



INDEPENDENT ADVISORY GROUP
REVIEW OF THE CENTRAL BANKING ACT 2000 & FINANCIAL SECTOR REGULATION
c/- Ministry of Treasury, Level 10, Treasury Haus, Waigani, NCD.
Website: <https://pngcentralbankactiag.org/>

Honorable Ian Ling-Stuckey CMG MP
Minister for Treasury
Office of the Minister
Level 10 – Treasury Haus
WAIGANI, NCD.

Chairman IAG 30th March 2022

TOR Phase II
Approved

My dear Minister,

PHASE II - REVIEW CENTRAL BANKING ACT 2000 & FINANCIAL SECTOR REGULATION REVIEW

Greetings!

You will recall in your appointment of the Independent Advisory Group and approval of the Terms of Reference on the Review of the Central Banking Act 2000 on 13th May 2021 and recent statements following NEC's consideration of the IAG's Phase I report that the IAG will continue its review to –

- undertake further work on 8 of its 31 recommendations principally related to the Monetary Policy Committee;
- focus on the financial sector, including the commercial banks and both the superannuation and insurance sectors; the application of the Anti-Money Laundering and Counter-Terrorism Financing rules; and
- Bank of PNG's financial health, management and performance, the shortage of cash in 2021, and improved data communications.

Following consultations with the Department of Treasury, the Bank of PNG, and Staff of your ministry, I now submit the Terms of Reference for Phase II of the Review for your approval.

Yours sincerely,

Robert Igara
Chair - Independent Advisory Group
Central Banking Act 2000 & Financial Sector Regulation Review

COPY: Mr. Andrew Oaeke, Acting Secretary, Department of Treasury, Treasury Haus, Waigani
Mr. David Toua, Chairman, Board of Bank of PNG, c/-To Robert Haus, Port Moresby
Mr Benny Popoitai, Acting Governor, Bank of PNG, c/-To Robert Haus, Port Moresby
Dr. Misty BALOILOI, Principal Secretary, Office of the Minister for Treasury, Treasury Haus



INDEPENDENT STATE OF PAPUA NEW GUINEA

Independent Advisory Group (IAG)

REVIEW OF THE CENTRAL BANKING ACT 2000 AND FINANCIAL SECTOR REGULATION

PHASE II – TERMS OF REFERENCE (29th March 2022)

1. Introduction

The Terms of Reference on the **Review of the Central Banking Act 2000** issued by the Minister for Treasury, Hon. Ian Ling-Stuckey, CMG MP dated 13th May 2021 called for the Review to be undertaken over two phases.

The Terms of Reference required that the Phase I review report would “...recommend from its findings and conclusions under TOR 1-4 critical strategic issues requiring in-depth analysis and development, which would...form the basis of the TOR for the second phase of the Review and cover broader issues of regulation of the financial system, actions to encourage competition, and follow-on work in light of the recent Financial Sector Reform review”.

The Terms of Reference for Phase II is therefore an extension of and forms part of the Terms of Reference issued by the Minister on 13th May 2021 (**Annex A**).

2. Phase I Follow-up

The Phase I report was delivered by the IAG on November 11, 2021, and is available on the IAG website: <https://pngcentralbankactiag.org/>. In his Parliamentary speech regarding the IAG Phase One report, the Minister for Treasury said that the government had accepted 21 of the IAG’s 31 recommendations in whole or in part, “with a further 8 recommendations deferred to work in with Phase 2 of the review.” These recommendations related to the Monetary Policy Committee (MPC), which the IAG had recommended. The Treasurer indicated that “the latter option may be the way forward for PNG, but a final decision on this has been deferred until the second phase of the review. This is because we may want a similar committee covering the important issue of financial regulation.”

Given this, the IAG will revisit the issue of the MPC in the context of its Phase II deliberation, also bearing in mind the issues raised by the IMF Safeguards Assessment report.

