up the cooperation and coordination between various agencies responsible for the implementation of the AML

regime in Macao SAR. International cooperation should be enhanced by improving the legal framework on international cooperation. The authorities should continue using both formal and informal channels to share information on AML matters with overseas police organizations.

Training. Measures should be taken to improve training of the staffs of the supervisory agencies, banks and other institutions subject to AML measures on the AML issues. The authorities should develop and implement a program aimed at increasing general awareness of AML issues in Macao SAR.

A PRINCIPLE-BY-PRINCIPLE ASSESSMENT OF BANKING STANDARDS

Principle 1: An effective system of banking supervision will have clear responsibilities and objectives for each agency involved in the supervision of banks. Each such agency should possess operational independence and adequate resources. A suitable legal framework for banking supervision is also necessary, including provisions relating to authorization of banking establishments and their ongoing supervision; powers to address compliance with laws as well as safety and soundness concerns; and legal protection for supervisors. Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.

Principle 1(1): An effective system of banking supervision will have clear responsibilities and objectives for each agency involved in the supervision of banks.

Description

The Monetary Authority of Macao (AMCM) is the sole supervisory agency of Macao's banking system. The Financial System Act of Macao (FSAM), approved by Decree law No. 32/93/M, Article 5, authorizes the AMCM to supervise, coordinate and inspect the financial markets and credit institutions. A credit institution is an undertaking whose business is to receive deposits or other repayable funds from the public and to grant credit on its own account and risk. Bank is a type of credit institutions under the FSAM. Decree Law No. 58/99/M, governing offshore activities, Article 29, provides that offshore financial institutions are subject to supervision by the AMCM under the general terms of the FSAM.

In its capacity as the supervisory authority, the AMCM is responsible for promoting the general stability and proper functioning of the financial system, including:

- Ensuring compliance with all the legal provisions which govern authorized institutions and the working of the financial, money and foreign exchange markets;
- Taking all reasonable steps to ensure that institutions under supervision are operated in a sound and prudent manner;
- Implementing and encouraging the adoption of correct standards of ethical conduct and sound business practices;
- Suppressing practices incompatible with the nature of the institutions and situations liable to adversely affect the proper running of the markets.

Also, the By-Law of the AMCM stated that the responsibilities of the AMCM include:

- Advise and support the Chief Executive in the formulation and conduct of the monetary, financial, exchange rate, and insurance policies, by reporting and issuing opinions on the matters referred for its consideration;
- Study and propose the measures required for the execution of the monetary, financial, exchange rate and insurance policies and provide for their enforcement;

- Guide, coordinate and inspect the money, financial, foreign exchange and insurance markets, providing for their smooth operation and supervising the relevant operators, in accordance with the rules and regulations applying to those activities;
- Act as intermediary in the monetary and financial external relations of the Macao SAR;
- Provide for the stability of the financial system, performing for this purpose the duty of lender of last resort.

The FSAM and supporting notices and circulars provide a framework of minimum prudential standards that the banks must meet. Notices must be published in the official Gazette, and circulars are issued and delivered to banks. The AMCM Banking Supervision Department and Legal Department have primary responsibility of updating banking laws when deemed appropriate. The proposed legislation is circulated to banks for consultation and comment.

The AMCM is involved in the resolution of a problem bank situation. The FSAM gives the AMCM the power to impose penalties on practices and acts that are especially serious. The penalty can be a simple warning, fine, temporary prohibition from holding any board or management positions in any credit institutions, or publication of penalties. In addition, when a credit institution persists in operating in an unsafe and unsound manner, the Chief Executive of Macao SAR, on advice from the AMCM, can issue an executive ruling for special measures to be imposed. The range of measures includes imposition of conditions, restriction on banking activities, suspension of directors from their offices, order of conservatorship, and closure. The AMCM had exercised its power in imposing stricter capital requirement and closing of banks.

Assessment

Compliant.

Principle 1(2): Each such agency should possess operational independence and adequate resources.

Description

The Banking Supervision Department of the AMCM is responsible for the supervision of the banking system. The department, comprising two deputy directors, eleven examiners, and five support personnel, reports to the board of directors of the AMCM. All professional staff are degree holders and have prior banking experience. Ten of them are also qualified accountants. The average experience of staff engaging in banking supervision is seven years. The responsibilities of the Banking Supervision Department include licensing and supervision of financial institutions; development of laws, regulations, and policies for the financial sector; as well as liaison with foreign supervisors and international and regional supervisory groups. The demands of the various duties have constrained the department's ability to write on-site and offsite supervision manuals and to develop supervisory handbooks or guidelines. It has expressed that two additional professionals to support the bank supervision policy area would be desirable. There are three vacancies in the department and

efforts to fill them have, to some extent, had to be postponed because of budget considerations and also by the desire to find candidates with appropriate education and experience. The ability to retain staff does not appear to be an issue in the department. Under Article 7 of the FSAM, the AMCM has the authority to engage independent experts to deal with special situations. It had used this authority when dealing with the Year 2000 date change situation.

The AMCM is funded by the return on its assets, earnings from its operations, fees paid by the entities subject to its supervisions, and fines collected. The bank supervision fee schedule is based on the head office or main branch and the number of branches. The board of the AMCM approves the budget for the agency under the overall guidelines that are applicable to all government departments. The Banking Supervision Department prepares a budget annually. There is a fairly extensive training program that has allowed staff to attend training programs organized by the Bank for International Settlements, the Financial Stability Forum, the Federal Reserve Bank of New York, the South East Asian Central Banks (SEACEN), and the South East Asia New Zealand Australia Banking Supervisors Forum (SEANZA). In addition, the staff participates in the anti-money laundering workshop sponsored by the Asia Pacific Group (APG) on Anti-Money Laundering. The AMCM training program also has supported higher academic and professional studies.

The FSAM provides that final decisions involving supervision fees, licensing, special (credit exposure) limits, special (supervisory) measures, and intervention rest with the Chief Executive of Macao SAR, on advice from the AMCM. This legal provision appears to imply considerable operational dependence on the government. However, we understand from AMCM senior staff that, despite the legal status, there has not been any instance where the recommendations of the AMCM have not been accepted by the government.

Assessment

Largely compliant.

The AMCM is not fully independent of the government of Macao SAR as decisions concerning banking supervision fees, licensing of banks, setting of special limits, and imposition of special measures are, legally, the prerogative of the Chief Executive of Macao SAR. This legal provision could interfere in the operational independence of the AMCM.

Recommendations

The AMCM should be granted final prudential decision-making power under general policy guidelines set by the government. An amendment to the legislation to provide for operational independence for the AMCM should be enacted.

It is also recommended that additional staffing resources be added to ensure that banking risks are identified and supervision guidelines are developed and implemented in a timely manner. In addition, it is recommended that supervision manuals and handbooks (e.g., internal controls, credit risk management, anti-money laundering) be developed. They are useful in communicating the practices and standards expected of

the banks, enhancing transparency to the supervisory processes, promoting consistency, and serving as a training tool.

Principle 1(3): A suitable legal framework for banking supervision is also necessary, including provisions relating to authorization of banking establishments and their ongoing supervision.

Description

The AMCM is the licensing authority for banks. The FSAM and the Offshore Decree Law established the procedures for application for authorization, capital requirements, and scope of authorized operations and liability. According to Article 19 of the FSAM, prior approval by the Chief Executive, on advice from the AMCM, is required for licenses to be issued.

Under the FSAM Article 8, the AMCM has the power to examine banks through its own examiners. Article 6 of the Act allows the AMCM to set prudential rules administratively without changing the law. Notices and circulars have been issued to provide further guidance on capital, liquidity, credit classification, provisioning, regulatory reporting, valuation of assets and liabilities, and anti-money laundering. The banks are required (Article 7 of the FSAM) to submit information as prescribed by the AMCM. Notice No. 007/92-AMCM sets the type and frequency of reports from the banks.

Assessment

Compliant.

Principle 1(4): A suitable legal framework for banking supervision is also necessary, including powers to address compliance with laws as well as safety and soundness concerns.

Description

The FSAM empowers the AMCM to enforce compliance with laws and address safety and soundness concerns. Article 8 of the FSAM specifically gives the AMCM the power to examine the books, accounts, transactions and other relevant records and documents of the banks at any time. The FSAM Articles 125 through 130 list the type of penalties that can be applied and specify the range of fines that can be imposed on practices and acts that are considered especially serious, which are listed in Article 122. The AMCM has the ability to exercise qualitative judgment in determining the penalty and the amount of fine. The Act further allows special measures, as listed in Article 83, to be applied to deal with unstable bank conditions. The recommended measures are submitted to the Chief Executive of Macao SAR for approval.

Assessment

Compliant.

Principle 1(5): A suitable legal framework for banking supervision is also necessary, including legal protection for supervisors.

Description

The AMCM stated that its staffs are protected under the Penal Code (Articles 30, 35 and 36) and the Civil Servants Regime article 10, paragraph 2 when acting in bona fide discharge of their functions and powers.

Assessment

Compliant.

Principle 1(6): Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.

Description

The AMCM is the sole supervisory agency of the financial system. The FSAM Articles 78 and 79 allow the exchange of information between the AMCM and other supervisory authorities provided that the information is used for supervisory purposes and remains subject to confidentiality. If information is requested for purposes other than supervision, disclosure has to be authorized by a Macao SAR court. The AMCM has signed Memorandum of Understanding (MOU) with the People's Bank of China, the Hong Kong Monetary Authority, and the Bank of Portugal. The MOUs describe the scope of information to be exchanged along with their confidentiality. There are regular meetings with these home country supervisors.

The AMCM allows foreign home supervisors to conduct on-site reviews in Macao SAR. The Hong Kong Monetary Authority has conducted annual inspections and the Bank of Portugal and the People's Bank of China have each carried out one inspection in Macao. In the framework of the licensing procedures, the AMCM exchanges information with foreign supervisors.

Assessment

Compliant.

Principle 2: The permissible activities of institutions that are licensed and subject to supervision as banks must be clearly defined, and the use of the word "bank" in names should be controlled as far as possible.

Description

Under Article 15 of the FSAM, bank is a type of credit institution. A credit institution is defined as an undertaking whose business is to receive deposits or other repayable funds from the public and to grant credit on its own account and risk. The FSAM Article 18 prohibits any entity which has not been authorized as a credit institution to use the words or expressions such as "bank," "banker," "banking," "deposit" or any other term which implies the idea of operating the business of a credit institution. Under Article 16, only those credit institutions that have been duly authorized under the terms of the FSAM or other special legislation may operate a business involved in accepting deposits and other repayable funds from the public.

The permissible activities of banks are defined in Article 17. They are:

- Accepting deposits and other repayable funds from the public;
- Lending, guarantees and other commitments, financial leasing and factoring;
- Money transmission services;
- Issuing and administering means of payment such as credit cards, travelers' checks and letters of credit;
- Trading for own account or for account of customers in money, financial and foreign exchange market instruments, financial futures and options, and transactions involving foreign exchange or interest rates and transferable securities;
- Participating in issues and placements of securities and provision of other services related to such issues;
- Operating in inter-bank market;
- Portfolio safekeeping, administration and management;
- Management of other assets;
- Financial consultancy;
- Investment in holdings in company capital;
- Credit reference services;
- Safe custody services;
- Sale of insurance contracts;
- Other similar transactions not forbidden by law.

The Offshore Decree Law prohibits offshore banks to carry out transactions with residents and conduct transactions denominated in patacas.

