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August 12, 2011

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 Sector Assessment Program Documentation—Assessment of Compliance on Basel Core Principles for Effective Banking Supervision**

Attached for the **information** of Executive Directors is the assessment of compliance on Basel core principles for effective banking supervision that was completed in connection with the Financial Sector Assessment Program (FSAP) assessment of Macao SAR.

It is intended that this paper will be published on the Fund's external website after August 19, 2011.

Questions may be referred to Ms. Gobat, MCM (ext. 39332).

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

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OFFSHORE FINANCIAL SECTOR ASSESSMENT PROGRAM—UPDATE

MACAO SAR

ASSESSMENT OF COMPLIANCE

BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

APRIL 2009

INTERNATIONAL MONETARY FUND
MONETARY AND CAPITAL MARKETS DEPARTMENT

MACAO SAR
OFFSHORE FINANCIAL CENTER ASSESSMENT

ASSESSMENT OF COMPLIANCE WITH THE BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

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I. SUMMARY, KEY FINDINGS, AND RECOMMENDATIONS

Summary

1. **In general, there is a high level of compliance with the Basel Core Principles (BCP).** The body of laws, rules and regulations are comprehensive and well developed, and provide a solid framework for banking supervision. There has been significant improvement in a number of areas since the 2002 Offshore Financial Center (OFC) assessment.

2. **Notwithstanding, a critical recommendation of the 2002 OFC assessment to amend the laws to address shortcomings in the operational independence of the Monetary Authority of Macao (AMCM) as financial regulator in the law, remains an outstanding issue**. The AMCM continues to have inadequate legal independence and lacks final decision authority over critical supervisory issues.

3. **Going forward, the conduct of supervision will need to evolve from a more compliance approach towards a risk focused one**. This would be line with the risk-oriented regulations and guidelines issued over the past two years, with far greater emphasis on the comprehensive assessment of the risk profile of individual banks and financial systemic risk.

Introduction

4. **An assessment of Basel Core Principles (BCP) for Effective Banking Supervision was conducted as part of the Update Offshore Financial Center (OFC) assessment of Macao SAR**.[1] The assessment of the BCP was based on the essential criteria and additional criteria. The organization assessed was the AMCM—the financial regulator and supervisor of commercial banks.

5. **The assessment covered three objectives**: (ii) assess the implementation of the 2002 mission's recommendations; (ii) assess compliance with the BCP for Effective Banking Supervision, based on the 2006 revised principles; and (iii) review the framework for cross-border supervisory coordination and information sharing.

Information and methodology

6. **The assessors received prior to the mission start from the authorities their comprehensive self assessment and had also full access to all relevant staff within AMCM** (including the Banking Supervision Department, other Departments, such as Insurance, Statistics and Research, as well as members of the Board of Directors), and all the relevant laws governing the financial sector. The discussions with the staff were both frank

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[1]The assessors were Mr. Jose Tuya (formerly with the Office of the Comptroller of the Currency, United States) and Mr. Michael Deasy, from the Irish Financial Services Regulatory Authority.

and open, and we wish to record our deep appreciation for their assistance and cooperation. The assessors also met a number of external parties, including the Secretary for Economy and Finance, six commercial banks, both branches and subsidiaries as well as an offshore branch of a foreign bank, the Bankers' Association, the Committee for the Registry of Auditors and Accountants, an audit and accounting firm and a legal firm.

Institutional and Market structure

7. **Responsibility for the regulation and supervision of the banking sector rests with the AMCM.** The legal basis for banking supervision is set down in the Financial System Act of Macao (Decree-Law No. 32/93/M, 1993, otherwise known as the FSA) and the Decree-Law No.14/96/M, 1996 (also known as the Charter), supporting Decree-Laws No.58/99/M, 1999, which deals with the offshore regime of Macao SAR; No.15/83/M, 1983, which deals with the finance companies, as well as No.38/97/M for money changers; No.39/97/M for exchange operators, and No.15/97/M for cash remittance companies.[2] The laws are supplemented by 16 notices and circulars of rules and guidelines dealing with capital adequacy, liquidity, market, country and other risks, internal controls, and anti-money laundering. The Banking Supervision Department (BSD) within the AMCM is responsible for the supervision of 30 credit institutions, 11 money changers (i.e., bureau de change), 2 cash remittance companies, 2 securities traders (with head offices in Hong Kong SAR), and 6 money exchange operators.

8. **The banking system is large and mainly foreign owned.** Banking assets account for more than 200 percent of GDP. The sector consists of 30 credit institutions, including 27 commercial banks, the government-owned post-office savings institution, one finance company, and one stored-value-card issuer. All but two commercial banks (whose combined business represents less than 1 percent of total banking assets in Macao SAR) are either subsidiaries or branches of foreign banks. Chinese mainland-owned banks account for a dominant market position with the Bank of China (operating on a branch basis) effectively accounting for 40 percent of the market when including its 50.3 percent stake in Tai Fung Bank. There are three offshore banks, all owned by Portuguese banks. Offshore banks may only transact with non-residents and in currencies other than the local currency, and are exempted from profit tax. Other than having a lower capital requirement, the same supervisory regime applies to offshore banks as to all banks.

9. **Banks engage mainly in traditional banking business—taking deposits, granting loans, and managing surplus liquidity.** Loans accounted for about 40 percent of deposits in 2007, with property related loans accounting for about 30 percent of total loans. A significant proportion of assets is denominated in Hong Kong dollars, which are interchangeable with the pataca. Banks are liquid (reflecting also the 30 percent liquid asset ratio) and they manage their surplus liquidity conservatively. Most of it deposited with their overseas banks, mainly

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[2] Laws and regulations are available on AMCM's website at http://www.amcm.gov.mo/rules_and_guidelines.

in Hong Kong SAR, or in money market instruments. There is no active local interbank market.

10. **Banks are generally profitable and well capitalized.** While the banks tend to be profitable and aggregate profits have risen in absolute terms, return on assets has declined over the last number of years, as a result of increases in personnel costs owing to a tighter labor market. The NPL ratio at 0.6 percent is in line with a sound banking system. Regulatory capital as a percentage of risk weighted assets on an aggregate basis (CAR) has been on a gradual decline since 2003, having fallen from 17 percent to 14 percent at end 2007. Nonetheless, it remains comfortably in excess of the minimum requirement of 8 percent.

