FINANCIAL STABILITY AND FINANCIAL SECTOR SUPERVISION: LESSONS FROM THE PAST DECADE AND WAY FORWARD
DECEMBER 17, 2007
TOKYO, JAPAN

BANKING SUPERVISION AND EXAMINATION IN THE PHILIPPINES

MR. NESTOR A. ESPENILLA, JR.
BANCO SENTRAL NG PILIPINAS

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Banking Supervision and Examination in the Philippines

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Nestor A. Espenilla, Jr.
Deputy Governor
Outline

- Overview of the Philippine Financial System
- The Philippine Banking System
- Banking Supervision in the Philippines
- Concluding remarks
Overview of the Philippine financial system

- Bank-dominated
- Philippine financial supervisory agencies
  - Bangko Sentral ng Pilipinas (BSP)
  - Securities and Exchange Commission (SEC)
  - Insurance Commission (IC)
  - *Philippine Deposit Insurance Corporation (PDIC)*
Overview of the Philippine financial system

**Financial Sector Forum**
- Formed in July 2004
- BSP, SEC, IC, and PDIC as members
- Cooperative effort without any legal mandate
- Not an integrated supervisory body
- **Key objectives**
  - Improvement of the supervision of financial conglomerates
  - Addressing regulatory grey areas
- **Working groups:** (1) supervision and regulatory policy, (2) reporting and information exchange, and (3) consumer protection
The Philippine banking system

- Banks differ according to capitalization and activities undertaken
  - Universal Banks (UBs) - KBs + investment house activities, 100% ownership of financial allied undertakings
  - Commercial Banks (KBs) - accept drafts, issue letters of credit, discount and negotiate evidences of indebtedness, accept deposits, buy/sell forex
  - Thrift Banks (TBs) - accumulate savings, grant retail loans, finance homebuilding
  - Rural Banks (RBs) - accept deposits, expected to meet credit needs of farmers/fishermen/cooperatives/merchants
  - Sustainable non-subsidized microfinance also undertaken by RBs and TBs and by KBs through wholesale funding
### The Philippine Banking System

<table>
<thead>
<tr>
<th>Category</th>
<th>Total Assets</th>
<th>Physical Count</th>
</tr>
</thead>
<tbody>
<tr>
<td>All Banks</td>
<td>4,930.1</td>
<td>848</td>
</tr>
<tr>
<td>Universal Banks (UBs)</td>
<td>3,539.1</td>
<td>16</td>
</tr>
<tr>
<td>Commercial Banks (KBs)</td>
<td>764.4</td>
<td>22</td>
</tr>
<tr>
<td>Thrift Banks (TBs)</td>
<td>477.9</td>
<td>82</td>
</tr>
<tr>
<td>Rural/Cooperative Banks</td>
<td>148.7</td>
<td>728</td>
</tr>
</tbody>
</table>
The Philippine banking system: Market Share

BANKING SYSTEM: ASSET SHARE BY CLASSIFICATION
As of End-Year 2006

- Universal/Commercial banks: 87%
- Rural and cooperative banks: 3%
- Thrift banks: 10%

Bangko Sentral ng Pilipinas
The Philippine banking system: *Asset Growth*

**BANKING SYSTEM: TOTAL ASSETS**
*As of End-Years 2000-2006 and End-September 2007*

<table>
<thead>
<tr>
<th>In PhP Bns</th>
<th>2005</th>
<th>2006</th>
<th>Sept. 2007(^p/)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Assets</td>
<td>4,319.4</td>
<td>4,865.6</td>
<td>4,930.1</td>
</tr>
<tr>
<td>Loans, net</td>
<td>2,008.7</td>
<td>2,294.9</td>
<td>2,274.0</td>
</tr>
<tr>
<td>Deposits</td>
<td>2,970.7</td>
<td>3,497.6</td>
<td>3,515.5</td>
</tr>
</tbody>
</table>

\(^p/\) preliminary

*Bangko Sentral ng Pilipinas*
The Philippine banking system: Profitability

BANKING SYSTEM: RETURN ON ASSETS (ROA)/ RETURN ON EQUITY (ROE)
FY 1999-2006 and for Nine Month Period Ended-30 September 2007

ROA
ROE
The Philippine banking system: *NPA Clean-up*

**SPV Transactions**
- Phase I – P97 billion NPAs disposed
- Phase II of amended SPV Law\(^1\)/
  - Done deals – P32.0 billion
  - Pending applications – P10.9 billion worth of NPAs for sale to SPVs and dacion en pago
- Joint venture arrangements

\(^1\)/Transactions as of 30 September 2007

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**Bangko Sentral ng Pilipinas**
The Philippine banking system: **Solvency**

**BANKING SYSTEM: CAPITAL ADEQUACY RATIO (CAR)**

As of End-Years 2001-2006 and end-June 2007
Banking supervision in the Philippines