3. Consultations and Public Engagement

Despite the unanimous support in Parliament for the changes introduced by the Government, the passage of the *Central Banking (Amendment) Act 2021* has generated much public debate, much of it “ill informed”. Informed public discourse and understanding is critical to effective reform. The role of the IAG is not to debate the Government’s response to its review, but to share with all interested stakeholders the analysis it has undertaken.

The IAG will therefore build awareness of Phase I report findings and the TOR for Phase II with key agencies and institutions, and the media. The IAG also stands ready to engage in dialogue with key government agencies, in particular the Governor and Board of BPNG in relation to the analysis of the IAG report, and the Secretary of Treasury in terms of the strengthened co-ordination and information sharing mechanisms now built into the *Central Banking (Amendment) Act 2021*.

4. Second Phase Issues

The final item in the terms of reference issued for the IAG in May 2021 requires that the IAG:

Recommend from the findings and conclusions under TOR 1-4 critical strategic issues requiring in-depth analysis and development – this will form the basis of the TOR for the second stage of the review and cover broader issues of regulation of the financial system, actions to encourage competition, and follow-on work in light of the recent Financial Sector Reform review.

In his parliamentary speech in relation to the IAG’s phase one report, the Minister for Treasury gave further direction as to the focus of the second phase. He indicated that:

“[T]he second phase of the review will focus on the financial sector, including the commercial banks and both the superannuation and insurance sectors. Few people realise how important the financial sector is to our economy. According to the 2022 budget papers, when we look at GDP numbers, we see that the Financial and Insurance sector is estimated to be worth K2,341.7 million in 2022. This is nearly 50% bigger than the entire manufacturing sector, and about the same size as the health sector.

Mr Speaker, we need to encourage development of our finance and insurance sectors. The Marape Government wants to harness the extraordinary advances in mobile phones, to modernize our entire financial system so that everyone through our country is finally included with access to cash and loans and insurance.

The second phase of the IAG’s work will also examine the application of Anti Money Laundering and Counter Terrorism Financing rules, BPNG’s financial management and performance, the shortage of cash in 2021, and improved data communication.”

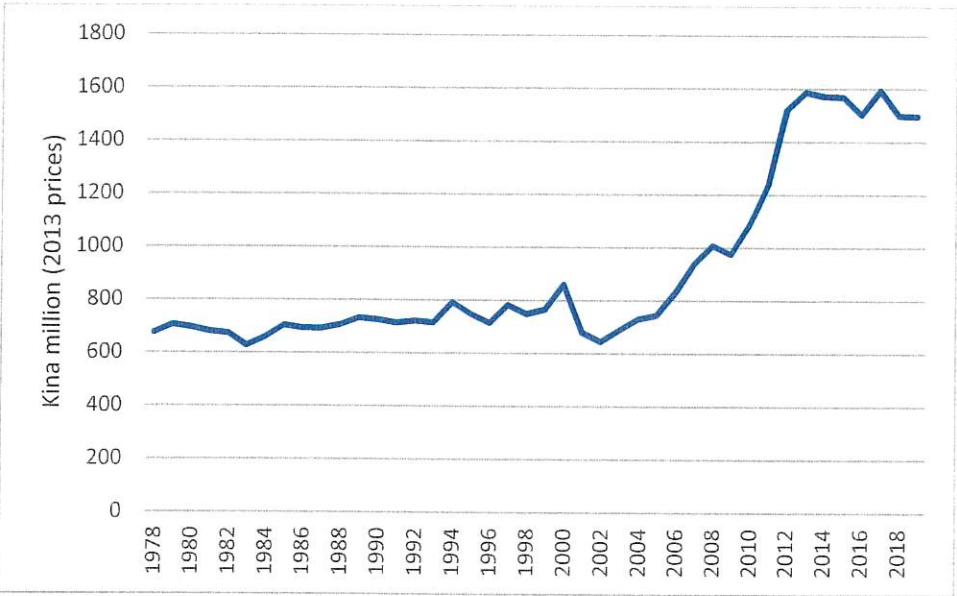
PNG’s financial sector is lacking in competition, and the margins between deposit and lending rates are among the highest in the world. There is also, as documented in our Phase I report, a large and long-standing problem of excess liquidity, that is, funds available but not being