The AMCM noted that the banking activities in Macao SAR are relatively traditional and straightforward. The banks' insurance and securities activities are limited to as agent capacity. Although permitted by the FSAM, the banks do not engage in fiduciary or trust activities. The banks are required to inform the AMCM of the nature and condition of new financial products prior to launching.

Assessment

Compliant.

Principle 3: The licensing authority must have the right to set criteria and reject applications for establishments that do not meet the standards set. The licensing process, at a minimum, should consist of an assessment of the banking organization's ownership structure, directors and senior management, its operating plan and internal controls, and its projected financial condition, including its capital base; where the proposed owner or parent organization is a foreign bank, the prior consent of its home country supervisor should be obtained.

Description

The AMCM Banking Supervision Department is the licensing authority for banks. The AMCM has the authority to set application and evaluation criteria, which are based on legal requirements and prudential guidelines, and is responsible for evaluating the applications. However, final decision on licensing rests with the Chief Executive of Macao SAR, based on recommendation from the AMCM (Article 19 of the FSAM). Article 36 requires approved banks to register with the AMCM prior to commencement of business. The FSAM Article 35 allows licenses to be revoked when false information was used. In the past two years applications for a variety of licenses have been received—two were for banks, seven for financial intermediaries, one money changer and one for cash remittance. There is no difference in the licensing process between onshore and offshore banks.

The AMCM has established licensing procedures for banks. They include application requirements and evaluation parameters. Some of the principal evaluation criteria are:

- Economic and financial reasons for establishment, and impact to Macao SAR.
- Suitability of shareholders, directors and senior management. The assessment of suitability of shareholders, directors and senior management takes into account, among other things, of professional record, financial standing, legitimacy of sources of income, and indications of bankruptcy filing, criminal activities or other offences.
- Group structure in which the applicant belongs to.
- Managerial and financial resources are commensurable to the type and volume of proposed operations.

- Adequacy of operational structure to safeguard deposit funds.

If the application is for the establishment of a subsidiary or a branch of a foreign institution, consideration is given to the position of the home country supervision authority, the possibility of an effective supervision on a consolidated basis, and reciprocity treatment. The home country supervisor is contacted for its views on the application; approval of the application; assurances that the parent institution is legal, meets the Basel standards, and is authorized to establish operations overseas; and certification that supervision is on a consolidated basis.

For onshore banks, the FSAM requires a minimum capital of 100 million patacas (US\$12.5 million) for locally incorporated banks (Article 21). There is no minimum share capital required of branches of foreign institutions. However, they are required to maintain at all times in Macao, in certain categories of assets to be defined by the AMCM, an amount of 50 million patacas (Article 23). The categories of assets are defined in Notice No. 010/93-AMCM. Separately, the Offshore Decree Law Articles 17 and 18 set the amount of share capital required of offshore banks. For incorporating and operating offshore financial subsidiaries, they must hold share capital amounting to at least half the share capital legally required for exactly the same kind of institution licensed to operate with residents. For establishing and operating an offshore branch, the relevant institution should be incorporated outside the Macao SAR and must have a share capital not lower than legally required for the kind of similar institution authorized to do business with residents.

All banks, both onshore and offshore, must maintain an office in Macao SAR.

Under Articles 31 and 32, establishment of local branches and overseas subsidiaries or branches must be approved by the AMCM. The application and evaluation criteria for overseas subsidiaries or branches include: country or jurisdiction in which the subsidiary or branch intends to operate, the nature of business, an explanation of the economic and financial reasons for the establishment, background information on the subsidiary or branch management, adequacy of operational structure, the management and financial capability of the bank. The AMCM also evaluates reciprocity treatment by the host country or jurisdiction.

Furthermore, the Chief Executive of Macao SAR, on advice from the AMCM (Article 113) must approve any division, merger or reorganization of a bank.

Assessment

Compliant.

Principle 4: Banking supervisors must have the authority to review and reject any proposals to transfer significant ownership or controlling interests in existing banks to other parties.

Description

The FSAM has a provision for "significant" ownership. Based on Article 40, it is a holding that, either directly or indirectly, represents 10 percent or more of the share capital or voting rights, or in any other form which confers the possibility to exercise a significant influence over the management of the institution. In addition, a shareholder becomes a controlling interest when the shareholder holds over half the voting rights, has the right to appoint or dismiss over half the members of the board of directors or of the supervisory board (i.e., audit committee), or, under an agreement with other shareholders of the company, has exclusive control of the majority of voting rights.

The Article requires that prior approval by the AMCM be obtained when an individual or corporate body acquires, either directly or indirectly, a significant holding of a bank incorporated in Macao SAR, or increases share capital or voting rights by over 5 percent. Under Article 41 of the FSAM, the AMCM is required to evaluate the suitability of shareholders. If it is not satisfied that the shareholders can ensure the sound and prudent management of the institution, it may oppose the acquisition of or increase in share capital or voting rights. Locally incorporated banks are required to submit to the AMCM, in April each year, a list of shareholders with holdings of more than 5 percent of the respective capital or voting rights.

Assessment

Compliant.

Principle 5: Banking supervisors must have the authority to establish criteria for reviewing major acquisitions or investments by a bank and ensuring that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.

Description

According to Article 68 of the FSAM, the banks may not have a shareholding in another company that exceeds, either directly or indirectly, 15 percent of its own funds, and the aggregate amount of shareholding in companies may not exceed 60 percent of the bank's own funds. In practice, these limits are applied to financial holdings, which the AMCM defines as investment in shares of companies for more than 6 months. (For investment in shares that are not financial holdings, that is, normal investments, see Core Principle 7 Loans and Investment Principles). In addition, Article 69 prohibits the banks from holding more than 25 percent of the voting rights, either directly or indirectly, of the capital of the companies that they invested in. The limit does not apply to the three exemptions listed in the Article. The exemptions are: (1) financial institutions subject to supervision deemed adequate by the AMCM; (2) insurance companies and pension fund management companies; and (3) companies whose activity is complementary to the activity of the bank, when prior authorization from the AMCM has been granted.

Under Article 113, any division, merger or reorganization of the bank must be approved by the Chief Executive of Macao SAR, on advice from the AMCM. Many of the evaluation factors used in the initial licensing procedures are used in assessing individual acquisition or investment proposals, including economic and financial reasons for merger or acquisition, impact to the stability of the Macao SAR financial system, management and financial capability, adequacy of operational structure, and compatible of activities to banking.

Additionally, the net aggregate value of the real estate, financial holdings and other tangible and intangible assets of a bank cannot exceed the value of its own funds (Article 70).

Assessment

Compliant.

Principle 6: Banking supervisors must set minimum capital adequacy requirements for banks that reflect the risks that the bank undertakes, and must define the components of capital, bearing in mind its ability to absorb losses. For internationally active banks, these requirements must not be less than those established in the Basel Capital Accord.

Description

The FSAM, Article 6, grants the AMCM power to issue directives on the solvency ratios and criteria for weighting assets and off balance-sheet items. Article 59 authorizes the AMCM to set higher capital adequacy ratios, on a case-by-case basis, in exceptional circumstances. In addition, Article 122 lists the failure to observe prudential limits as an especially serious practice or act, which is punishable under Article 126 and 127. (See Core Principle 3 Licensing regarding minimum capital requirement).

The AMCM has issued Notice No. 013/93-AMCM that requires both locally incorporated onshore and offshore banks to maintain a solvency ratio of not less than 8 percent after June 30, 1994. The calculation of the capital ratio encompasses both on-balance-sheet and off-balance-sheet assets. However, market risk is not addressed in the calculation of the capital ratio. The AMCM noted that the banks operating in Macao SAR are engaged in traditional banking activities. Their trading activities are small in scope, focused on foreign currencies trading, and mainly transacting for customers. The AMCM plans to address market risk by 2005 when the new Basel capital guidelines are expected to become effective.

Circular No. 003/A/94-DSB/AMCM requires locally incorporated banks that have subsidiaries to calculate the capital ratio on a solo and consolidated basis, and to maintain corresponding documents and records to show the respective calculations. The Circular further requires the banks to report their solvency ratios to the AMCM on a quarterly basis.

The definition of capital and method of calculation (credit risk) are consistent with the Basel Capital Accord. The elements of capital include core and supplementary capital, and the supplementary capital cannot exceed the amount of core capital. The components of core capital are: paid-up share capital; share premium; profits or losses brought forward; legal, statutory and other reserve; minority interest arising from consolidation; and deduction of

goodwill. The legal, statutory and other reserve component includes all the reserves constituted by appropriation of profit approved but not distributed to shareholders. Only audited profits are permitted to be included in the profits or losses brought forward component. The components of supplementary capital are reserves on revaluation of premises; revaluation of securities (up to 45 percent of unrealized surplus or gain); general provision (limited to 1.25 percent of total risk weighted assets); perpetual subordinated capital instruments; and non-perpetual subordinated capital instruments (limited to 50 percent of core capital). Prior approval by the AMCM is required if the reserves on revaluation of premises component is to be included in the supplementary capital. The deductions from total capital are generally consistent with the Basel guidelines.

Overall, the on-balance-sheet categories and risk weights, as well as the off-balance-sheet instruments, credit conversion factors, and two-step approach are within the Basel framework. The AMCM reported that the average capital ratio of locally incorporated banks averaged 15–16 percent.

Assessment

Largely Compliant.

Recommendation

Market risk is not addressed in the Basel capital adequacy ratio calculation. It is recommended that the AMCM address the requirement of market risk in the Basel capital adequacy ratio calculation. The supervisory guideline should identify the type of banks that are required to incorporate market risk in the capital adequacy calculation, and the methodology on market risk adjustments to capital ratio calculation.

Principle 7: An essential part of any supervisory system is the independent evaluation of a bank's policies, practices and procedures related to the granting of loans and making of investments and the ongoing management of the loan and investment portfolios.

Description

All licensed banks are subject to regular on-site visit and offsite reviews. An objective of on-site examination is to assess the bank's asset quality and compliance with laws, notices and circulars. The AMCM examiners review bank policies and procedures to ensure that a sound credit granting and investment criteria have been established, that an appropriate credit administration is maintained, that adequate controls are in place, and that there is an ongoing monitoring and reporting process on credit risk. Accounts are tested to verify that bank policies are complied with and practices are consistent with bank procedures. The review coverage of individual loan relationships ranges from 30 to 50 percent of total loans. The AMCM examiners also verify compliance with statutory limits and guidelines issued by the AMCM. The statutory limits include those governing aggregate lending; large exposure; exposure to qualifying shareholders and companies under their control; exposure to members of the board of directors and supervisory board or companies under their control; exposure to

each bank staff; investments in shares which are not financial holdings; and financial holdings. The guidelines issued by the AMCM include those concerning loan classification, non-accrual loan and provisioning requirements, and valuation rules. A checklist is used to facilitate the compliance review.

In addition, the AMCM examiners verify that loans are granted free of conflict of interests, on an arm's-length, and in compliance with Article 51 of the FSAM, which prohibits the bank's board of directors, supervisory board, management, employees, and consultants from participating in the credit assessment and decision-making processes involving granting credits to themselves or their related parties.

Where weaknesses are identified, they are brought to the attention of bank management in a management letter.

The banks are permitted to invest in shares that are not for financial holdings. The FSAM Article 66 defines financial holdings as shares that are not traded within six months. According to the AMCM, investments in shares for less than six months are considered normal investments. Article 66 requires that investments in shares that are not financial holdings observe the following rules:

Shares issued by companies incorporated overseas should be listed in a stock exchange.

The holding of shares issued by the same company may not exceed 5 percent of the credit institution's own funds nor represent more than 5 percent of the capital of the issuing company.