Preconditions for effective banking supervision

11. **Macroeconomic management in Macao SAR has traditionally been conducted in a prudent and conservative manner. This has helped provide stability to Macao SAR's financial system.** Macao SAR has a currency board arrangement with the local currency, the pataca, pegged to the Hong Kong Dollar since 1977. By law, foreign exchange reserves must at least cover 100 percent of the monetary base. Fiscal policy, which can be used as a countercyclical instrument, is conservatively managed, visible in no public debt, substantial fiscal reserves, and a Moody's Aa3 sovereign rating.

12. **Macao SAR has a well developed legal system that is heavily influenced by the Portuguese legal system.** Its legislative regime for issues relating to the efficient and smooth running of a banking environment is in place (e.g., insolvency, foreclosure, collateral).

13. **The accounting framework however is lagging somewhat.** Macao SAR is in the process of adopting International Financial Reporting Statements (IFRSs). To date it has adopted 16 IFRSs (effective January 1, 2007), but for accounting issues not covered by these standards, the law simply states that accounts should be prepared in accordance with generally accepted accounting principles without specifying what is meant by "generally." In practice, many of the banks adopt the accounting standards of their overseas head office/parent, most of which are applying either IFRSs or standards drawn from IFRSs. To enhance the transparency and credibility of its accounting system, Macao SAR should adopt the IFRS system in full.

14. **There is also no formal deposit protection scheme.** Nevertheless, given that the banks rely heavily on retail deposits as a source of funding, consideration could be given to introducing a deposit protection scheme. This would also help assure a timely and stable resolution of a bank in difficulty.

Main findings

Previous assessment

The previous report of 2002 identified the following shortcomings in banking supervision:

The assessment recommended that the AMCM be granted independence from the government of Macao SAR. This would have required an amendment of the laws, and no such change has occurred. The issue remains a significant shortcoming.

The assessment recommended that market risk be included in the Basel capital adequacy ratio requirement. This has since been addressed.

The assessment recommended that the AMCM issue guidelines governing interest rate, country, concentration, market risks. This has been done. Various guidelines have been introduced for the identification, monitoring and measurement of such risks.

The assessment recommended that staff resources be reviewed in the light of current unfulfilled positions and additional responsibilities. The BSD has since increased its resources by a net four professional staff and one support staff, bringing its current complement to 23—i.e., 17 professional and 6 support. It is also in the process of recruiting four additional staff over the next year. At this level, its staffing complement appears complete.

The assessment recommended the development of procedure manuals, particularly to support onsite inspections. The AMCM has commenced drafting an onsite manual. Six of the 14 chapters therein are complete and are being applied. The remainder are being worked on.

Current assessment

Independence (BCP 1.2)

15. **This was the only area that received a materially non-compliant rating,** and it relates to the power granted under the law to the Chief Executive of Macao SAR (chief executive). For important supervisory matters—such as licensing and revocation of licenses, approving the AMCM's budget, appointing the chairman and other members of the board of directors, and dismissing the chairman of the AMCM—the law gives the chief executive the final authority and decision making power.

16. **While there is no evidence that the chief executive has ever interfered in the operational independence of the AMCM** and has approved the advice put forward by the AMCM, the possibility exists that he or she could, thereby threatening the ability of the AMCM to achieve its objective of assuring financial stability.

Recommendation

Amend the FSA and the Charter to give operational independence to the AMCM. As part of this amendment, the AMCM should have full licensing authority (approval and revocation); the appointment of the chairman should be confirmed by a broader body (such as the Legislative Assembly); the AMCM should be able to set its overall budget, without government approval; and finally, the dismissal conditions for the chairman should be clearly spelled out in the law.

Legal powers (BCP 1.4)

17. **The legislation provides a full range of corrective/remedial measures that can be used when a bank encounters difficulties.** However, it is the chief executive who takes the decision on whether they should be implemented or not, on the advice of the AMCM. In addition to undermining the AMCM's independence as described under BCP1.2, having to take the extra step to have to advise the chief executive and allowing him or her the time to consider the matter, valuable time will have been lost in a situation where timely action is critical to assuring a sound and effective bank resolution process.

Recommendation

Amend the legislation to give full legal powers over a range of supervisory issues, including corrective and remedial measures that can be taken when a bank is in difficulty, to the AMCM. Remove the role of the chief executive in Articles 83 and 85.

Exposure to related parties (BCP 11)

18. **Neither existing legislation nor supervisory guidelines address the issue** that all loans to related parties should be at arm's length.

Recommendation

The AMCM should introduce an explicit requirement that loans to related parties are not granted on terms more favorable than those granted to third parties.

Supervisory approach (BCP 19)

19. **The AMCM receives considerable balance sheet and income information** from the banks through the prudential returns, and identifies any development that is deviated from trend for follow-up with banks. However, the AMCM does not have a systematic approach to detecting trends and indicators that could point to emerging problems emerging in the banking system as a whole.

Recommendation

It is recommended that the AMCM enhance its offsite analysis to deepen the trend analysis it undertakes for individual banks (incl. information of the parent banks) and collate this into a systemic risk analysis framework for the overall banking sector. This analysis can serve as the basis for the development of an early warning system.

Corrective and remedial powers of supervision (BCP 23)

20. **It is standard international practice among financial regulators** that the regulator has decision making authority where corrective/remedial actions against a particular bank or in the event of a banking crisis are required. While the AMCM is involved in the decision forming process—that is it advises the chief executive on the type of actions required—it is

the chief executive who makes the final decision. The chief executive could, in theory, decide against the AMCM's proposed corrective actions.

Recommendation

Amend the legislation to give the AMCM full decision making power over the corrective actions and remedial powers of supervision, thereby eliminating the role of the chief executive in the matter.

Table 1A. Summary Compliance with the Basel Core Principles—ROSCs

Core Principle	Comments
1. Objectives, independence, powers, transparency, and cooperation	For all of these criteria, except independence, the AMCM is compliant.
1.1 Responsibilities and objectives	
1.2 Independence, accountability and transparency	The AMCM is not independent of the Government. The chief executive has the final say in a number of very important supervisory matters, e.g. licensing and revocation of banks. The chairman should be appointed by the Legislative Assembly rather than the chief executive and the terms of removal should be spelt out and published. The AMCM should be able to set its overall budget, without government approval.
1.3 Legal framework	
1.4 Legal powers	The AMCM should have the final decision making authority in implementing corrective or remedial action to assure timely and effective bank resolution.
1.5 Legal protection	
1.6 Cooperation	
2. Permissible activities	
3. Licensing criteria	
4. Transfer of significant ownership	
5. Major acquisitions	
6. Capital adequacy	
7. Risk management process	
8. Credit risk	
9. Problem assets, provisions, and reserves	
10. Large exposure limits	
11. Exposure to related parties	The AMCM should introduce an explicit requirement that loans to related parties are not granted on terms more favorable than those granted to third parties.
12. Country and transfer risks	
13. Market risks	
14. Liquidity risk	
15. Operational risk	
16. Interest rate risk in the banking book	
17. Internal control and audit	
18. Abuse of financial services	
19. Supervisory approach	The AMCM should enhance its offsite analysis to deepen the trend analysis it undertakes for individual banks and collate this into a systemic risk analysis framework for the overall banking sector.
20. Supervisory techniques	
21. Supervisory reporting	
22. Accounting and disclosure	