used for investment. These are among the most fundamental challenges facing the PNG economy. Fixing them will go well beyond amending a particular law, but certainly the Bank of PNG plays the role of financial sector regulator, and reviewing the Act to examine what can be done to increase competition and the use of technology in the financial sector, push down margins, and increase investment should yield high returns. This requires review not only of banks, and financial institutions, but also the superannuation and insurance sectors. In undertaking this work, the IAG should be mindful of the Financial Sector Reform Review (Annex B).

The *Anti-Money Laundering and Counter Terrorism Act 2014* has laudable objectives of increasing transparency and reducing corruption, but there have been many complaints that it is reducing the accessibility and connectivity of the banking system.¹ As advised by the Minister, the review will examine the rules imposed through the *Anti-Money Laundering and Counter Terrorism Financing Act 2014*, and the governance arrangements for the Financial Analysis and Supervision Unit (FASU). More broadly, and looking forward, the review will consider if the central bank has the appropriate legislation to fulfill its functions especially in light of rapidly changing technologies.

In recent years, cash in circulation has only kept pace with inflation (Figure 1). It may be that businesses and households are moving away from cash to bank, credit and digital transitions. However, there have also been reports of cash shortages.² The review will examine these reports and whether the supply of cash is adequate for the needs of PNG’s business and households.

Figure 1: Cash in circulation



Source: PNG Economic Database

¹ See [“Anti-money laundering regulations in the Pacific – a double edged sword”](#) by Dek Joe Sum, Devpolicy Blog, 15 February 2022.

² See for example the article in *The National* on 29 January 2021 [“Bank assures customers ATMs will not be shut down.”](#)

Finally, there are outstanding issues of governance that the IAG did not have time to examine in its first phase. These include the following:

- The first phase found that data release onto the BPNG website was not timely. Beyond improving timeliness, and as is now being done in other countries, there should also be an examination of ways in which more, up-to-date “real time” data on the PNG economy can be obtained, through “big data” sources such as tax and superannuation, and whether legislative changes would be required to support this.
- The first phase of work found that illegal payment of dividends had occurred from BPNG to the PNG Government in earlier years. This unfortunate situation arose out of the breaching of rules safeguarding BPNG’s financial health. There is clearly a need to review those rules, and whether they need strengthening or otherwise revising.
- While the focus of the review is on the Central Bank Act, the question arises as to how this legislation interacts with, and should interact with, supplementary legislation that also may impact on the Bank of Papua New Guinea, such as *Banks and Financial Institutions Act 2000*, *Superannuation (General Provisions) Act 2000*, *Insurance Act 1995*, *Securities Commission Act 2015*, *Capital Markets Act 2015*, *National Procurement Act 2018*, *Public Finances (Management) Act 1995*, the *Audit Act 1989*, and the *Salaries and Conditions Monitoring Committee Act 1988*. This deserves further investigation.

5. Terms of Reference

Arising out of the issues above, the following will constitute the specific Terms of Reference for the review.

(a) Phase I Outstanding Issues

1. Re-examine the IAG’s analysis and recommendations regarding the establishment of Monetary Policy Committee bearing in mind the arrangements required and recommended for financial sector regulation.
2. Analyse and make recommendations regarding BPNG’s asset and financial performance and management, including provisions for support for financial institutions, reserve asset arrangements, recapitalization and lender of last resort, valuation of liabilities and assets and other financial relations with government.
3. Analyse and make recommendations regarding other legislation impacting BPNG, including the *Banks and Financial Institutions Act 2000*, *Superannuation (General Provisions) Act 2000*, *Insurance Act 1995*, *National Procurement Act 2018*, *Public Finances (Management) Act 1995*, the *Audit Act 1989*, the *Salaries and Conditions Monitoring Committee Act 1988*, the *Securities Commissions Act 2015*, *Capital Markets Act 2015*, and other relevant legislation.