Notice No. 011/93-AMCM requires the banks to re-value securities that are not financial holdings at the lower of cost or market value on a monthly basis.

The AMCM noted that banks are allowed to hold debt securities in addition to equity securities, and their holdings of debt securities must comply with bank policies on type, quality and limits. The FSAM does not address holdings of debt securities.

The banks are formally required to monitor concentration in large exposure and connected lending (see Core Principles 9 and 10), and are reporting loans and advances by industry segments as prescribed in the monthly monetary and financial statistical return. However, the AMCM stated that there is no formal supervisory requirement on the identification and monitoring of other concentration risk in the loan portfolio.

Assessment

Largely Compliant.

Recommendation

A regulatory aggregate limit has not been established for investments in shares that are not financial holdings. An aggregate limit could control excessive investments and risk to capital from the highly volatile equity markets. Formal supervisory guidelines on the

type (e.g., government vs. corporate), quality (e.g., investment rating), and limits should be developed for investments in debt securities. In addition, monitoring of other concentration risk in the loan portfolio should be formally required. Information about concentration risk should be identified and monitored by loan type, by industry segment, by geographic area, by collateral, etc. A definition on concentration, for example, a percentage of capital for locally incorporated banks or of total assets for foreign branches, should be developed.

Principle 8: Banking supervisors must be satisfied that banks establish and adhere to adequate policies, practices and procedures for evaluating the quality of assets and the adequacy of loan loss provisions and reserves.

Description

The FSAM Article 6 authorizes the AMCM to issue directives to set the criteria for provisioning and to establish minimum limits for the general and specific provisions. Notice No. 18/93-AMCM establishes a general framework, to be observed by all credit institutions, on loan classification, provisioning, non-accrual of interests, and requirement for independent appraisal. According to the Notice, accounts are delinquent when either the payment of interest or the repayment of principal is delayed. Accounts that are over three months past due are required to be placed on non-accrual status. The loan classification system classifies loans into pass, special mention, doubtful and bad categories. The system follows the internationally recommended standard for classifying loans, i.e., loans are classified when payments are contractually a minimum number of days in arrears (e.g., 30, 60, 90 days). Loans are classified doubtful when over three months but less than or equal to 18 months delinquent. Loans are classified bad when past due over 18 months.

Also, the Notice requires the establishment of a loss reserve, comprising of both specific (see table below) and general components. The general reserve is based on 1 percent of the entire loan portfolio amount after deducting Group II, III and IV loans. The system for loan classification and provisioning includes off-balance sheet exposures. An independent valuation of tangible collateral is required for credits over 1,000,000 patacas (US\$125,000) and are classified as Group II, III or IV. The external auditors, when conducting the audits of the financial statements, review the provisioning policies of the banks.

Group	Delinquency Status	Minimum Specific Provision (based on net realizable value)
I	Up to 3 months	-
II	Over 3 months but less than or equal to 12 months	40%
III	Over 12 months and less than or equal to 18 months	80%
IV	Over 18 months	100%

The banks are required to review and submit a bad (i.e., Group IV loans) and doubtful (i.e., Group II and III loans) loans report to the AMCM on a quarterly basis. The report lists the individual accounts, outstanding balance, collateral value, net exposure, and provision amount. The AMCM noted that only tangible collateral and real guarantees are considered in valuing collaterals and guarantees. During on-site examination, the AMCM examiners review the appropriateness of loan classification and specific provision. The AMCM examiners have the authority to require the bank to set up or increase provisions when they are found to be inadequate.

The bank writes-off loans when approved by the court, which is a complex and slow process. In addition to court decisions, AMCM accepts the writing off of bad loans provided those loans have already been fully provided and have been overdue more than 18 months and all factors prove that there is remote possibility of repayment. The writing off of accounts without a court decision can only occur with the prior approval of AMCM. The AMCM has the authority to require branches of foreign banks to transfer delinquent accounts, which are booked in the branch but were approved or contracted by the head office or other overseas establishments, to their head office or other overseas establishments. The AMCM had exercised this power.

Assessment

Compliant.

Principle 9: Banking supervisors must be satisfied that banks have management information systems that enable management to identify concentrations within the portfolio and supervisors must set prudential limits to restrict bank exposures to single borrowers or groups of related borrowers.

Description

The FSAM Article 63 defines large exposure as the total exposure with a client or group of closely related clients equals to or exceed 15 percent of the bank's own funds. The Article also defines exposure as any facility, whether drawn or undrawn, granted to a client or group of connected clients, on- or off-balance sheet, including guarantees and other commitments, whether or not it is used, and also the acquisition or holding of financial holdings and securities of any kind issued by the client or group of clients. In addition, Article 64 imposes an aggregate limit on large exposures to 800 percent of the bank's own funds.

- A group of "closely related clients" is defined in Article 63 as:
- Two or more persons, whether individual or corporate, represent a single risk because one of them controls, directly or indirectly, the other or others, or because liability for their respective debts are transferable; or

- Two or more persons, whether individual or corporate, who do not share a relationship of control as described above, but who are interconnected in such a way that if one of them experiences financial problems, the other or all of them are likely to encounter repayment difficulties. Interconnection may include the existence of common ownership or common directors, cross guarantees, or direct commercial interdependency that cannot be substituted in the short term.

The term "controlling power" is further defined in the Article.

Under Article 64, a general credit limit has been established on exposure to a client or a group of connected clients. The limit is 30 percent of the bank's own fund. The FSAM further sets restrictions on exposures to shareholders and directors and their related interests (see Core Principle 10 Connected Lending).

Concentration in large exposures is monitored quarterly. Banks are required to submit a large exposure report to the AMCM at the end of each quarter. In addition, the AMCM examiners verify that banks are properly identifying and reporting large exposures at their on-site examination. (See Core Principle 7 Loan and Investment Principles regarding identification and monitoring of other concentration risk).

Assessment

Compliant

Principle 10: In order to prevent abuse arising from connected lending, banking supervisors must have in place requirements that banks lend to related companies and individuals on an arm's-length basis, that such extensions of credit are effectively monitored, and that other appropriate steps are taken to control or mitigate the risks.

Description

In addition to the general restrictions described in Core Principle 9, the FSAM further sets limits on exposures to shareholders and board of directors and their related interests. Article 65 limits the exposure of any qualifying shareholders and companies under their control to 20 percent of the bank's own funds. The aggregate exposure of all qualifying shareholders and companies under their control is limited to 40 percent of the bank's own fund. The Article further requires that the board, with a favorable opinion from the supervisory board, must approve all credits granted to qualifying shareholders and that the terms of the credit must be reported to the AMCM within 10 days after approval. A qualifying shareholding is a holding which, either directly or indirectly, represents 10 percent of more of the share capital or voting rights, or in any other form which confers the possibility to exercise a significant influence over the management of the institution (Article 40).

The FSAM Article 66 establishes a general individual account limit of 1 percent of the bank's own fund and an aggregate limit of 10 percent of the bank's capital for members of the board of directors and supervisory board, their spouses, children, parents, step-children, step-

parents, sons-in-law, daughters-in-law, parents-in-law, or companies under their control or to which board of directors or supervisory board they belong.

Under Article 51 of the FSAM, members of the board of directors and supervisory board, general managers, managers, other employees, and consultants are not permitted to participate in the assessment and decision-making process involving granting credits to themselves or their related parties. The provision on conflict of interest prohibits terms to be extended on a more favorable basis. As a part of their on-site examination scope, the AMCM examiners, through account testing and review of board minutes, evaluate the terms of loans to shareholders and directors and their related interests to ascertain that they are not preferential or create conflict of interest.

Assessment

Compliant.

Principle 11: Banking supervisors must be satisfied that banks have adequate policies and procedures for identifying, monitoring and controlling country risk and transfer risk in their international lending and investment activities, and for maintaining appropriate reserves against such risks.

Description

The banks are required to collect credit exposures classified by countries and report to the AMCM monthly in their monetary and financial statistical return. The AMCM examiners analyze the return and prepare an internal report on the review. The AMCM informally monitors exposure to Mainland China. However, the AMCM indicated that it has not adopted a formal supervisory program in classifying and monitoring country risk or set policy on provisioning requirement against transfer risk. The delay is, in part, due to banks have low levels of international lending and investment activities outside China. A very high number of banks in Macao SAR are branches and subsidiaries of banks incorporated overseas, country and transfer risks of these banks are subject to consolidated supervision guidelines of the parent bank and the home supervisor.

Assessment

Largely Compliant.

Recommendation

It is recommended that exposures be formally classified and monitored on an individual country or cross border basis, and that an appropriate minimum provisioning policy be introduced. As Mainland China has a separate and different political, economic, social and foreign exchange control structure and conditions, events in Mainland China could adversely affect the banks' financial interests. The supervisory program should include Mainland China as well as Hong Kong.

Principle 12: Banking supervisors must be satisfied that banks have in place systems that accurately measure, monitor and adequately control market risks; supervisors should have powers to impose specific limits and/or a specific capital charge on market risk exposures, if warranted.

Description

The banking activities in Macao SAR focus on traditional lending, market risk related activities are limited. Bank trading activities (normally a part of the bank's treasury function) are small in scope, focused on foreign currencies, and mainly transacting (i.e., taking orders) for customers. Other foreign currency activities involve intra-day trading. At the on-site inspection, the AMCM examiners verify that the banks have established policies, such as position limits or squaring of positions at the end of the day, to control risks to earnings and capital. In addition, the AMCM examiners verify that the banks revalue their foreign currency trading positions and mark their investments in shares that are not financial holdings to lower of cost or market value, as required by Notice 011/93-AMCM. A very large number of banks in Macao SAR are branches and subsidiaries of banks incorporated overseas, market risks of these banks are subject to consolidated supervision guidelines of the parent bank and the home supervisor.

Assessment

Largely Compliant.

Recommendation

It is recommended that assessment of market risk be formally required. Although the scope of market risk is relatively low, the AMCM should develop guidelines requiring market risk to be formally quantified and evaluated. Criteria should be established for determining incorporation of market risk in capital ratio calculation. The guidelines should indicate whether the AMCM should be notified.

Principle 13: Banking supervisors must be satisfied that banks have in place a comprehensive risk management process (including appropriate board and senior management oversight) to identify, measure, monitor and control all other material risks and, where appropriate, to hold capital against these risks.

Description

Banking activities in Macao SAR are focused on lending and interbank placements. Foreign banks operating in Macao SAR are a source of funding for their overseas parent bank or affiliates. At on-site examination, the AMCM examiners verify that the banks have policies and procedures to monitor risks in the bank and that they are complying with policies and procedures. They ascertain that the banks are monitoring liquidity risk through assessments of the banks' asset and liability structure, including off balance sheet items, the maturity schedule, the contingency plan, and compliance with supervisory liquidity rules and ratios. The AMCM has issued Notice No. 006/93-AMCM on liquidity, which defines the types of acceptable liquid assets, establishes minimum amounts or ratios that banks are required to

maintain, and sets applicability to offshore banks. The banks are required to monitor their liquidity on a daily and weekly basis, and submit liquidity reports on a weekly and monthly basis.