Core Principle	Comments
23. Corrective and remedial powers of supervisors	The AMCM should have the final decision making power in implementing corrective or remedial action to avoid delays and to assure effective bank resolution.
24. Consolidated supervision	
25. Home-host relationships	

Table 1B. Summary Compliance with the Basel Core Principles—Detailed Assessments

Core Principle	Grading	Comments
1. Objectives, independence, powers, transparency, and cooperation	LC	For all of these criteria, except independence, the AMCM is compliant.
1.1 Responsibilities and objectives	C	
1.2 Independence, accountability and transparency	MNC	The AMCM is not independent of the Government. The chief executive has the final say in a number of very important supervisory matters, e.g., licensing and revocation of banks. The chairman should be appointed by the Legislative Assembly rather than the chief executive. The terms of removal should be spelled out in the law and published. The AMCM should be able to set its overall budget, without government approval.
1.3 Legal framework	C	
1.4 Legal powers	LC	The AMCM should have the final decision making power in implementing corrective or remedial supervisory action to assure timely and effective bank resolution.
1.5 Legal protection	C	
1.6 Cooperation	C	
2. Permissible activities	C	
3. Licensing criteria	C	
4. Transfer of significant ownership	C	
5. Major acquisitions	C	
6. Capital adequacy	C	
7. Risk management process	C	
8. Credit risk	C	
9. Problem assets, provisions, and reserves	C	
10. Large exposure limits	C	
11. Exposure to related parties	LC	The AMCM should introduce an explicit requirement that loans to related parties are not granted on terms more favorable than those granted to third parties.
12. Country and transfer risks	C	
13. Market risks	C	
14. Liquidity risk	C	

15. Operational risk	C	
16. Interest rate risk in the banking book	C	
17. Internal control and audit	C	
18. Abuse of financial services	C	
19. Supervisory approach	LC	The AMCM should enhance its offsite analysis to deepen the trend analysis it undertakes for individual banks and collate this into a systemic risk analysis framework for the overall banking sector.
20. Supervisory techniques	C	
21. Supervisory reporting	C	
22. Accounting and disclosure	C	
23. Corrective and remedial powers of supervisors	LC	The AMCM should have the final decision making power in implementing corrective or remedial supervisory action to avoid delays and to assure effective bank resolution.
24. Consolidated supervision	C	
25. Home-host relationships	C	
Aggregate: Compliant (C) – #, Largely compliant (LC) – #, Materially noncompliant (MNC) – #, Noncompliant (NC) – #, Not applicable (N/A) – #		

Recommended action plan

Table 2. Recommended Action Plan to Improve Compliance with the Basel Core Principles

Reference Principle	Recommended Action
BCP1.2, BCP1.4, and BCP23	Amend legislation to give greater operational independence to the AMCM. The chairman should be appointed by the Legislative Assembly rather than the chief executive and the terms of removal should be spelt out and published. The AMCM should be able to set its overall budget, without government approval. The AMCM should have the final decision making authority in implementing corrective or remedial action to assure timely and effective bank resolution.
BCP11	The AMCM should introduce an explicit requirement that loans to related parties are not granted on terms more favorable than those granted to third parties.
BCP19	The AMCM should enhance its offsite analysis to deepen the trend analysis it undertakes for individual banks and collate this into a systemic risk analysis framework for the overall banking system.

Authorities' response to the assessment

21. **Regarding the independence and legal powers of the AMCM,** the authorities highlighted the complexity of addressing the issue and report that it will require major

legislative changes and an overhaul of the administrative structure of the Macao SAR government in relation to the regulation of the financial market. The issue has already been raised to the Secretary of Economy and Finance and BCP1.2, BCP1.4 and BCP23 will then be jointly addressed. In addition, formulation of guidance on how to proceed with the emergency or intervention measures in the event of bank difficulties as recommended for BCP 23 will be considered.

22. **Currently, the FSA, which has come into force since 1993, is now under review for amendments**. Industry has been invited to give opinions about the adaptability of the Act to its current operating environment and any suggestions of changes. Revision of the FSA will be prepared on the basis of these comments and opinions, together with the AMCM's past experience gained from its supervisory work in relation to the implementation of the Act as well as relevant international supervisory standards.

23. **In the review process, consideration will be made to see if a specific provision should be added in the FSA,** addressing the requirement that loans to related parties should be granted on an arm's length basis. Or alternatively, certain supervisory guidelines may include such requirement.

24. **Offsite analysis will be enhanced in the following ways:**

- Implementation of a more systematic early warning system and periodic stress testing will be considered.
- Following the finalization of the new rules on asset classification and provisioning, more detailed information for credit risk analysis will be collected through bank returns like increased breakdown of loan categories and respective delinquency ratios.
- To enhance understanding of the circumstances of the head office banks or parents, regular updates to relevant risk profiles will be performed by making reference to credit rating reports, and visits will be paid to these overseas institutions, if necessary.

25. **Regarding the deposit insurance scheme, the AMCM understands that the deposit insurance scheme is one of the components of a sound financial safety net.** The AMCM has conducted a study in the past on whether Macao SAR should introduce one. The study concluded that Macao SAR did not have an immediate need for such a scheme. In accordance with Article 12 (i) of the Charter, the AMCM is charged with a responsibility to act as a lender of last resort (LOLR), and it believes that this LOLR element, together with prudential supervision, would continue to play a major role in the operations of Macao SAR's financial safety net in the foreseeable future. In addition, the SAR government paid all depositors when BCCI collapsed in early 1990's and this is the only case of bank failure happened in Macao SAR so far. Notwithstanding, the AMCM plans to review again the deposit insurance scheme, including studies on the relevant legal framework, scope of insurance coverage, form of participation, calculation of premium, fund management and operation model.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles

Principle 1.	**Objectives, autonomy, powers, and resources.** An effective system of banking supervision will have clear responsibilities and objectives for each authority involved in the supervision of banks. Each such authority should possess operational independence, transparent processes, sound governance and adequate resources, and be accountable for the discharge of its duties. 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.
Description	In terms of objectives, autonomy, powers and resources, the AMCM is compliant in all but one significant factor—operational independence.
Assessment	Largely compliant
Comments	The lack of operational independence is dealt with in some detail in Principle 1 (2).
Principle 1(1).	**Responsibilities and objectives.** An effective system of banking supervision will have clear responsibilities and objectives for each authority involved in the supervision of banks.
Description	There are two main pieces of legislation governing banking supervision in Macao SAR—the FSA and the Charter. They designate the AMCM as the body responsible for banking supervision and clearly specify the supervisory objectives of the FSA. Article 5 of the FSA specifically charges the AMCM with the responsibility for promoting the general stability and proper functioning of the financial system. They provide the FSA with wide powers of supervision over banks, including the ability to inspect banks, assess applications for licenses, establish regulatory rules, sanction banks, etc. The FSA and the Charter, supplemented by a number of supporting regulations, establish detailed prudential requirements relating to capital adequacy, liquidity, large exposures, country, transfer, interest rate and market risk. While all this governing documentation provides for an adequate banking supervisory regime, some of the provisions of the FSA and the Charter are out of keeping with current best international practice in financial supervision. These provisions relate to the role of the Chief Executive of Macao SAR in banking supervision and particularly its potential impact on the operational independence of the AMCM (See also Principle 1(2)).
Assessment	Compliant
Comments	While the FSA, the Charter and the supporting documentation provide for an effective supervisory framework, the FSA and the Charter should be amended to provide greater independence to the AMCM.
Principle 1(2).	**Independence, accountability and transparency.** Each such authority should possess operational independence, transparent processes, sound governance and adequate resources, and be accountable for the discharge of its duties.
Description	While the AMCM is charged with the supervision of the financial sector in Macao SAR, there are provisions in both the FSA and the Charter, whereby the chief executive retains certain powers which could adversely impact on its independence and threaten its ability to achieve its objective. For example, in the FSA it is the chief executive, generally on the advice of the AMCM, who decides on: • Granting of a banking license to an applicant (Article 19) (See Principle 3); • Revocation of licenses (Article 35); • Reduction of bank capital (Article 58); • Implementation of emergency measures in the event of bank difficulties (Article 83); • Appoints the liquidator of an insolvent bank (Article 95) and the liquidator reports

	solely to the chief executive (Article 99). As such, there is a significant scope of government interference in the supervisory decision making of the AMCM. While there is no evidence of such intervention to date, it is recommended that the FSA and the Charter be amended so that all decisions affecting the regulation and supervision of banks be taken solely by the AMCM. Furthermore, the Board of Directors of the AMCM (which must comprise of at least three persons and at most five—currently it consists of three members, including the chairman) is nominated by the chief executive (Article 15 of the Charter). Also, the chief executive decides which other director replaces the chairman if the latter is absent or prevented, and where a matter of serious concern to the AMCM arises and the chairman is unable to convene a Board meeting, because of a lack of quorum, the chairman must first obtain the consent of the chief executive before making a decision (Article 16 of the Charter). The chairman's term of office is for two years, and renewable for another two years ("Despachos" of the Secretary for Economy and Finance on 6 July 2007). He can be removed from the office during the two year term only when (i) "there is a necessity for reallocation of job duties within the top management of the government departments and agencies (which includes the AMCM) with sufficient justification; or (ii) he is subject to disciplinary punishment" (Article 5 of the Decree-Law No.85/89/M, 1989). This latter point would be inconsistent with Article 15 of the Charter which states that posts of directors of the AMCM are not equivalent to any other within the public administration. As a final matter on the issue of independence, the budget of the AMCM must be approved by the chief executive. In other jurisdictions where the financial regulator is part of the central bank, it is normal practice for it to be funded and approved by the central bank. Typically, also these central banks set their own budget. With the recent hiring of staff and projected hiring in 2008/09, the BSD views that it has the resources to effectively supervise banks. In addition, it has hired three external experts in recent years to provide advice on supervisory issues.
Assessment	Materially non-compliant
Comments	The fact that the final decision on important supervisory matters (e.g., Articles 19, 35, 58 and 83) rests outside the AMCM is clearly unsatisfactory and the practice is potentially open to abuse, although there is no evidence that this ever happened. Nonetheless, to ensure the operational independence of the regulator, it is recommended that the FSA and the Charter be amended so as to assign full supervisory responsibility to the AMCM. To enhance the independence of the chairman of AMCM, it is recommended that (a) the chairman be appointed by, for instance, the Legislative Assembly; (b) his term of office be extended to five years or slightly more; (c) the Board of Directors of the AMCM be excluded from the provisions of Article 5 of the Decree-Law No.85/89/M, 1989; and (d) the terms under which the chairman can be dismissed be clearly spelt out and made public; and (e) the AMCM should set its own budget, without government approval. Finally, it is recommended that the four additional staff budgeted for 2008 and 2009 be recruited as a matter of urgency.
Principle 1(3).	**Legal framework.** A suitable legal framework for banking supervision is also necessary, including provisions relating to authorization of banking establishments and their ongoing supervision.
Description	The FSA provides for a suitable legal framework for banking supervision. Articles 19

	and 35 contain provisions for the authorization and revocation respectively of licenses, although it is the chief executive who makes the final decision in both instances (See Principle 1(2)). Article 6 of the FSA allows the AMCM to set prudential standards while Article 7 of the FSA requires banks to submit information to the AMCM as prescribed by it.
Assessment	Compliant
Comments	
Principle 1(4).	**Legal powers.** 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 FSA provides the AMCM with suitable framework. Article 5 of the FSA (and others) confer wide powers on the AMCM to set prudential standards and to monitor them. Article 8 gives it power to examine the books, accounts and other relevant documentation, and to have full access to a bank's board, management and relevant staff to allow it check compliance with relevant rules. Article 83 lists special measures which can be taken when a bank encounters difficulties. These include revocation and suspension of licenses, restrictions on the activities of banks, removal of directors, imposition of conditions, etc. These special measures, however, may only be imposed by the chief executive. Articles 125 to 130 of the FSA list the sanctions which the chief executive may impose, including fines and the suspension of shareholder voting rights for a period of up to five years.
Assessment	Largely compliant
Comments	The undesirability of the chief executive having a role in the decision making process of the AMCM is dealt with as a general principle in Principle 1(2). However, there is an extra concern in his having the final say in the application of special measures. In many instances, speed is of the essence in applying such measures (e.g. the possible need to restrict certain activities of a bank). Having to advise the chief executive on such matters and allowing him time to give due consideration to the issues may impede speed of action.
Principle 1(5).	**Legal protection.** A suitable legal framework for banking supervision is also necessary, including legal protection for supervisors.
Description	Under Article 30 of the Penal Code, the actions taken by the AMCM and its staff when discharging their legal duties will not be considered as illegal. Moreover, any challenge to the AMCM must be taken against the AMCM and not its staff.
Assessment	Compliant
Comments	
Principle 1(6).	**Cooperation.** Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.
Description	Under Article 79 of the FSA, the AMCM may provide confidential information to other domestic or foreign supervisory authorities provided that the information remains subject to secrecy and is used only for supervisory purposes. The AMCM has established MOUs with the supervisory authorities of those jurisdictions which have a strong banking presence in Macao SAR, i.e. Chinese mainland, Hong Kong SAR and Portugal. Confidential information provided by other regulators is protected by the secrecy provisions of Article 78 of the FSA.
Assessment	Compliant
Comments	
Principle 2.	**Permissible activities.** 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 1 of the FSA only credit institutions may "receive deposits or other repayable funds from the public and grant credit on its own account and risk". Credit institutions are defined as commercial banks , the Post Office Savings Department and financial leasing companies. Article 17 sets out the activities which banks may