4. Analyse and make recommendations regarding the ways in which more up-to-date “real time” data on the PNG economy can be obtained, through “big data” sources such as tax and superannuation.

(b) Financial sector and other economic issues

5. Analyse and make recommendations regarding the regulation of Banks and other financial institutions, in particular how to prudently –
 - a. Encourage new, low-risk entrants;
 - b. Expand the capacity of the domestic financial sector to meet the economy’s need for credit, drive down borrowing costs, and better meet the needs of small and medium enterprises including through open banking and fintech; and
 - c. Expand the capacity for improved access to international financial markets to support investment and financing, including the links to the *Superannuation (General Provisions) Act 2000*, *Securities Commissions Act 2015*, and *Capital Markets Act 2015*.
6. Analyse and make recommendations regarding the regulation of the financial sector as a whole, including securities, superannuation, and insurance, and the roles of the Office of Insurance Commissioner, the Securities Commission and BPNG.
7. Analyse and make recommendations regarding the governance of the Financial Analysis and Supervision Unit (FASU) within BPNG, as per the *Anti Money Laundering and Counter Terrorism Financing Act 2014*, and its relationship to the responsibility of BPNG under the *Banks and Financial Institutions Act 2000*.
8. More broadly, and looking forward, the review will consider if the central bank has the appropriate legislation to fulfill its functions especially in light of rapidly changing technologies.
9. Analyse and make recommendations regarding the shortage of cash in January 2021, and what lessons, if any, are to be learnt.
10. Take up other issues as required and approved by the Minister of Treasury.

(c) Dissemination. Outreach and Consultations

11. Build awareness of Phase I report findings and the TOR for Phase II with key agencies and institutions, and the media. Stand ready to engage in dialogue with key government agencies, in particular the Governor and Board of BPNG, and Secretary of Treasury, in relation to the analysis of the IAG report.
12. Solicit submissions and undertake the Review in a consultative manner as per Phase I.

6. Reports

The IAG will provide progressive reports on a monthly basis to the Minister and Secretary for Treasury, and the Chair of the Board and Governor of the Bank of PNG.

7. Period of Review

The review will be undertaken over a period of 12 months ending 31st December 2022.

8. Technical Support Group/Secretariat

A Technical Group/Secretariat consisting of Staff from the Department of Treasury, Bank of PNG, and Attorney General's Department will be appointed under a full-time Executive Manager.

The Department of Treasury and the Bank of Papua New Guinea to provide funding for the IAG with staff and appropriate office, facilities, and services for the duration of the IAG's term.

**Port Moresby
29 March 2022**



ANNEX A

REVIEW OF THE CENTRAL BANKING ACT 2000 TERMS OF REFERENCE

13TH MAY 2021

The Treasurer, in consultation with the Prime Minister and the Ministerial Economic Committee of the National Executive Council, has decided it is timely to have a review of the Central Banking Act 2000. The objective is to modernise the Central Banking Act 2000 in line with international developments over the last 20 years while continuing to ensure the independence of the central bank in line with international norms.

The review will benefit from the advice of an Independent Advisory Group. An Independent Advisor Group was similarly established by the late Sir Mekere Morauta when looking at the changes that led to the Central Banking Act 2000. The Independent Advisory Group will be chaired by Robert Igara, Chancellor at the University of Papua New Guinea, and formerly Chief Secretary when the Central Banking Act was introduced in 2000. Other members of the Independent Advisory Group will include the former Governor of the Bank of Papua New Guinea from 1999 to 2009, Sir Wilson Kamit. Professor Stephen Howes, Head of the Development Policy Centre at the Australian National University, and a good friend of PNG through its linkages with the University of Papua New Guinea and his support for the Femili group fighting domestic violence, will also be a member of the Group.