The AMCM examiners review the appropriateness of policies and procedures for operational (e.g., internal audit, procedures to counter money laundering and fraud, business resumption plan, major system modifications) and foreign currency (e.g., translation of currencies) risks. Compliance with policies and procedures are verified at on-site examination. The AMCM examiners, among other things, determine that the internal audit function is independent, proper accounting and record-keeping systems are maintained, management reports and regulatory returns are accurate, front and back offices have segregation of duties, physical assets are under dual control, and regulatory guidelines are complied with. Under Article 17 of the FSAM, the banks are required to inform the AMCM prior to any launching of new financial products. As a part of the supervisory review process for electronic banking application (i.e., internet banking, automated teller machines), the AMCM ensures that the bank has adequate controls over the security of these products. The AMCM indicated that the banks only began offering internet banking a year and a half ago, and only two banks are currently providing this service. It is expected that internet banking will be a part of the scope of the next on-site examination.

The AMCM examiners evaluate the banks' policy on interest rate risk monitoring, including pricing and hedging of risks. However, the AMCM has not issued formal requirements on assessment of interest rate risk. A very high numbers of banks operating in Macao SAR are branches and subsidiaries of banks incorporated overseas, interest rate risk of these banks are subject to consolidated supervision guidelines of the parent bank and the home supervisor.

Assessment

Largely Compliant.

Recommendation

It is recommended that assessment of interest rate risk be formally required. The AMCM should establish guidelines on the management of interest rate risk and formally evaluate the risk. The guidelines should include measuring of risk to earnings under different interest rate scenarios, for example, parallel shift in yield curve, pressure on the currency peg system in Macao SAR and Hong Kong.

Principle 14: Banking supervisors must determine that banks have in place internal controls that are adequate for the nature and scale of their business. These should include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding its assets; and appropriate independent internal or external audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.

Description

The FSAM, Article 51, sets out the standards expected of the board of directors and management in their performance of duties. They are required to perform their duties in a prudent and judicious manner, with integrity and full independence, and observing laws, regulations of good professional conduct, promoting an adequate diversification of the risks involved and safety in the application of funds and taking into their account the interest of the institution, its depositors and other creditors.

During the on-site examination of the various bank functions, the organizational responsibilities, reporting line, approval authorities, segregation of critical functions, the "four eyes principles," accounting procedures, safeguarding of assets, and other relevant internal controls are covered under the review process of the functions.

The internal audit function is part of the internal control system of the banks. The AMCM, in the course of on-site examination, assesses the independence and adequacy of the function. The examiners verify that the members of the supervisory board, i.e., audit committee, of locally incorporated banks are elected by shareholders and are not bank officers involved in the daily operation of the bank (Commercial Code, under Decree Law 40/99/M, Article 240). They also review the audit scope and reports and meet with the internal auditors to discuss the issues identified by them and management response. Through AMCM's own review and findings, examiners determine whether the internal audit scope, reporting, resource, and training are sufficient. A large number of banks operating in Macao SAR are branches of foreign banks, and they rely to some extent on parent internal audit and/or compliance department in this process. The AMCM reviews the audit reports and where visits occur, the AMCM may arrange to meet the head office personnel.

The banks are required to obtain an external audit of their financial statements annually by a firm approved by the AMCM. Whenever possible, the audit firm for the branch or subsidiary of foreign bank should be the same firm for the foreign parent bank or head office. The AMCM holds tripartite meeting with the external auditor, whenever necessary.

To achieve a strong control environment, the AMCM evaluates the composition of the board of directors and senior management to determine that they have necessary skills for the size and nature of the activities of the bank. Under Article 47 of the FSAM, a locally incorporated bank must have a minimum of three directors of the board, and at least two of them are residents of Macao SAR (at least one for locally incorporated offshore banks). Branches of foreign banks must be managed by at least 2 persons residing in Macao SAR. The AMCM evaluates the suitability and competency of the directors and senior managers as a part of the initial licensing process (see Core Principle 3 Licensing) and on a continuous basis through on-site examinations and offsite reviews. As authorized by the FSAM, Article 49, the AMCM can cancel the registration of the members of the board of directors, supervisory board and management when they are determined to be unsuitable or incompetent. Any new member appointed must meet the suitability test and register with the AMCM prior to commencing their duties. Failure to comply can result in the bank license being revoked or special measures being imposed by the AMCM.

Assessment

Compliant

Principle 15: Banking supervisors must determine that banks have adequate policies, practices and procedures in place, including strict "know-your-customer" rules, that promote high ethical and professional standards in the financial sector and prevent the bank being used, intentionally or unintentionally, by criminal elements.

Description

The legislation for combating money-laundering activities in the banking sector is under the FSAM Article 106. To implement the law, the AMCM issued Circular No. 001/A/96-DSB/AMCM on anti-money laundering. Under the Circular, the banks are required to obtain identification of customers at account opening, and on cash transactions over 100,000 patacas (US\$12,500) with non-bank customers. In addition, the Circular requires the banks to designate a compliance officer and to establish training for appropriate personnel. Subsequent to the issuance of the Circular, the government of Macao SAR passed Decree Law No. 24/98/M requiring the banks to report suspicious transactions to the Judicial Police and the AMCM, and indemnifying those who report suspicious transactions. The investigation of suspicious transactions is conducted by the Judicial Police.

The existing guidelines for banks (the AMCM Circular) are not clear as to whether the rules for customer identification set out therein apply in all cases, i.e., whether they apply both to transactions which involve the opening of a bank account and transactions for which no bank account needs to be opened. Also, the existing rules appear to allow Macao banks to rely on customer identification records to be provided by other financial institutions (which are limited to banks located in the jurisdictions specified in the AMCM's guidelines) in the event of transactions that do not require opening an account.

The existing guidelines concentrate on the procedures for verifying the customer's identity and to not stress the importance knowing the nature of customer's business on a continuous basis as an important factor in preventing money laundering. However, the existing guidelines for banks are currently being revised. The new guidelines should provide more comprehensive rules on customer identification.

There is no supervisory requirement on reporting cash transaction over a specific threshold amount. The AMCM noted that, in practice, the banks have established internal thresholds to monitor large cash transactions. The transactions are analyzed and reported when determined to be suspicious.

At on-site inspection, the AMCM examiners review the bank's anti-money laundering program to ensure that a compliance officer has been designated, proper identification information of customers have been obtained, large transactions are being monitored, suspicious transactions are being reported to the compliance officer and management, transactions are filed with the Judicial Police and the AMCM when determined to be suspicious, and training is being given to the bank staffs. At present, the AMCM does not

have manuals for assessing banks' compliance with prudential standards, including anti-money laundering.

Since the decree law on suspicious transaction reporting was passed in 1998, the banks have filed only eight suspicious reports. It appears that there is a distrust of the Judicial Police, and the banks have chosen to close the accounts rather than report the transactions.

The AMCM is revising Circular No. 001/A/96-DSB/AMCM. The revisions being made include broadening the type of financial institutions to be covered; standardizing the suspicious reporting format; specifying the information to be obtained for remittances and money exchanges; lowering the identification requirement for cash transactions with non-bank customers to 20,000 patacas (this is not yet a firm threshold amount); specifying the penalties for noncompliance with suspicious reporting requirement; regular reporting of high risk accounts to management and compliance officer; and requiring independent testing by internal auditor. In addition, the revision includes examples of suspicious transactions.

The AMCM, as expressly mandated by Decree Law No. 24/98/M, exchanges information about suspicious transactions with the Judicial Police. However, exchange of information with other law enforcement authorities is limited by the provision of the FSAM Article 80, which provides that the confidentiality of information concerning relations between the institution and its customers may only be waived upon the customer's consent or by court order under the terms provided for in criminal law or in criminal procedure law.

The FSAM, Articles 78 and 79, allow exchange of information between the AMCM and other foreign supervisory authorities provided that the information is not used for any purpose other than supervision and remains subject to secrecy. If information is requested for purposes other than supervision, disclosure has to be authorized by a Macao SAR court.

Assessment

Materially Non-Compliant.

Recommendations

It is recommended that revisions to the Circular be completed expeditiously. The revised AML guidelines should establish detailed rules on customer identification, the implementation of the "know your customer" rule, detection of suspicious transactions and training of staff. In the revision of the AML guidelines, account should be taken of the recent developments on the revision of the FATF 40 recommendations, including additional recommendations on the prevention of financing of terrorism. The requirements on customer identification should be tightened to reduce reliance on documentation provided by other financial institutions. The regulations should stress close knowledge of the customer and the customer's business as an important control tool.

As a part of the effort to heighten public awareness, it may be useful for the bankers' association to issue a statement to show the industry's commitment to anti-money laundering. The AMCM examiners should continue to participate in anti-money

laundering training, for example, workshops sponsored by the Asia Pacific Group on Anti-Money Laundering, to further develop expertise. Money laundering activities can be very complex and sometimes involve fraudulent schemes.

The legislation on mandatory reporting of suspicious transactions should be improved. The existing legislation should be amended to expressly prohibit warning (“tipping off”) customers when information relating to them is being reported to the Judicial Police or other competent authorities and to require financial institutions to file a suspicious transaction report where a prospective client has refused to provide proper identification and the bank turns down such a customer.

Enforcement of the existing legislation should be tightened, including through a more vigorous application by the AMCM of sanctions for failure to report suspicious transactions.

Until the distrust of the Judicial Police is overcome, the level of suspicious transaction reporting is not likely to see much change and the effort to combat money laundering will remain ineffective. It is recommended that the AMCM continue to work with banks, the bankers' association, and other appropriate law enforcement agencies on building trust in the Judicial Police. In addition, cooperation of the AMCM with other domestic authorities and with regulators (non-banking supervisors) in other jurisdictions needs to be enhanced.

The introduction of mandatory reporting of cash transactions exceeding a specified threshold should be considered.

Principle 16: An effective banking supervisory system should consist of some form of both on-site and off-site supervision.

Description

The AMCM employs a combination of on-site visit and off-site reviews in its supervision of banks (there is no distinction between onshore and offshore banks). Normally, the AMCM will conduct on-site examination once every two years. However, the AMCM can shorten the examination time interval or conduct special examinations if the condition of the bank warrants such action. The power of shortening on-site examination interval is exercised on a bank. Between on-site examinations, the AMCM monitors the condition of the bank through reviews of reports regularly submitted by the bank. The banks are required to comply with the reporting instructions and format prescribed by the AMCM.

The AMCM applies the CAMEL (i.e., capital, asset quality, management, earnings, liquidity) concept to its supervision of banks. The examination scope also evaluates the internal audit function and the anti-money laundering program. The examiners assess the adequacy of risk identification, controls, monitoring and reporting. The risk management process and compliance with bank policies, banking laws, notices, circulars and other legal requirements are verified through testing of individual accounts or transactions. At the conclusion of the examination, findings are reviewed with area management. Where weaknesses are identified,

they are brought to the attention of the executive director of the bank in a management letter. Meetings with bank management will be held if determined to be necessary.

In off-site reviews, bank regularly submitted reports are analyzed. If needed, additional reports are requested from the bank or calls are made to the bank for explanation. The review is documented in an internal report, which requires to be signed-off by the Executive Director for Banking. The results of the offsite reviews are a factor in planning the scope of the on-site examination. Reports required to be submitted by the banks are:

- Weekly: Liquidity report
- Monthly: Solvency report
 - Monetary and financial statistical return (asset/liability and income accounts)
- Quarterly: Large exposure report
 - Bad and doubtful loans report
 - Calculation of own funds (CAR) report—local banks
 - Weighted exposure report—branches of foreign banks
 - Trial balance of banks
- Annually: Income statement and balance sheet (to be published)

Assessment

Compliant.

Principle 17: Banking supervisors must have regular contact with bank management and a thorough understanding of the institution's operations.