	undertake. In addition to deposit-taking and the granting of loans, they may engage in other activities commonly associated with banking ,e.g. money transmission, asset management safe custody services ,etc. Article 18 prohibits the use of words such as "bank", "banker," "banking," "deposit," or any other term which implies the idea of operating the business of a credit institution, except where it does apply to a credit institution. The AMCM is required to publish annually (Article 14) a list of all credit institutions operating in Macao SAR.
Assessment	Compliant
Comments	The inclusion of financial leasing companies in the definition of credit institution dates back to the days of Portuguese rule. While such companies may have been regarded as credit institutions in Portugal, they have no relevance in Macao SAR. It is recommended that they be deleted from the definition of credit institution.
Principle 3.	**Licensing criteria.** The licensing authority must have the power 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 ownership structure and governance of the bank and its wider group, including the fitness and propriety of Board members and senior management, its strategic and operating plan, internal controls and risk management, 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	Article 5 of the FSA charges the AMCM with the supervision, coordination and inspection of credit institutions and describes its role as the supervisory authority. However, the authority to grant or reject an application for a banking license rests with Chief Executive of Macao SAR , on advice from the AMCM (Article 19 of the FSA). It is also required for the following: opening of branches in Macao SAR by credit institutions incorporated overseas; setting up of subsidiaries and opening of branches and representatives overseas by credit institutions incorporated in Macao SAR. An application for authorization is submitted to the AMCM which assesses it against a comprehensive list of authorization criteria listed in Article 22 of the FSA. On the suitability of shareholders, Article 22(5) of the FSA states that "If the Governor is not satisfied that all the shareholders with qualifying shareholdings [i.e., holding 10 percent or more] meet the conditions to ensure the sound and prudent management of the credit institution, authorization shall be refused". After concluding its assessment, the AMCM makes its recommendation to the chief executive who, as indicated above, will decide whether or not to authorize. The role of an external body (i.e., the chief executive) in approving or otherwise an application for a banking license does not conform with best international practice. While the chief executive has never rejected the advice of the AMCM, the possibility exists that he could, resulting in the authorization of a bank which the AMCM would not wish to be authorized or the rejection of an application the AMCM believed met all the necessary criteria.
Assessment	Compliant
Comments	The central requirements of this Principle—that is the setting of an appropriate licensing criteria and the establishment of an effective licensing process—have been met. The role of the chief executive in the process is dealt with in Principle 1 (2)—the independence of the regulator. As noted under Principle 1 (2), the role of the chief executive in the licensing approval process should be removed.
Principle 4.	**Transfer of significant ownership.** The supervisor has the power to review and reject any proposals to transfer significant ownership or controlling interests held directly or indirectly in existing banks to other parties.
Description	Under Article 40 of the FSA, no individual or corporate body may acquire, either directly or indirectly, a qualifying shareholding (i.e., 10 percent or more of the share capital or voting rights) of a credit institution incorporated in Macao SAR or increase

	the same by over 5 percent of the share capital or voting rights, in one or more stages, without the prior approval of the AMCM. Moreover, locally incorporated banks must inform the AMCM as soon as they become aware of any changes of qualify shareholdings. They must also provide the AMCM on an annual basis with a list of shareholders with holdings of 5 percent or more in their capital or voting rights. All prospective qualifying shareholders are subject to a fitness and proper test.
Assessment	Compliant
Comments	
Principle 5.	**Major acquisitions.** The supervisor has the power to review major acquisitions or investments by a bank, against prescribed criteria, including the establishment of cross-border operations, and confirming that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.
Description	Rules relating to acquisitions by banks are set down in Article 68 of the FSA. It states that "No credit institution may have a shareholding in another company which exceeds, either directly or indirectly, 15 percent of its funds. The aggregate amount of holdings referred to in the previous sentence may not exceed 60 percent of the credit institution's own funds" Holdings in financial institutions subject to supervision deemed appropriate by the AMCM are excluded from these provisions. All such acquisitions, however, must seek the prior approval of the AMCM. In the case of a proposed acquisition of an overseas financial institution, the level of host supervision and related issues regarding cross-border and consolidated supervision, including effective exchange of supervisory information, will be taken into consideration.
Assessment	Compliant
Comments	
Principle 6.	**Capital adequacy.** Supervisors must set prudent and appropriate 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. At least for internationally active banks, these requirements must not be less than those established in the applicable Basel requirement.
Description	Article 6 of the FSA grants the AMCM the power to issue directives on the solvency ratios and criteria for risk-weighting assets and off-balance-sheet items. Article 59 of the FSA authorizes the AMCM to set higher capital adequacy ratios as warranted by a bank's financial condition. Articles 82 and 83 of the FSA provide the chief executive on the advice of the AMCM, the power to require remedial action should a bank fall below the minimum capital ratio. As authorized by Article 6, the AMCM has prescribed the requirements of its capital adequacy regime through Notices 012/93 (Composition of Own Funds and their characteristics) and 013/93 (Determination of capital adequacy ratio). Most recently, the AMCM issued 011/2007 (Determination of market risk adjusted capital adequacy ratio) which implements the 1996 amendment to the Basel Capital Accord to reflect market risk. The overall capital requirements are consistent with the Basel Capital Accord. In addition, the AMCM has established 12 percent as the level at which the bank is contacted to determine whether action is required and 10 percent the level at which the bank is required to have an action plan. Elements of Basel II will be implemented gradually.
Assessment	Compliant
Comments	
Principle 7.	**Risk management process.** Supervisors must be satisfied that banks and banking groups have in place a comprehensive risk management process (including Board and senior management oversight) to identify, evaluate, monitor and control or mitigate all material risks and to assess their overall capital adequacy in relation to their risk profile. These processes should be commensurate with the size and complexity of the institution.
Description	The AMCM has issued Circular 169/B/2002-DSB (Internal Control Guideline for