The Independent Advisory Group will be supported by a Technical Support Group consisting of equal numbers of Treasury and BPNG staff, support from Justice and Attorney General's and broader support from the IMF. Specific technical assistance will also be sought from bilateral sources.

This will be an important review, so it is vital that there is wide consultation, strong communication and that the review draws on best international practice for countries in similar circumstances to PNG.

Terms of Reference

The review will be in two stages. The first stage is to report in mid-July for possible legislative changes in the August sitting of Parliament, and the second stage to report in early October for the November sitting of Parliament.

The specific Terms of Reference for the first stage of the review focus on the following five elements:

1. Review whether the objectives of the Central Banking Act 2000 give adequate priority to the growth and development of PNG, and in managing national economic crisis (Section 7);
2. Review the current economic in particular monetary policy governance and management mandate of the central bank, including whether the Board or another

similar body should have responsibility under the Act for determining monetary policy, (sections 7-14 focusing on section 10);

3. Review the current arrangements around advances and financing to the government by the Central Bank, including a review of the TAF and options around quantitative easing options during a declared emergency (focus on Section 55)
4. Review the institutional governance and management of the Central Bank whether there is a need for strengthened accountability and transparency, and management performance and terms, in line with international norms (sections 15-36, and sections 42-50 with potentially new sections); and
5. Recommend from the findings and conclusions under TOR 1-4 critical strategic issues requiring in-depth analysis and development – this will form the basis of the TOR for the second stage of the review and cover broader issues of regulation of the financial system, actions to encourage competition, and follow-on work in light of the recent Financial Sector Reform review.

The Independent Advisory Group will consult and agree with the Minister for Treasury on the specific expected outcomes and the work schedule under Phase I of the TOR, in particular those recommendations which will require legislation and Parliamentary approval in 2021.