Description

The banks are required, under the FSAM, to inform the AMCM of any difficulties or unstable situations affecting the operation of the bank; changes (e.g., suitability) relating to managers, directors and qualifying shareholders; new financial products prior to launching; and termination of the service of the external auditor. The external auditors are required to report to the AMCM, in writing, of any matters that they detect during their audit that may jeopardize the soundness of the bank or the financial system of Macao SAR.

In addition to meetings that may arise as a result of on-site visit or offsite reviews (see Core Principle 16), the AMCM holds prudential meetings with bank management about once a year. The subjects discussed at these meetings include matters outstanding, organization and operations, strategies, and general banking issues. Tripartite meetings are held with the external auditors, whenever necessary.

A thorough understanding of the bank's operations can also be gained through the licensing procedures. (See Core Principle 3 Licensing).

Assessment

Compliant.

Principle 18: Banking supervisors must have a means of collecting, reviewing and analyzing prudential reports and statistical returns from banks on a solo and consolidated basis.

Description

The FSAM Article 7 requires the banks to submit to the AMCM all accounting, statistical and other relevant information as prescribed by the AMCM. Notices No. 006/93-AMCM and 007/93-AMCM specify the type and frequency of reports on liquidity, solvency and statement of assets and liabilities that the banks are required to submit. In addition AMCM has instructed banks to submit other reports such as quarterly reports of large exposures and on bad and doubtful loans. Articles 10 and 75 of the FSAM require those locally incorporated banks with subsidiaries to provide information as prescribed by the AMCM pertaining to their subsidiaries and to report their financial statements on both solo and consolidated basis. The reports must conform to the instructions and format prescribed by the AMCM.

According to representatives of the Macao SAR Auditing Association, the AMCM requires that the audited financial statements follow either the international accounting standards (IAS) or the Hong Kong accounting standards, which are materially close to the IAS. In practice, bank auditors use the international accounting and auditing standards.

Failure to observe applicable accounting standards and procedures, to submit information as prescribed by the AMCM, and to file accurate information are considered especially serious practices and are punishable acts. If the offense can be remedied and has not significantly damage the soundness of the bank or the financial system, the AMCM can require amendments to be made within a specified period.

The regularly submitted reports are set out above, see Core Principle 16.

The monthly monetary and financial statistical return include supporting schedules that identify, among other things, deposits by residents vs. non-residents, maturities and countries; loans by industry segments and countries; doubtful and bad loans; loan loss provisioning and reserve; and off balance sheet items. The bad and doubtful loans report lists accounts that are over three months past due (See Core Principle 8 Loan Classification). These reports are analyzed at the offsite reviews and the results from offsite analyses are a factor in the on-site examination planning process. The accuracy of regulatory reports is verified at on-site inspections.

Assessment

Compliant.

Principle 19: Banking supervisors must have a means of independent validation of supervisory information either through on-site examination or use of external auditors.

Description

The on-site examination of banks is normally conducted by the AMCM (see Core Principle 16 On-site-Offsite Supervision), which has the legal right of full access to all bank records and, when required, to the board, senior management, and staff. However, under Articles 8 and 57 of the FSAM, the AMCM may appoint outside qualified parties to examine the books, accounts, transactions and other relevant records and documents of the bank or to carry out special audits. The AMCM uses this authority under exceptional circumstances. It had appointed a management consultant firm to advise on the banking system Y2K issues and had jointly conducted Y2K testing for the banking system. The respective roles and responsibilities are defined in the agreement by the AMCM.

The annual financial statements of the banks must be audited by independent audit firms, approved in advance by the AMCM (Article 53 of the FSAM). The selected audit firm must prove that they have adequate human and technical resource to conduct the audit. Whenever possible, the audit firm for the branch or subsidiary of foreign bank should be the same firm for the foreign parent bank or head office. The AMCM is not involved in the determination of the audit scope or the terms and remuneration of services. However, as a part of its supervision process, it reviews the scope of audit and the final report. According to Article 55 of the FSAM, AMCM may on its own accord or upon a duly justified request submitted by the credit institutions or their respective auditors, call meetings to discuss any relevant matters concerning the said credit institutions, as long as all parties have been notified. The AMCM holds tripartite meetings with the external auditor whenever there are outstanding issues that require the opinion of the external auditor, such as the adequacy of provision, and normally the meetings are held before finalization of accounts to make sure the accounts presented for approval comply with the legal requirements. Also, when appropriate, the AMCM holds tripartite meeting with the external auditor after review of the audit report to discuss issues, management responses, and any relevant matters concerning the bank.

The external audit firm is required to inform the AMCM immediately, in writing, of any situations, which are detected during the audit that may jeopardize the soundness of the bank or the financial system of Macao SAR (Article 56). In addition, the external auditor and the bank must inform the AMCM, in writing, of its decision to terminate the agreement prior to expiration (Article 54). As the appointment of the external auditor is on an annual basis, the AMCM can refuse to approve the appointment at renewal in the event that the work of the external auditors is unsatisfactory.

Assessment

Compliant.

Principle 20: An essential element of banking supervision is the ability of the supervisors to supervise the banking group on a consolidated basis.

Description

The FSAM Article 9 gives the AMCM the authority to supervise financial institutions on a consolidated basis. The Article states that the supervision of financial institutions with head office in Macao SAR shall be performed on the basis of consolidation of their financial situation with other companies in which the institution has a holding of over 50%. The Article further allows the AMCM to decide whether supervision should be done on a consolidated basis if the holding equals to or is less than 50%.

The AMCM is apprised of the overall structure of the banking organization through its licensing procedures and ongoing on-site and offsite supervision processes. If a bank intends to set up a subsidiary or branch overseas, Article 32 of the FSAM requires the bank to submit an application with the AMCM. In addition, under Article 113, the banks must obtain prior approval from the Chief Executive of Macao SAR, on advice from the AMCM, of any division, merger or reorganization of the bank. (See Core Principle 3 Licensing).

Ongoing understanding of the activities and risk of the subsidiaries are obtained through on-site visit and offsite reviews. The FSAM Article 8 authorizes the AMCM to conduct examination on the premise of the financial institution, and to examine the books, records, transactions, and other relevant records and documents of the financial institution at any time. The AMCM conducts on-site reviews of the subsidiaries of banks incorporated in Macao SAR, normally as a part of the on-site inspection of the parent bank.

In addition, the banks that have subsidiaries subject to consolidated supervision are required to report on both solo and consolidated basis. Circular No. 004/A/94-DSB/AMCM requires capital ratio to be calculated on a consolidated basis. Article 75 of the FSAM requires that banks with subsidiaries overseas to publish consolidated balance sheet and income statement.

Assessment

Compliant.

Principle 21: Banking supervisors must be satisfied that each bank maintains adequate records drawn up in accordance with consistent accounting policies and practices that enable the supervisor to obtain a true and fair view of the financial condition of the bank and the profitability of its business, and that the bank publishes on a regular basis financial statements that fairly reflect its condition.

Description

The banks are required to submit reports, as prescribed by the AMCM on a weekly, monthly, quarterly and annual basis (Notice No. 007/93-AMCM). The FSAM Articles 75 and 76 require the annual audited balance sheet and income statement and the quarterly trial balance to be published in the Boletim Oficial (Official Gazette). The annual audited financial statements must be published by the 31st of May, and a copy of the information to be published must be submitted to the AMCM at least ten days prior to publication (Article 77). The banks that are incorporated in Macao SAR are required to publish the following information annually:

- The balance sheet;
- The profit and loss account;
- A summary of the management report;
- The report from the supervisory board;
- A summary of the external auditors' report.

A list of the institutions in which they have holdings in excess of 5 percent in the share capital, or over 5 percent of their own funds, with an indication of the respective percentage;

- A list of the shareholders with qualifying holdings;
- The names of the members of the company boards.

In addition, locally incorporated banks that have subsidiaries subject to consolidated supervision are required to publish their consolidated financial statements.

Branches of banks incorporated overseas are required to publish their audited balance sheets, profit and loss account, external auditors' report, and a brief management report on their activity in Macao SAR.

The published balance sheet and profit and loss account must conform to the format prescribed by the AMCM.

The AMCM has issued Notice No. 13/93-AMCM on valuation of assets and liabilities. The banks must ensure that their valuation policy, among other things, is consistent, realistic, and take into account of current values where relevant. Also, the banks are required to report profits net of provisions.

The FSAM Article 74 requires the banks to maintain proper accounting records, and Article 122 lists submitting or showing AMCM any false information or document, and refusal to provide information or send compulsory data to the AMCM as punishable acts.

(See Core Principle 19 for information regarding external audit, communications with the external auditors, and appointment of a bank's external auditor; Core Principle 18 for

information regarding consolidated reporting and accounting and auditing principles; and Core Principles 16 for information on regulatory reporting).

Assessment

Compliant

Principle 22: Banking supervisors must have at their disposal adequate supervisory measures to bring about timely corrective action when banks fail to meet prudential requirements (such as minimum capital adequacy ratios), when there are regulatory violations, or where depositors are threatened in any other way. In extreme circumstances, this should include the ability to revoke the banking license or recommend its revocation.

Description

The FSAM gives the AMCM the authority to sanction banks when there are regulatory violations, when they fail to meet prudential requirements, or where depositors or the financial system are threatened in any other way. Article 122 lists the practices and acts that are considered especially serious, and are punishable by any of the following (Articles 126 through 130).

A simple warning with instruction to rectify the offense within a period fixed by the AMCM, if the offense committed can be remedied and has not resulted in significant damage to Macao SAR's economy or its financial and monetary system.

Fines, which can vary between ten thousand patacas to five million patacas. In the case of an offense repeated within a period of one year, the fine is twice the original amount. Other sanctions include: Suspension of the voting rights of any shareholder for a period of one to five years; prohibition from holding any board position or carrying out management or directorship duties in any institution under the AMCM's supervision for a period of six months to five years and publication of the sanctions.

Additionally, the AMCM can confiscate any gains obtained from illegal activities. These sanctions may be applied concurrently. According to Article 124, the liabilities are applicable to not only the bank but also to board members, shareholders, directors, and/or managers.

When a bank persists in violating the regulations governing its operations or the conditions of its authorization, the AMCM can recommend to the Chief Executive of Macao SAR to issue an executive ruling to impose special measures on the bank. The range of special measures (Article 83) that can be applied include:

- Order the investigations required for clarifying the activity of the bank;
- Impose temporary restrictions on the activity of a specific credit institution or order it to adopt practices or measures appropriate to the situation;
- Appoint one or more persons to advise a specific institution in decision-making;

- Suspend one or more of the directors from their office as a preventive measure;
- Provide adequate monetary or financial support to the institution or institutions in question;
- Issue conditions for orderly reimbursement of deposits to customers;
- Revoke or suspend the authorization granted for carrying on the business or, if this authorization is to be continued, incorporate new clauses and conditions.

The FSAM Article 121 provides for an imprisonment term of up to two years for unauthorized acceptance of deposits or other repayable funds.

Whenever the condition of a bank jeopardizes the fulfillment of its obligations to depositors or other creditors, or puts at risk the confidence in the financial system, the AMCM can advise the Chief Executive of Macao SAR to order immediate intervention in the management of the bank in question.

In addition to the above enforcement actions, the AMCM has the authority (Article 59) to impose higher capital adequacy ratios, on a case-by-case basis. It has exercised this authority on a bank.

Assessment

Compliant.

Principle 23: Banking supervisors must practice global consolidated supervision over their internationally active banking organizations, adequately monitoring and applying appropriate prudential norms to all aspects of the business conducted by these banking organizations worldwide, primarily at their foreign branches, joint ventures and subsidiaries.