	Authorized Credit Institutions) which establishes the fundamental requirements for credit institutions to maintain an effective risk management process. In addition, the AMCM has issued or is in the process of issuing risk management guidance for banks in the areas of investment management, liquidity, interest rate, electronic banking, outsourcing and business continuity. The internal control circular covers the basics of a control environment, risk recognition and assessment, control activities, accounting and monitoring. The role of the Board of directors and management are also addressed. Inspectors review compliance during on-site reviews.
Assessment	Compliant
Comments	
Principle 8.	**Credit risk.** Supervisors must be satisfied that banks have a credit risk management process that takes into account the risk profile of the institution, with prudent policies and processes to identify, measure, monitor and control credit risk (including counterparty risk). This would include the granting of loans and making of investments, the evaluation of the quality of such loans and investments, and the ongoing management of the loan and investment portfolios.
Description	Article 51 of the FSA requires the Board and management to diversify risks and to ensure transactions are at arm's length. Circular 169/B/2002-DSB on internal controls provides guidelines to the Board and management on how to accomplish risk control. The Circular requires the Board to formulate, approve and periodically review policies, including policies regarding risk management. The AMCM has full access to information in credit and investment files and to bank officers as stipulated in Articles 7 and 8 of the FSA. During onsite examinations the banks' credit risk management system, credit granting standards, loan portfolio composition, asset quality, adequacy of loan provisions are reviewed to ensure that the overall credit risk management system is adequate.
Assessment	Compliant
Comments	
Principle 9.	**Problem assets, provisions and reserves**. Supervisors must be satisfied that banks establish and adhere to adequate policies and processes for managing problem assets and evaluating the adequacy of provisions and reserves.
Description	Article 6 of the FSA authorizes the AMCM to set the criteria for provisioning and to establish minimum limits for the general and specific loan loss provisioning. Notice 018/93 sets out the basic framework for loan classification and provisioning. Banks are required to review and report their problem assets to the AMCM on a quarterly basis. During on-site examinations loans, provisions and problem loans are reviewed to ensure that the bank complies with established processes and that loans are accurately rated reflecting repayment capacity.
Assessment	Compliant
Comments	The AMCM has drafted new guidance (Guideline on Asset Classification and Provisioning) that will be out for consultation and that provides guidelines on a more risk-focused approach and provides banks with three alternatives for problem loan classification and provisioning. This will enable banks, most of which are branches or subsidiaries of global banks, to better benefit from their parent internal systems and avoid duplication of a separate system for Macao SAR.
Principle 10.	**Large exposure limits.** Supervisors must be satisfied that banks have policies and processes that enable management to identify and manage concentrations within the portfolio, and supervisors must set prudential limits to restrict bank exposures to single counterparties or groups of connected counterparties.

Description	FSA 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 the types of exposure to be aggregated under the limit. In addition, Article 64 imposes an aggregate limit on large exposures to 800 percent of the bank's own funds. Through the collection of reports and on-site examinations, the AMCM monitors compliance.
Assessment	Compliant
Comments	
Principle 11.	**Exposures to related parties.** In order to prevent abuses arising from exposures (both on balance sheet and off balance sheet) to related parties and to address conflict of interest, supervisors must have in place requirements that banks extend exposures to related companies and individuals on an arm's length basis; these exposures are effectively monitored; appropriate steps are taken to control or mitigate the risks; and write-offs of such exposures are made according to standard policies and processes.
Description	Article 65 of the FSA limits the exposure of any qualifying shareholders and companies under their control to 20 percent of the bank's own funds. The aggregate exposure to all qualifying shareholders and companies under their control is limited to 40 percent. 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). Article 66 of the FSA 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 to related parties. Under Article 51 of the FSA, 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. During on-site examinations, examiners 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	Largely compliant
Comments	While in their onsite examinations examiners review loans to related parties to ensure that they are not granted on terms that are more favorable than those granted to outsiders, there is no specific requirement in the law or supervisory issuances to that effect. It is recommended that the law be amended or supervisory guidelines issued, addressing the requirement for market terms.
Principle 12.	**Country and transfer risks.** Supervisors must be satisfied that banks have adequate policies and processes for identifying, measuring, monitoring and controlling country risk and transfer risk in their international lending and investment activities, and for maintaining adequate provisions and reserves against such risks.
Description	Circular 008/B/2008-DSB (Guideline on Management of Country Risk) establishes the requirements for the identification, monitoring measurement and control of country and transfer risk. Adequate documentation must be maintained to monitor and support the quality of the credits, exposure limits must be established and stress testing conducted and provisions established as warranted. Banks are required to report exposures in excess of 30 percent of own funds to the Board. The AMCM conducts periodic reviews on the level of provisioning established for individual countries. And on a case-by-case basis may require a bank to reassess the level of provisioning.

Assessment	Compliant
Comments	While banks are not required to file country risk/exposure reports, under Article 8, the AMCM may acquire that information onsite or by requesting special reports. It is recommended that regular reporting be required from banks on country risk**.**
Principle 13.	**Market risk.** Supervisors must be satisfied that banks have in place policies and processes that accurately identify, measure, monitor and control market risks; supervisors should have powers to impose specific limits and/or a specific capital charge on market risk exposures, if warranted.
Description	Notice 011/2007-AMCM (Determination of Market Risk Adjusted Capital) implements the 1996 Basel Accord market risk amendment and establishes a reporting requirement for banks. The notice requires the establishment of risk limits, establish investment policies, and authorization requirements. Compliance will be monitored by AMCM, primarily through off-site reporting.
Assessment	Compliant
Comments	
Principle 14.	**Liquidity risk.** Supervisors must be satisfied that banks have a liquidity management strategy that takes into account the risk profile of the institution, with prudent policies and processes to identify, measure, monitor and control liquidity risk, and to manage liquidity on a day-to-day basis. Supervisors require banks to have contingency plans for handling liquidity problems.
Description	Notice 006/93 (Rules on Cash in Hand and Minimum Liquidity Requirements) addresses liquidity requirements for banks. In addition the AMCM will issue for consultation “Guideline on Management of Liquidity Risk” which implements the recommendations in the Basel Committee papers “Sound Practices for Managing Liquidity in Banking Organizations” and “Principles for Sound Liquidity Risk Management and Supervision”. The 1993 notice 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.
Assessment	Compliant
Comments	The liquidity guidance is expected to be implemented in 2009.
Principle 15.	**Operational risk.** Supervisors must be satisfied that banks have in place risk management policies and processes to identify, assess, monitor and control/mitigate operational risk. These policies and processes should be commensurate with the size and complexity of the bank.
Description	The overall supervisory framework for operational risk management is addressed in guidelines issued by the AMCM. Although a specific document addressing operational risk has not been issued, the AMCM has issued for implementation or for prior consultation a compendium of documents fully addressing the risk. The documents include the Internal Control Guidance (which covers operational risk), Guideline on Risk Management of Electronic Banking, Business Continuity Planning and Guideline on Outsourcing.
Assessment	Compliant
Comments	
Principle 16.	**Interest rate risk in the banking book.** Supervisors must be satisfied that banks have effective systems in place to identify, measure, monitor and control interest rate risk in the banking book, including a well defined strategy that has been approved by the Board and implemented by senior management; these should be appropriate to the size and complexity of such risk..
Description	The AMCM examiners evaluate the banks' policy on interest rate risk monitoring, including pricing and hedging of risks. Most banks operating in Macao SAR are branches or subsidiaries of foreign banks and interest rate risk management at these banks is under head office/parent and home country supervision guidelines. The AMCM has issued for consultation “Guideline on Management of Interest Rate Risk”