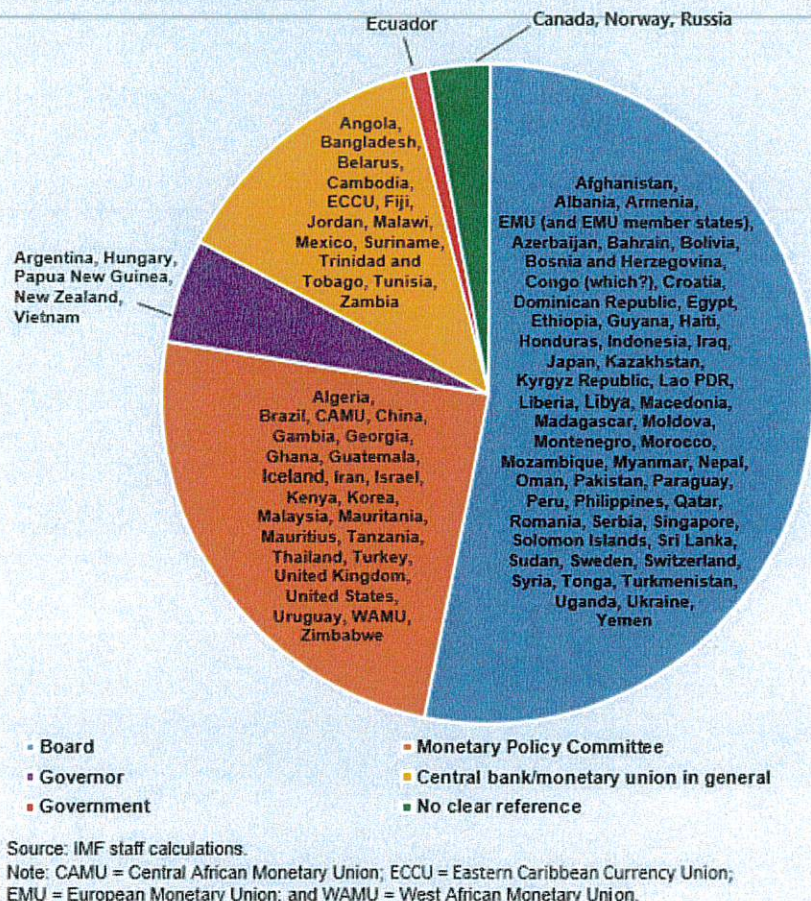
Background

The COVID-19 crisis has highlighted that PNG does not have the same flexibility as many other nations to respond to national emergencies. PNG has fallen behind international best practice in being able to access monetary policy instruments to support a country in a declared emergency situation. Changes were made in the context of the 2020 Budget to provide greater cash management flexibility within the year and PNG is now benefitting from this reform through early payment of school fees and more support through the development budget – such as for Bougainville – than was previously possible.

However, other monetary options to support the economy in the on-going COVID-19 crisis, with a revenue shortfall of over K2 billion still expected in 2021, are available to other countries but not PNG. The review will be asked to review both the form and level of the Temporary Advance Facility, as well as other Quantitative Easing options including the possibility of direct financing of the budget as is done in many other countries (such as Australia, New Zealand, Singapore, Indonesia and the Philippines).

One very unusual feature of PNG's Central Banking Act is that the Governor is given sole power to determine monetary policy. In 2018, there were only five countries in the world that did this (shown in purple in graph below). Since 2018, New Zealand has moved the power to a Monetary Policy Committee. The majority of countries in the world have their Central Bank Board make monetary policy, followed by a Monetary Policy Committee. The terms of the bank's senior management are also lengthy relative to international norms.

Chart 3
Monetary policy determination



BPNG's accountability and transparency arrangements are also very limited in comparison to international standards. Specifically, and given its unique role which reach beyond Papua New Guinea, and the need to provide assurance to international partners, the governance and audit function require compliance with international best practise and standards. Similarly, there is a wider lack of transparency around the Board and its deliberations, and a lack of accountability on its annual budget. These require a review of the scheme of governance adopted some 20 years ago under the *Central Bank Act 2000*. BPNG has recognised this and is undertaking a corporate governance review, and early results of that work will be built into this review process but not supersede this higher level review.

There is a broader range of matters that should also be considered by the review – aimed at ensuring the central bank has the appropriate legislation to fulfil its functions especially in light of rapidly changing technologies, as well as challenges around some elements of global financing flows (such as anti-money laundering actions).

Any changes to the Central Banking Act 2000 will be through Parliament. This becomes the ultimate test point to ensure the changes are in the best interests of PNG. As part of this process, the changes will also need to go through the National Executive Committee after vetting by the Central Agencies Co-ordinating Committee as well as the State Solicitor. The Treasurer, as the responsible Minister, will take forward any recommended changes to NEC drawing on the advice of the Independent Advisory Group and its Technical Assistance Group. There will be broad inputs to the review.

Consultation will be an important part of the review. This will include consultation with SMEs, larger firms, exporters and importers, consumer groups as well as key government institutions such as the ICCC on issues such as maintaining both competitiveness and stability in the banking system.

The processes of the review also need to be transparent. A website is proposed to cover the considerations of the review, along with regular updates to the public and Parliament.

Hon. Ian Ling-Stuckey, CMG. MP
Minister for Treasury

13th May 2021



ANNEX B

REVIEW OF RECENT FINANCIAL SECTOR REFORM

Government of PNG established in 2015 a Financial Services Sector Review (FSSR) team led by Department of Treasury and included Bank of PNG. FSSR was tasked to undertake a comprehensive review of the policy framework for PNG's financial services sector, taking into account diagnostics reports provided by the World Bank. The objective of the FSSR has been to foster further development of the contribution made by PNG financial services sector to PNG's economic and social development.