Description

The FSAM Articles 8 and 9 give the AMCM the authority to supervise on a consolidated basis and to carry out on-site supervision at bank premise, including overseas location. When a bank intends to set up a subsidiary, a branch or a representative office overseas, it must obtain authorization from the AMCM (Article 32). One of the application evaluation criteria is assessment of the suitability of the managers in charge of overseas establishments. The AMCM requires the overseas offices to provide a copy of their reports to the AMCM. At on-site examination, the AMCM examiners verify that the overseas office complies with the activities authorized, is following bank policies and procedures, and is providing adequate information to its Macao SAR parent bank. Under the FSAM Articles 33, 59 and 83, the AMCM can impose limitations on the activities of the overseas office, impose higher capital adequacy ratio on the Macao SAR parent bank, or revoke authorization of the overseas office. It was noted by the AMCM that the application would likely not be approved if the host country supervisor does not provide reciprocity treatment, or is determined to have inadequate supervision relative to the risks the office presents. The AMCM noted that very few banks have subsidiary operations.

Assessment

Compliant.

Principle 24: A key element of consolidated supervision is establishing contact and information exchange with the various other supervisors involved, primarily host country supervisory authorities.

Description

The AMCM is the home country supervisor to a very limited number of banks. The FSAM Articles 78 and 79 permit exchange of information between the FSAM and other foreign supervisory authorities provided that the information is not used for any purpose other than supervision and remains subject to secrecy or confidentiality. The exchanges of information with foreign host supervisors are carried out in the framework of licensing procedure, as well as during ongoing supervision. (See Core Principle 3 Licensing regarding sharing of information during licensing procedure and reciprocity of treatment).

The AMCM exchanges information with foreign host supervisors through formal and informal arrangements. As home country supervisor, formal letter will be send to foreign supervisors in jurisdictions where there are branch or subsidiary operations, of material change of the parent company, if it is considered by the AMCM as a supervision concern. The AMCM has signed memorandum of understanding (MOU) with the foreign host supervisor where a bank subsidiary operates. The MOU describes the scope of information to be exchanged along with their confidentiality. The AMCM has biannual meetings with the Hong Kong Monetary Authority, People's Bank of China and the Securities and Futures Commission of Hong Kong and visits the Bank of Portugal every two years. The nature of cooperation extends to supervisory advice and training.

Most requests for information by foreign supervisors have been related to background data on a particular company.

Assessment

Compliant.

Principle 25: Banking supervisors must require the local operations of foreign banks to be conducted to the same high standards as are required of domestic institutions and must have powers to share information needed by the home country supervisors of those banks for the purpose of carrying out consolidated supervision.

Description

A very high number of banks in Macao SAR are branches and subsidiaries of foreign banks. They are subject to similar prudential, inspection, and regulatory reporting requirements as domestic banks. For the purposes of the licensing process as well ongoing supervision, the AMCM assesses whether the home country supervisor practices consolidated global supervision (also see Core Principle 3 Licensing).

The FSAM Articles 78 and 79 permit exchange of information between the FSAM and other foreign supervisory authorities provided that the information is not used for any purpose other than supervision and remains subject to secrecy or confidentiality. The AMCM has signed memorandum of understanding (MOU) with the People's Bank of China, the Bank of Portugal, and the Hong Kong Monetary Authority. The MOUs describe the scope of information to be exchanged along with their confidentiality. The AMCM's contacts with foreign supervisors are noted in Core Principle 24 above.

Formal letter will be send to foreign home supervisors of any material change in the condition of the branch or subsidiary, if it is considered by the AMCM as a supervision concern. The AMCM allows the home supervisors to conduct on-site reviews in Macao SAR. The Hong Kong Monetary Authority has carried out annual inspections and the People's Bank of China and the Bank of Portugal have each conducted one inspection.

The AMCM exchanges information with home authorities from time to time through both formal and informal channels. The matters include opinions on newly appointed management, supervisory issues and enquiries about rules and regulations on certain activities.

Assessment

Compliant.

A PRINCIPLE-BY-PRINCIPLE ASSESSMENT OF INSURANCE STANDARDS

Introduction

The insurance market is served by 24 insurance companies, 15 of which are involved in non-life business and 9 of which transact only life business. Composite (both life and non-life) insurers are not permitted. Seven of the companies are local and the remaining 15 are branches of overseas companies from eight different countries, including Japan, United States, United Kingdom and Bermuda. There is a large intermediary sector with almost 1800 agents, salesmen and brokers. Gross premiums in 2000 were MOP 348m non-life and MOP 755m life. Non-life has declined from a peak of 413m in 1996, due to the general economic downturn in the following years, the business has, nevertheless, remained profitable.

There are three representative bodies; the Macao Insurers Association, the Insurance Agents and Brokers Association and the Federation of Professional Insurance Intermediaries.

At the time of writing there are no captive insurance companies in Macao and the whole of this assessment is conducted on the premise that no captive insurance business will be carried on from or from within Macao until an appropriate supervisory system is put in place (see further discussion at end of this section).

The ultimate authority for the supervision of the insurance market rests with the Chief Executive of the SAR, while the day-to-day supervisory functions are the responsibility of the AMCM through its Insurance Supervision Department. This department is sixteen persons strong, with collectively a great deal of experience. Legal assistance is available through the AMCM legal department.

The current insurance laws comprise the Macao Insurance Ordinance covering insurers, and the Insurance agents & Brokers Ordinance, which covers intermediaries. The latter was updated during 2001.

The Insurance Supervision Department takes a lively interest in international insurance affairs; Macao is a member of the International Association of Insurance Supervisors, the International Association of Insurance Fraud Agencies, and this year has been accepted as a full member of the Offshore Group of Insurance Supervisors. A further example of international activity is found in the hosting, in November of this year, of a conference "Challenges and Opportunities for Insurance in Asia in the New Millennium" which drew 461 attendees. It also offers training assistance to jurisdictions such as Cape Verde and Sao Tome and Principe, and has Memorandum of Understanding with the Insurance Commissioner in Hong Kong (six Macao insurers have head offices there) and the Portuguese Insurance Supervisory Authority (ISP). The significance of both these bodies to the successful development of the Macao insurance supervisory regime should not be overlooked. Recently HK has assisted with the preparation of the new Agents Examination Program and the ISP has assisted, among other things, with the Private Pensions Funds legislation, for which AMCM has been responsible since March 1999.

Captive insurance business, a discussion

The AMCM has expressed interest in developing captive insurance business subsequent to the introduction of the Offshore Regime Decree Law of 1999. Whilst that Law in a sense opens the door for captive business it provides no actual framework for its operation, either within itself or within the Macao Insurance Ordinance.

It is understood that there is already more than one party interested in establishing a captive within the jurisdiction. However, the development of a captive insurance center depends on many factors, the principle one being that the jurisdiction should provide a comfortable environment from which to operate, comfortable that is in the sense of reputation, services, ease of access, and, of course, the requisite legal framework, none of which exist at the present time.

The difficult question is, if an appropriate legal framework is put into place, will an offshore industry follow? There are already other jurisdictions in the region providing captive facilities, Singapore is well established, and Hong Kong and Labuan are also open for business, so whatever Macao might be able to provide would need to be attractively competitive.

Since there is no existing expertise in this area the first step would be to catch the attention of one of the international insurance brokers that already has captive insurance management facilities in several other jurisdictions. The broker would have to consider the cost of establishment, the likelihood of persuading experienced staff to relocate (housing, education, health care, etc.) and what benefits he could offer potential captive clients that were not already available nearby. Once one such management operation was established others may well follow.

It has been suggested that the opening up of the China market might provide good opportunities for new business that might be handled through Macao.

Legislative/Supervisory issues

Some offshore centers choose to have an entirely separate captive insurance law, others roll the specific provisions into the domestic insurance law. Either way, the important issue is that the distinct nature of captive business should be recognized and a proper regulatory base established. The law should therefore include, inter alia, different capital provisions, different solvency provisions, and the licensing of captive insurance management companies (and their on-site inspections). The supervisory body should have sufficient experience in captive insurance business to be able to adequately assess applications (which often involve complicated business plans with unusual financial structures) and the subsequent development of the business once licensed. Equally important would be the ability to determine the integrity of the applicant parties, and the integrity of the on-going business, and to take prompt action in event of any problematical issues arising.

Recommendation

It is recommended that no attempt should be made to further develop captive business until an appropriate legal and supervisory support framework is in place.

Principle-by-Principle Assessment.

Principle 1: Organization of an Insurance Supervisor

The insurance supervisor of a jurisdiction must be organized so that it is able to accomplish its primary task, i.e., to maintain efficient, fair, safe and stable insurance markets for the benefit and protection of policyholders. It should at any time be able to carry out this task efficiently in accordance with the Insurance Core Principles. In particular the insurance supervisor should:

- be operationally independent and accountable in the exercising of its functions and powers;
- have adequate powers, legal protection and financial resources to perform its functions and exercise its powers;
- adopt a clear, transparent and consistent regulatory and supervisory process;
- clearly define the responsibility for decision making; and
- hire, train and maintain sufficient staff with high professional standards who follow the appropriate standards of confidentiality.

Description

The day-to-day responsibility for the operation of the supervisory division rests with its Director Mr Oscar Menezes, who reports to Mr Felix Pontes, the Executive Board Director with overall responsibility for the Division. Mr Pontes, a former director of the supervisory division, has been with the AMCM for 22 years, and Mr Menezes has served 18 years. Ms Man, the Deputy Director, has 10 years experience.

All significant decisions of the division require ratification by the Chief Executive of the SAR. The Executive Board Director is of the opinion that this does not impact on the operational independence of the division in that since 1982 none of the division's decisions have been challenged.

The Macao Insurance Ordinance was first introduced in 1981, at which time there were 35 insurance companies operating, of those only 8 were licensed. The first law was very limited in scope; a new one was introduced in 1989 with better provisions (on site inspections, etc.) and the latest version was introduced in 1997 and included an important provision for annual returns. From the beginning the law, with its Portuguese roots, has provided for integrity of reserves, which cannot be drawn down without the supervisor's authority.

This year the Insurance Agents and Brokers Ordinance has been revised after consultation with industry; the HK Insurance Commission has assisted in this, and the principle change is to provide for the agent examinations, there are also limits placed on the number of companies an agent can work for, and a provision for employees of corporate agents to be registered.

These examinations are a major project; by the 2001 year-end there may be 2000 agents to go through the process. New candidates will face examination immediately, agents of more than three years standing can seek exemption and all others have two years to qualify. The Vocational Training Council of HK is assisting in the arrangements (this is useful because most of insurance company managers in Macao come from HK). One anticipated outcome is a reduction in the number of agents.

Strengths of the organization are seen by the Executive Director and Director as up-dated legislation, strong control of investments, good staff (16, including 6 examiners—2 of whom are actuaries) and the intention to follow international standards to the best of their ability. Weaknesses are seen as the present lack of an on-site inspection program (being addressed, will follow NAIC guidelines) and adequate staff to cover this program and that for the agent examinations. There is also a problem in the legal area, where insurance related legal advice is not readily available from the in house legal department, which means the Director still has to turn to the Portuguese supervisor for specialist assistance.

Operating procedures are fairly informal; there are no procedures manuals or check lists but the law itself is arranged in such a way that aspects of application materials for instance can be readily identified (see Article 38). The present staff is able to handle the present workload very competently, but the planned new programs will require some augmentation.

Assessment

Largely observant

Given today's volume of business, and today's relationship with the Chief Executive of the SAR, Macao is close to compliance, powers, processes, responsibilities and staff are all adequate. Independence may be an issue for the future so that is the principle stumbling block to full compliance. Additional staff will be needed to deal with the demands of the upcoming programs, which in turn would call for more attention to procedures manuals and training, and in house insurance experienced legal assistance would be helpful.