	that implements the Basel guidance issued in 2004.
Assessment	Compliant
Comments	The new guidelines will be implemented by the end of this year.
Principle 17.	**Internal control and audit.** Supervisors must be satisfied that banks have in place internal controls that are adequate for the size and complexity 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 the bank's assets; and appropriate independent internal audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.
Description	Article 51 and Circular 169/B/2002- DSB on internal controls establishes the responsibilities of the Board and senior management with respect to corporate governance. The AMCM closely monitors compliance and during onsite examinations reviews the organizational structure, accounting policies and internal processes. Article 49 gives the AMCM authority to remove directors. The AMCM also reviews internal audits performed by head office of foreign banks, meets with head office staff, and requires head office audit to visit Macao SAR annually.
Assessment	Compliant
Comments	
Principle 18.	**Abuse of financial services.** Supervisors must be satisfied that banks have adequate policies and processes in place, including strict "know-your-customer" rules, that promote high ethical and professional standards in the financial sector and prevent the bank from being used, intentionally or unintentionally, for criminal activities.
Description	Significant legislation has been issued in the past few years to strengthen the AML/CFT regime, including the establishment of an FIU. To implement the new legislation AMCM has issued "Anti-money laundering and combating the financing of terrorism guideline for financial institutions." Article 106 of the FSA establishes requirements for financial institutions to identify customers. The AMCM conducts onsite examinations to ensure compliance with the AML guidelines.
Assessment	Compliant
Comments	
Principle 19.	**Supervisory approach.** An effective banking supervisory system requires that supervisors develop and maintain a thorough understanding of the operations of individual banks and banking groups, and also of the banking system as a whole, focusing on safety and soundness, and the stability of the banking system.
Description	The Banking Supervision Department believes that it has a thorough knowledge of the banks and the banking system as a whole. Its familiarity with the banks begins during the authorization process when a profile for each bank is established. This profile includes information on the banks' parent, group structure, home supervisor, the activities it carries out in Macao SAR, its management and staff. This information is updated during the course of onsite and offsite examination. Beyond this, banks are required to seek prior AMCM approval in respect of new products and services it proposes to launch. The AMCM collates information relating to the banks on an aggregate basis and undertake some trend analysis. However, it does not have a formal structure of assessing trends of particular loan categories across banks, except for housing mortgages and analyze how any trend changes could impact the banking system as a whole.
Assessment	Largely compliant
Comments	It is recommended that the AMCM enhance its offsite analysis to deepen the trend analysis it undertakes for individual banks, including reviewing developments in various loan categories (including mortgages, sectoral loan, delinquencies etc), collate this information and analyze how changes in the deviation from trend could impact the banking system on the whole (i.e., systemic analysis). This analysis can

	serve as the basis for the development of an early warning system. In addition, in monitoring the activities of the banks, the AMCM should pay increasing attention to the circumstances of the head office bank/parent, particularly when many banks are being affected by the credit crunch. In many instances these banks are rated by credit rating agencies and their reports should be obtained by AMCM. Country developments in which head offices/parents are located should also be closely monitored.
Principle 20.	**Supervisory techniques.** An effective banking supervisory system should consist of on-site and off-site supervision and regular contacts with bank management.
Description	The AMCM carries out both onsite and offsite supervision. Normally it carries out onsite examinations every two years or at more frequent intervals, if warranted. It uses the CAMEL method of assessment (i.e., looking at capital, asset quality, management, earnings and liquidity). The AMCM compiles a yearly plan of inspection targets in November for the following year. An end-of - inspection meeting is held with the management of the bank at which proposed recommendations are discussed. The AMCM is in the process of finalizing an inspection manual – it hopes to have it finished in the second half of 2008. In the meantime, it is using that part of the manual that is complete and an informal version of the incomplete part during inspections. Offsite supervision includes the analysis of the prudential returns submitted by the banks to the AMCM (see Principle 21). (These returns are verified during onsite inspections.) The AMCM also carries out regular meeting with individual banks either on a twice yearly or annual basis. This is to increase its knowledge of the banks and to update the banks of new regulatory initiatives. Also, banks are required to inform AMCM of any new products/services they propose to launch.
Assessment	Compliant
Comments	While a program of onsite inspections is compiled every year, it is suggested that the AMCM adopt a more formal risk based approach to onsite examinations. Such an assessment would take into account, for example, the following: the status of the bank (i.e., branch or locally incorporated); whether it is owned by a bank; the extent to which the head office/parent oversees its operations; the extent to which the regulator of the headoffice/parent involves itself with the Macao SAR bank, etc. [Note: The last two have always been taken into account when planning onsite examinations by BSD.] The assessment of 2001 recommended that the AMCM prepare an onsite manual. While six of the 14 chapters have been completed to date, it is recommended that its completion be given priority.
Principle 21.	**Supervisory reporting.** Supervisors must have a means of collecting, reviewing and analyzing prudential reports and statistical returns from banks on both a solo and a consolidated basis, and a means of independent verification of these reports, through either on-site examinations or use of external experts.
Description	Under Article 7 of the FSA, all banks must submit to the AMCM, at such time and in such manner as the latter may prescribe, all prudential, statistical, accounting and other relevant information as AMCM may deem necessary for the proper discharge of its legal obligations. It receives all the standard returns which would be expected, e.g., liquidity returns on a weekly basis, monthly balance sheets and profit and loss statements, quarterly capital adequacy calculations, quarterly non performing loan reports, quarterly operational risk reports, etc. All returns are checked by the off-site inspection staff and are verified by examiners during on-site inspections. Furthermore, all banks are required to appoint external auditors who report annually (all banks in Macao SAR are audited by one of the “Big 4” auditing firms).
Assessment	Compliant
Comments	
Principle 22.	**Accounting and disclosure.** Supervisors must be satisfied that each bank maintains