The resulting **Financial Sector Development Strategy (FSDS) 2018 – 2030** charted a course for taking PNG's financial services sector to a "next level of development", and outlined strategic directions covering four areas:

1. The architecture of PNG's financial sector regulatory and supervisory arrangements.

The main challenge relates to the level of skills/leadership and effective coordination and implementation, with PNG Insurance Commission (PNGIC) and PNG Securities Commission (SEC-PNG) having little critical mass, and inefficient separate supervision of life insurance and general insurance companies, respectively by BPNG and PNGIC.

Other regulatory and supervisory issues include –

- Current absence of supervisory oversight of land-owner trust funds.
- Housing of SEC-PNG within IPA with consequential conflict of interest.
- Economy wide breath of ICCC role as PNG's consumer protection agency with limited capacity to address scams and other forms of abusive conduct in the financial sector.

Proposed financial sector regulation and supervision over next decade to move to a more coordinated and integrated approach, in stages initially with prudential supervision of general insurance shifting to BPNG as PNG's single prudential supervisor. This will be alongside BPNG –

- Completing implementation of PNG's framework for AML/CFT;
- Completing re-licensing if, and implementation of updated prudential supervision for Savings & Loans Societies (S&LS); and
- Further developing a risk-based approach to prudential supervision.

Three further steps to broaden and strengthen financial regulation are:

- Strengthening of role of SEC-PNG, as an independent securities market regulator;
- Assigning SEC-PNG as a supervisory oversight role in respect of land-owner trust funds;
- Strengthening consumer protection in the financial sector including establishing Centre for Excellence in Financial Inclusion (CEFI) for consumer complaints and referral to enforcement agencies (ICCC, SEC-PNG and BPNG).

Move to further integration of financial regulation in PNG to bring prudential supervision and securities market regulation together in a single financial sector regulatory authority could be considered in the long term.

Implementation of the move to a single prudential supervisor and building the capacity of SEC-PNG are prerequisites for any further integration.

Consideration should also be given to enhancing PNG's superannuation arrangements. A task force was to investigate possibilities and report to the Minister for Treasury not later than end-2020.

2. Development of PNG's government bond and capital markets.

Trading in PNG's bond and equity markets currently (2015) is shallow.

First step towards developing PNG capital markets is establishment of a project team tasked to put in place arrangements needed to enable regular trading.

Further work required to strengthen corporate governance, financial disclosure practices, and capacity of PNG-SEC to oversee and regulate the market, and support development of a local equity market.

Ownership of POMSOX is a matter for medium/longer term consideration.

3. Development of a national payments system.

A Strategy and Acting Plan for development of the PNG National Payments System 2015-2018 in place, setting a comprehensive path forward for development of the PNG payments system.

Further steps to be implemented in 2018-2022 include –

- Installation of a “central payments switch” to enable payments interoperability across all authorised electronic retail payments platforms.
- Updating systems for safe and efficient settlement of capital markets (government bond and other capital market security) transactions.
- Reducing cost of international remittances.

4. Financial inclusion.

Strategy approved by NEC and launched in December 2016. Key priorities for 2018-2022 set out in FSDS.

CEFI now well established as PNG's apex financial inclusion institution with financial inclusion and literacy transferred from BPNG and MEP to CEFI.

FSDS Governance and Implementation

Key to achieving effective implementation of the FSDS work program is good project management, strong coordination and collaboration amongst implementing agencies.

Peak financial sector governance and coordination policy committee established known as PNG Financial Services Council (FSC), chaired by Governor BPNG, with Secretary for Treasury and Chair of PNG Securities Exchange Commission, with other agencies (ICCC and FASU) included. FSC is supported by a FSD Steering Committee with representatives from Department of Treasury, BPNG, CEFI, SEC-PNG and ICCG, with a Secretariat based in BPNG.