Recommendations

Some further consideration should be given to the independence issue. The principle will only be seen to be fully observed when independence is absolute. Staff complement should be reviewed in the light of the additional responsibilities of agents' examinations and on-site visits and procedures manuals and training should be implemented so that these programs can be introduced and managed effectively. The legal department should be encouraged develop insurance expertise and to respond more readily to requests for assistance. Finally the supervisor should consider publishing guidance notes on the legal framework for insurers and intermediaries.

Principle 2: Licensing

Companies wishing to underwrite insurance in the domestic insurance market should be licensed.

Within the Methodology this Principle is broken down into three parts, these notes will follow likewise.

Principle 2(1) Companies wishing to underwrite business in the domestic insurance market should be licensed.

Description

All companies wishing to transact insurance (including reinsurance) business in or from Macao SAR must be licensed. The MIO defines all the appropriate classes, and composite companies are not allowed.

This Principle does not actually mention intermediaries, but it should be noted that the Insurance Agents and Brokers Ordinance was recently strengthened to provide for the examination of agents. See later comments under Market Conduct.

Assessment

Observant

Principle 2(2) The supervisor, in granting a license, should assess the suitability of owners, directors, and/or senior management, and the soundness of the business plan, which could include pro forma financial statements, a capital plan and projected solvency margins.

Description

All the above elements of the licensing process are taken into account. Articles 17 thru 22 of Chapter III of the MIO deal adequately with capital, criteria, integrity, professional experience and the authorization procedure itself.

The review process is thorough, but no checklists are used, the points being made that the low volume of applications, and the good expertise of the present staff which would handle them, scarcely warrants these. The supervisor has adequate powers to pull in such additional information as he thinks fit. The detail required within the business plan does not include that of investments or sources of funds; it is claimed that this is not really necessary given the very limited opportunities for local investment, and these areas are, in any event, checked out.

The capital requirements are not geared towards offshore (captive) business; at approx. US\$2m for non-life and \$4m for life they are slightly above those for HK. The requirement for re-insurers is much higher, at \$13m and 20m respectively. Branches of overseas companies can come in at one third of the above levels.

Assessment

Observant, but would benefit from some procedural changes.

Principle 2(3) The Supervisor, in permitting access to the domestic market, may choose to rely on the work carried out by an insurance supervisor in another jurisdiction if the prudential rules of the two jurisdictions are broadly equivalent.

Description

This is more of a provision than a principle; overseas companies are subject to similar evaluation as domestic companies. That means the supervisor does not rely on the work of others. On the other hand he has not seen it necessary to check with the home regulator to see if there are any issues of which he should be aware - a process which is required under the Cross Border Business Principle.

Assessment

Observant. The latter issue should be addressed.

Recommendations

The introduction of a procedures manual would be beneficial; this should include specimen application forms and check lists, and the specimen business plan should be expanded to include details of investments and sources of capital funds.

Where applications from foreign insurers are received enquiry should be made of the insurer's home regulator as to his satisfaction with the proposal.

Principle 3: Changes in Control (not applicable to mutual companies).

The insurance supervisor should review changes in the control of companies that are licensed in the jurisdiction. The insurance supervisor should establish clear requirements to be met when a change in control occurs. These may be the same as, or similar to, the requirements which apply in granting a license. In particular, the insurance supervisor should:

- require the purchaser or the licensed insurance company to provide notification of the change in control and/or seek approval of the proposed change; and

- establish criteria to assess the appropriateness of the change, which could include the assessment of the suitability of the owners as well as any new directors and senior managers, and the soundness of any new business plan.

Description

Adequate provisions exist to cover this Principle; a movement of 10 percent or more in total shareholding, or the increase in any one shareholding to 5 percent or more of capital or of the voting rights, are to be reported, and normally require prior authorization. There are full background checks on persons and funds. The supervisor may reject the proposed change.

Assessment

Observant.

Principle 4: Corporate Governance

It is desirable that standards be established in the jurisdictions, which deal with corporate governance. Where the insurance supervisor has responsibility for setting requirements for corporate governance, the supervisor should set requirements with respect to:

- the roles and responsibilities of the board of directors;
- reliance on other supervisors for companies licensed in another jurisdiction; and
- the distinction between the standards to be met by companies incorporated in his jurisdiction and branch operations of companies incorporated in another jurisdiction.

Description

There are no specific provisions within the Insurance Law dealing with Corporate Governance so technically, since the supervisor has no responsibility, the Principle is not applicable. The commercial Code has some bearing with its provisions for directors' and officers' responsibilities, but these are limited. Given the constituency of the insurance market place this is probably not a big issue; with such a small number of companies the supervisor should have a reasonable appreciation of their inner workings (a situation which will be much improved when the new on-site inspection program comes on stream later this year). There is also the factor that most insurers are branches of major internationally operating insurers with head offices in well-regulated jurisdictions and which should have good corporate governance policies in place.

There is, of course, the possibility that the Principle may become all embracing at some future date. Also, conventional wisdom might suggest that, in any event, the supervisor would be well advised to take a greater interest in this area.

Assessment

The Principle is **Not Applicable**, but some ideas on further involvement should be recommended.

Recommendation

A practical approach to becoming more closely involved might be for the supervisor to write to all licensed insurers requesting a description of their corporate governance principles and the way in which they are followed through. Once this information has been received and digested further action could be formulated; this could range from recommending changes to the MIO to bring corporate governance within its ambit, to issuing guidelines as to regulatory expectations, to simply checking that satisfactory arrangements continue to operate. The latter should then be a permanent element of the on-site inspection process. New applicants should be asked to address the issue at time of application.

Principle 5: Internal Controls

The insurance supervisor should be able to:

- review the internal controls that the board of directors and management approve and apply, and request strengthening of the controls where necessary; and
- require the board of directors to provide suitable prudential oversight, such as setting standards for underwriting risks and setting qualitative and quantitative standards for investment and liquidity management.

Description

Again, this is not so much a matter of legislation, but of good practice. The Insurance Law has no particular provisions but the supervisor, as in the previous case, does have a certain familiarity with corporate internal controls, and he does have the authority to take much closer interest on a case- by- case basis. As with Corporate Governance he will have an opportunity to become much more closely involved following the introduction of the on-site inspection program.

The essential criteria beneath this Principle are numerous, and include reference to money laundering (“reporting of irregular and suspicious activities”). In this regard guidance notes were issued to all insurers in March 2001. These have already resulted in several reports by insurers, mainly of suspicious cash payments by persons from the Chinese mainland.

Assessment

Macao is **largely observant**, but will need to pay considerable attention to the essential criteria to become fully observant. Some suggestions should be offered towards that end.

Recommendation

The supervisor should review the essential criteria to determine which elements might be best picked up within the previously recommended application form and those best dealt with at the time of annual reporting or of the periodic on-site visits. Check lists should be introduced to ensure all requisite aspects are covered at each of these points. The Guidance Notes on Prevention of Money Laundering should be circulated to the intermediary sector also.

Principle 6: Assets

Standards should be established with respect to the assets of companies licensed to operate in the jurisdiction. Where insurance supervisors have the authority to establish the standards, these should apply at least to an amount of assets equal to the total of the technical provisions, and should address:

- diversification by type;
- any limits or restrictions on the amount that may be held in financial instruments, property, and receivables;
- the basis for valuing assets which are included in the financial reports;
- the safekeeping of assets;
- appropriate matching of assets and liabilities; and
- liquidity.

Description

This principle is designed to ensure that the supervisor takes a very close interest in the composition and safe keeping of assets, and is able to carry out all the requisite checks, and to require the introduction of remedial measures where deficiencies are observed.

In practice there are two significant considerations, first, Macao insurers are very conservative (partly due to the lack of local investment opportunities) with most investments being limited to office premises and bank deposits (a full breakdown of investments is filed annually as part of the annual return) and second, that assets covering Technical Provisions (loss reserves, etc.) are required to be pledged to the AMCM. Before they can be pledged they must be approved, and once pledged they cannot be drawn down without AMCM's agreement.

There is also a published list (a “legal directive”) of non-admitted assets. It is also worth noting that no allowances are given for reinsurance recoveries when calculating loss reserves.

Assessment

Largely observant. Superficially there is already almost full compliance, however the underlying elements of the checking procedures under the Principle are quite complex and are only likely to be fully satisfied when the on-site inspection program is activated and conscientiously carried through.

Recommendation

This is another element to be included in the on-site inspection program.

Principle 7: Liabilities

Insurance supervisors should establish standards with respect to the liabilities of companies licensed to operate in their jurisdiction. In developing the standards, the insurance supervisor should consider:

- what is to be included as a liability of the company, for example, claims incurred but not paid, claims incurred but not reported, amounts owed to others, amounts owed that are in dispute, premiums received in advance, as well as the provision for policy liabilities or technical provisions that may be set by an actuary;
- the standards for establishing policy liabilities or technical provisions; and
- the amount of credit allowed to reduce liabilities for amounts recoverable under reinsurance arrangements with a given reinsurer, making provision for the ultimate collectability.

Description

The supervisor has the power to, and does, set standards for the establishment of technical reserves and other liabilities, to check the sufficiency of same, and to require changes if considered necessary. The insurance law, taken together with the annual reporting forms, provides an ample framework for monitoring. The point has been made that no real long tail business is written locally, such liability is usually written offshore.

Reference has already been made to the fact that reserves have to be covered gross (i.e., before any reinsurance recoveries that may be due).

Technical provisions of life insurers are subject to actuarial assessment, and the supervisor may also conduct on-site reviews of claims files.

Assessment

Observant.

Principle 8: Capital Adequacy and Solvency

The requirements regarding the capital to be maintained by companies, which are licensed or seek a license in the jurisdiction, should be clearly defined and should address the minimum levels of capital or the levels of deposits that should be maintained. Capital adequacy requirements should reflect the size, complexity, and business risks of the company in the jurisdiction. Note: The IAIS Issues Paper on Solvency and Solvency Assessment should be reviewed in order to obtain a comprehensive view of the control of capital adequacy and solvency.

Description

Solvency margins are clearly set out in the law, and are properly monitored by way of the annual returns (not a difficult job considering there are only seven local insurers). Loss ratios are monitored and where abnormal (50 percent above market experience) the minimum capital amount can be doubled. If noncollectible or overdue premiums represent more than 40 percent of the whole then only 50 percent of the totals are allowed for solvency purposes. The supervisor has the power to require any shortfalls to be dealt with.

Assessment

Observant.

Principle 9: Derivatives and “off-balance sheet” items

This section applies in jurisdictions where derivatives or other items are not reported on the balance sheet and are thus not subject to the reporting requirements established for financial statements. The insurance supervisor should be able to set requirements with respect to the use of financial instruments that may not form a part of the financial report of a company licensed in the jurisdiction. In setting these requirements, the insurance supervisor should address:

- restrictions in the use of derivatives and other off-balance sheet items;
- disclosure requirements for derivatives and other off-balance sheet items; and
- the establishment of adequate internal controls and monitoring of derivative positions.

Description

There are no dealings in Derivatives in the Macao market.

Assessment

Not applicable.