	adequate records drawn up in accordance with accounting policies and practices that are widely accepted internationally, and publishes, on a regular basis, information that fairly reflects its financial condition and profitability.
Description	Article 74 of the FSA requires banks to maintain proper accounting records. Articles 75 and 76 require banks to publish their audited balance and income statements on an annual basis. The appointment of external auditors is subject to the prior approval of the AMCM. (All banks in Macao SAR are audited by one of “Big 4” accounting firms). Until 2007, the law in Macao SAR (Section 3 of Chapter 1 of the Macao SAR Commercial Code) stipulated that accounts be prepared in accordance with “generally accepted accounting principles”. However, “generally” was not defined and it appeared that various accounting principles were applied, for example, branches/subsidiaries adopted the accounting standards of their home country (e.g., Portugal, Hong Kong SAR, Chinese mainland). In 2007, a new law became effective (Regulation No 25/2005) whereby Macao SAR adopted 16 IFRS standards (out of 41). For accounting issues not covered by these standards, the old regime continues to apply. The Committee for the Registry of Auditors and Accountants (the statutory regulatory body of the auditing and accounting profession in Macao SAR) has recently issued a consultative paper to interested parties seeking their views on the proper timing for adoption of the remaining IFRS. At present, banks are not required to publish information about risk management strategies and practices, risk exposures, transactions with related parties, etc., as would be generally best practice in this area. However, starting with the 2008 annual accounts, such information will be published to reflect the requirements of Pillar 3 of Basel II.
Assessment	Compliant
Comments	It is recommended that the AMCM encourage the relevant authorities to introduce the remaining IFRSs, and, in particular, IFRS 39 which deals with the valuation of financial instruments and has particular relevance for banks.
Principle 23.	**Corrective and remedial powers of supervisors.** Supervisors must have at their disposal an adequate range of supervisory tools to bring about timely corrective actions. This includes the ability, where appropriate, to revoke the banking license or to recommend its revocation.
Description	In seeking to resolve a problem in a credit institution, the AMCM will in the first instance seek to resolve by negotiation with the management. Where the problem cannot be resolved at this level or where the credit institution in question persists in the wrong doing, the FSA provides for a broad range of intervention measures. Articles 83 allows the chief executive, on the advice of the AMCM, to issue an executive ruling to, inter alia, revoke or suspend the authorization, issue conditions for an orderly reimbursement of deposits to customers, suspend one or more directors, impose temporary restrictions on the activity of a credit institution, etc. Article 85 empowers the chief executive, on the advice of the AMCM, to appoint an administrative committee to run the credit institution. Thus, while the law provides for a wide range of corrective measures and remedial actions, the final decision rests with the chief executive and not the AMCM. This would appear to put these provisions somewhat at variance with essential criteria 2 of Principle 23, viz., “The supervisor participates in deciding when and how to effect the orderly resolution of a problem bank situation…” The AMCM is involved in the decision forming process but not the decision making. Articles 125 to 134 deals with the imposition of sanctions (e.g., fine or suspension of the voting rights of a shareholder for a period of one to five years, prohibition on a director from holding a directorship in any regulated entity, loss of capital in the operations capital in the credit institution in question, publication of the sanction).

	Currently a bank against which the AMCM has taken sanctions can appeal in the first instance to the AMCM and thereafter to the chief executive. Is it suggested that in the event of a change in the legislation, consideration could be given to amending the appeals procedure so that instead of the chief executive, some form of appeals committee be established as the court of final appeal
Assessment	Largely compliant
Comments	The role of the chief executive more broadly is dealt with under Principle 1(2). However, the fact that the AMCM is not involved in the decision making process when corrective/remedial action is required and that this seems to be in contravention of an essential criteria would merit a further qualification here. It once again highlights the need for greater independence for the AMCM. The FSA contains sufficient corrective and remedial powers to be effective. However, it should seek to formally document how it would proceed in the event of a crisis arising. Such a plan should identify trigger clauses that would indicate that the crisis was looming, and what actions should be taken at various stages. The role of the AMCM as central bank and the role of the government, particularly if it appears that depositors may lose funds, should be spelled out in this process.
Principle 24.	**Consolidated supervision.** An essential element of banking supervision is that supervisors supervise the banking group on a consolidated basis, adequately monitoring and, as appropriate, applying prudential norms to all aspects of the business conducted by the group worldwide.
Description	Article 9 of the FSA gives the AMCM the authority to supervise credit institutions on a consolidated basis. It has the power to impose prudential standards on a consolidated basis for the entire banking group. Banks that have subsidiaries are required to report on a both a solo and consolidated basis. They must also calculate the capital ratio on both a solo and consolidated basis. Articles 8 and 9 of the FSA give the AMCM the authority to carry out inspections of overseas operations- it has exercised this power for the one bank that has an overseas subsidiary in Hong Kong SAR (the only one). Banks proposing to establish either a subsidiary or a branch overseas must first obtain the authorization of the chief executive on advice of the AMCM. There are strict limits on banks holding non-bank subsidiaries (see Principle 5) and such structures are not a feature of Macao SAR banking.
Assessment	Compliant
Comments	
Principle 25.	**Home-host relationships.** Cross-border consolidated supervision requires cooperation and information exchange between home supervisors and the various other supervisors involved, primarily host banking supervisors. Banking supervisors must require the local operations of foreign banks to be conducted to the same standards as those required of domestic institutions.
Description	Articles 78 and 79 of the FSA permit exchanges of information between the AMCM and other overseas supervisory authorities provided that the information is used for supervision purposes and remains subject to confidentially. The AMCM has signed MOUs with the 3 jurisdictions which have a significant presence in Macao SAR: Chinese mainland, Hong Kong SAR and Portugal. The one bank with overseas operation in Hong Kong SAR is covered by the MOU with that jurisdiction. The MOUs are in standard format. The MOUs provide for bi-lateral meetings and such meetings have taken place. Home country supervisory can inspect the overseas' operations of its banks.
Assessment	Compliant
Comments	