Principle 10: Reinsurance

Insurance companies use reinsurance as a means of risk containment. The insurance supervisor must be able to review reinsurance arrangements, to assess the degree of reliance placed on these arrangements and to determine the appropriateness of such reliance. Insurance companies would be expected to assess the financial positions of their re-insurers in determining an appropriate level of exposure to them. The insurance supervisor should set requirements with respect to reinsurance contracts or reinsurance companies addressing:

- of the reinsurance business of a company which is incorporated in another jurisdiction. the amount of the credit taken for reinsurance ceded. The amount of credit taken should reflect an assessment of the ultimate collectability of the reinsurance recoverables and may take into account the supervisory control over the reinsurer; and
- the amount of reliance placed on the insurance supervisor

Description

Full details of all reinsurance arrangements are disclosed in the insurer's original business plan and in the subsequent annual returns. These are carefully checked both as to the significance of the reinsurance in the overall activity of the company and as to the credit ratings of the individual re-insurers.

As mentioned earlier no credit is allowed for outstanding reinsurance recoveries so ultimate collectability is not an issue as far as solvency is concerned.

Assessment

Observant.

Principle 11: Market Conduct

Insurance supervisors should ensure that insurers and intermediaries exercise the necessary knowledge, skills and integrity in dealings with their customers.

Insurers and intermediaries should:

- at all times act honestly and in a straightforward manner;
- act with due skill, care and diligence in conducting their business activities;

- conduct their business and organize their affairs with prudence;
- pay due regard to the information needs of their customers and treat them fairly;
- seek from their customers information which might reasonably be expected before giving advice or concluding a contract;
- avoid conflicts of interest;
- deal with their regulators in an open and cooperative way;
- support a system of complaints handling where applicable; and
- organize and control their affairs effectively.

Description

Other than the need for improving standards within the agency force there seems to be no real problems in this area. The supervisor enjoys good relations with the industry associations. In 2001 some dissatisfied members of the Insurance Agents and Brokers Association formed the new Federation of Macau Professional Insurance Intermediaries, which has already attracted 230 members. As far as can be judged both agent's and insurer's associations have put their full weight behind the new agent examination program, which they estimate will lead to something like a 30 percent reduction in the number of agents.

The new relationship with Mainland China is prompting the agent's associations, and indeed the insurers, to look towards the China market, and the agent's would like to see some Chinese recognition of their standing.

Insurers themselves are concerned at the trend of declining revenues, said to be 22 percent down over the last four years, and also have concerns at the likely high cost of reinsurance for 2002. (The latter is, of course, a global problem, but at the time of writing, mid January, seems to have been somewhat less severe than originally predicted.)

From the supervisor's perspective the agent examination program is the most significant development, but there are others worth mentioning; an arbitration panel for dealing with small claims has been introduced, and from November 2001 a customer protection declaration is required to be mentioned in every policy issued. An optional cooling off period may be introduced during 2002.

The supervisor would like to have more regular meetings with the market associations and more publicity given to public education regarding life and motor insurance (has already begun to issue some brochures on compulsory motor insurance).

Assessment

Largely observant. The successful implementation of the agent examination program should open the way to full observance. In addition, some encouragement in the areas of industry meetings and public education would be appropriate.

Recommendation

In view of the increased regulatory involvement in this area the supervisor has expressed a desire for more regular meetings with the industry associations, and these could only be beneficial. He has also raised the issue of public education regarding life insurance and those classes of compulsory insurance, e.g. motor, and he should be encouraged to develop these areas.

Once the Agent Examination system is fully operational Macao will be fully observant of the principle.

Principle 12: Financial Reporting

It is important that insurance supervisors get the information they need to properly form an opinion on the financial strength of the operations of each insurance company in their jurisdiction. The information needed to carry out this review and analysis is obtained from the financial and statistical reports that are filed on a regular basis, supported by information obtained through special information requests, on-site inspections and communication with actuaries and external auditors.

A process should be established for:

- setting the scope and frequency of reports requested and received from all companies licensed in the jurisdiction, including financial reports, statistical reports, actuarial reports and other information;
- setting the accounting requirements for the preparation of financial reports in the jurisdiction;
- ensuring that external audits of insurance companies operating in the jurisdiction are acceptable; and
- setting the standards for the establishment of technical provisions or policy and other liabilities to be included in the financial reports in the jurisdiction.

In so doing a distinction may be made:

- between the standards that apply to reports and calculations prepared for disclosure to policyholders and investors, and those prepared for the insurance supervisor; and

- between the financial reports and calculations prepared for companies incorporated in the jurisdiction, and branch operations of companies incorporated in another jurisdiction.

Description

The MIO has adequate provisions for financial reporting both annually and quarterly, and the examination of the reports is carried out in a timely and effective manner.

For the annual return the supervisor publishes a comprehensive 40-page form, including the auditor's report, which has to be filed 30 days before the companies AGM, which usually takes place in March or April. The return is reviewed first by two examiners, then by the managers, particular interest being taken in assets and technical reserves. This process usually takes two weeks after which a satisfactory return is then signed off by the supervisor and the Executive Board director with insurance responsibilities.

The company's own annual report must be published in two local newspapers, one in Chinese and one Portuguese, within 60 days of its AGM, after having filed a copy with the supervisor 15 days in advance. Quarterly returns on a simplified form are to be filed within 30 days of the close of the quarter. Both auditors and actuaries need to be approved by the supervisor. A regular on-site inspection program is to be introduced in 2002.

Assessment

Largely observant. Although no checklists are used the system seems to work effectively; each examiner has only four companies to review and the process is well understood by the present team. The range of investments open to local insurers is very limited so there are few problems in that area, and re-insurers are generally large European companies with top ratings, which can be easily verified. As the Principle includes on-site inspections, which are not yet implemented, Macao is only largely observant. The implementation of the on-site inspection program should clear the way for full observance.

Recommendation

Check lists should be introduced for the annual review process.

Principle 13: On-Site Inspection

The insurance supervisor should be able to:

- carry out on-site inspections to review the business and affairs of the company, including the inspection of books, records, accounts, and other documents. This may be limited to the operation of the company in the jurisdiction or, subject to the agreement of the respective supervisors, include other jurisdictions in which the company operates; and

- request and receive any information from companies licensed in its jurisdiction, whether this information be specific to a company or be requested of all companies.

Description

The supervisor has the authority to conduct on site inspections of all licensed entities, covering all aspects of the licensee's activity. He also has power to require compliance with any remedial action. However to date inspections have only been carried out on an as needed basis, i.e., to deal with particular situations. A team of two usually carry out such visits and they have enjoyed good cooperation from the companies concerned. A program of regular visits is to be introduced in 2002, which will result in each company being inspected once every three years. This will probably require extra staff.

Assessment

Meanwhile **materially non-observant**. There is certainly good intention being demonstrated here; the proof will be a couple of years down the line when the program is fully operational.

Recommendation

The new program should have a formal procedure, with check- lists for both the visits and the subsequent review work in office. New staff should be added if necessary. Once the program has been tried and tested the principle will be observed.

Principle 14: Sanctions

Insurance supervisors must have the power to take remedial action where problems involving licensed companies are identified. The insurance supervisor must have a range of actions available in order to apply appropriate sanctions to problems encountered. The legislation should set out the powers available to the insurance supervisor and may include:

- the power to restrict the business activities of a company, for example, by withholding approval for new activities or acquisitions;
- the power to direct a company to stop practices that are unsafe or unsound, or to take action to remedy an unsafe or unsound business practice; and
- the option to invoke other sanctions on a company or its business operation in the jurisdiction, for example, by revoking the license of a company or imposing remedial measures where a company violates the insurance laws of the jurisdiction.

Description

The supervisor has full powers of intervention, and powers to apply sanctions where necessary. These range from warnings to fines or imprisonment to suspension or final revocation of licenses.

There have been no instances of serious non-compliance or violations in the last two years. Some problems of an administrative nature have been dealt with by way of meetings with management.

Assessment

Observant. The proper framework is there, (and presuming it) which it is presumed would work when put to the test.

Principle 15: Cross-Border Business Operations

Insurance companies are becoming increasingly international in scope, establishing branches and subsidiaries outside their home jurisdiction and sometimes conducting cross-border business on a services basis only. The insurance supervisor should ensure that:

- no foreign insurance establishment escapes supervision;
- all insurance establishments of international insurance groups and international insurers are subject to effective supervision;
- the creation of a cross-border insurance establishment is subject to consultation between host and home supervisors; and
- foreign insurers providing insurance cover on a cross-border services basis are subject to effective supervision.

Description

At present the only business which comes under the category of cross border is that conducted in Macao by branch offices of major international companies, most of whom have regional offices in Hong Kong. None of the indigenous insurers conduct any business over seas.

All of the branch offices are subject to full regulatory oversight of their local operations; this includes the requirement to pledge assets to the AMCM as with local companies, so the market is very well protected.

The supervisor has an excellent working relationship with his counterpart in HK, and a Memorandum of Understanding to formalize that relationship was effected late in 2001.

Macao is a member of the International Association of Insurance Supervisors and is very cognizant of the need for full attention to this Principle.

Assessment

Observant.

Principle 16: Coordination and Cooperation

Increasingly, insurance supervisors liaise with each other to ensure that each is aware of the other's concerns with respect to an insurance company that operates in more than one jurisdiction either directly or through a separate corporate entity.

In order to share relevant information with other insurance supervisors, adequate and effective communications should be developed and maintained. In developing or implementing a regulatory framework, consideration should be given to whether the insurance supervisor:

- is able to enter into an agreement or understanding with any other supervisor both in other jurisdictions and in other sectors of the industry (i.e., insurance, banking or securities) to share information or otherwise work together;
- is permitted to share information, or otherwise work together, with an insurance supervisor in another jurisdiction. This may be limited to insurance supervisors who have agreed, and are legally able, to treat the information as confidential;
- should be informed of findings of investigations where power to investigate fraud, money laundering and other such activities rests with a body other than the insurance supervisor; and
- is permitted to set out the types of information, as well as the basis on which information obtained by the insurance supervisor may be shared.

Description

The supervisor is able to discuss the affairs of, and share information concerning, any entity licensed under the insurance law with any other supervisor, insurance or otherwise, in any other jurisdiction on a confidential basis. However there is some restriction on disclosing information on persons involved in criminal proceedings arising out of provisions in the Macao constitution.

The comment on the preceding principle is also relevant here. The only problem identified is relative to the penultimate point in the box above. Where the supervisor provides information to the police he is generally not kept informed of any resultant developments. (The supervisor does not have law enforcement powers.) This can be a hindrance to further investigation work on the part of the supervisor.

Assessment

Largely observant. A recommendation to the AMCM on the latter problem would be helpful.

Recommendation

Whilst the supervisor is not a law enforcement official he does have a keen interest in knowing the subsequent history of cases which he has referred to other investigatory bodies (e.g., judicial police). Such knowledge can be both an encouragement and an aid towards identifying future suspicious activity at an early stage, but unless the supervisor has some part to play in formal proceedings he remains uninformed. The AMCM should be encouraged to address this issue at the highest level; some way of sharing such information would be very helpful.

Principle 17: Confidentiality

All insurance supervisors should be subject to professional secrecy constraints in respect of information obtained in the course of their activities, including during the conduct of on-site inspections.

The insurance supervisor is required to hold confidential any information received from other supervisors, except where constrained by law or in situations where the insurance supervisor who provided the information provides authorization for its release.

Jurisdictions whose confidentiality requirements continue to constrain or prevent the sharing of information for supervisory purposes with insurance supervisors in other jurisdictions, and jurisdictions where information received from another insurance supervisor cannot be kept confidential, are urged to review their requirements.

Description

Professional secrecy is provided for within both the MIO and the By Laws of the AMCM. The supervisor is able to hold confidential information received from other supervisors.

Assessment

Observant