Legal Framework

- R.A. No. 7653 (The New Central Bank Act, 1993) - Consolidated supervision
- General Banking Law of 2000 - Risk-based approach to supervision
Banking supervision in the Philippines

- **Consolidated supervision**
  - Driven by complex banking groups and mixed conglomerates
  - Since 1998; accelerated implementation since 2005

- **Risk-based approach to supervision**
  - Driven by complexity of banking business
  - Gradual shift since 1997; accelerated implementation since 2005
  - Allows banks to take risks as long as these are ably managed, absorbed, and priced
Banking supervision in the Philippines

- Internal requirements for the risk-based approach to supervision
  - Data collection and storage
    - Financial reporting package
    - Data Warehouse System
    - Informal arrangements with financial regulatory agencies
  - Overhaul of the examination/off-site monitoring processes
    - Report of Examination, CAMELS, Institutional Overview
Banking supervision in the Philippines

- Internal requirements for the risk-based approach to supervision
  - Skill sets and training
    - In-house structured training program
    - External training programs
    - International certifications
  - Re-organization of the BSP Supervision and Examination Sector
Banking supervision in the Philippines

Past Organizational Structure of the BSP Supervision and Examination Sector (SES)
Banking supervision in the Philippines

Other supervisory tools

- Bank Performance Reports (BPR) system
- Bank Early Warning System (EWS)
- Examiner Resource Scheduling System (ERSS)
Banking supervision in the Philippines

Identified gaps in Compliance with the Basel Core Principles for Effective Banking Supervision (based on 2002 IMF assessment)

- Legal protection for supervisors
- Formalization of information sharing and cooperation with local and foreign financial supervisory agencies
- Conduct of consolidated supervision and bank examination
- Framework for prompt corrective action and problem bank resolution
- Appropriate standards for banks’ risk management systems
Banking supervision in the Philippines

Developments in Compliance with the Basel Core Principles for Effective Banking Supervision

- Legal protection for supervisors -
  - included in proposed revisions to BSP Charter

- Formalization of information sharing and cooperation with local and foreign financial supervisory agencies
  - Information exchange and cooperation among local financial supervisors through the Financial Sector Forum (FSF)
  - 5 formal agreements with foreign financial supervisory agencies, negotiating with 7 others
Banking supervision in the Philippines

- Developments in Compliance with the Basel Core Principles for Effective Banking Supervision
  - Conduct of consolidated supervision and bank examination
    - BSP-SES reorganization also intended to support consolidated supervision
    - One of proposed revisions to BSP Charter is the grant of authority to BSP to look into banks’ non-allied subsidiaries and affiliates
    - Manual on Supervision and Examination of Banks revised through a TA with USAID
    - Development of a sustainable and relevant formal foundation training program for BSP examiners through a TA with First Initiative
Developments in Compliance with the Basel Core Principles for Effective Banking Supervision

- Framework for prompt corrective action and problem bank resolution
  - PCA framework reviewed and enhanced in 2006
  - Explicit criteria for placing banks under PCA and measures to be undertaken
  - Procedures already in place for financially distressed banks, but application is hampered by absence of coercive legal instruments
  - Proposed revisions to BSP Charter intended to give BSP more powers to effectively carry out problem bank resolution
Banking supervision in the Philippines

Developments in Compliance with the Basel Core Principles for Effective Banking Supervision

- Appropriate standards for banks’ risk management systems

  - The following supervisory guidelines on risk management have already been issued and implemented
    - Risk management of financial derivatives
    - Internal credit risk rating systems
    - Market risk management
    - Liquidity risk management
    - IT risk management
    - Supervision by risk
Adoption of international standards

- Basel II adopted in July this year
  - Preparatory work: Active monitoring of developments, revisions/adjustments in local framework, capacity-building
  - Simple approaches adopted + Pillar 3 guidelines
  - Advanced approaches may be allowed by 2010; ICAAP guidelines under exposure to industry
  - Approach to home-host issues on approval work to be dictated by legal status of foreign bank entities

- International accounting standards adopted since 2005
  - Supported by an external auditor accreditation system
Banking supervision in the Philippines

- **Enhancing corporate governance**
  - Re-defined duties and responsibilities of bank’s board of directors
  - Adoption of “fit and proper” standards for bank officers

- **Strengthening anti-money laundering regulations**
  - Customer identification requirements
  - KYC programs compliant with BCBS standards
Banking supervision in the Philippines

Developmental Initiatives

- Capital market development through:
  - contributions to foreign exchange liberalization
  - domestic bond and derivatives market development
  - payments systems upgrade

- Enhanced access to banking services by the poor through:
  - sustainable microfinance practices of banks
  - innovative deployment of mobile banking services

- Financial literacy

- Legislative advocacies
Concluding remarks

- Supervision of banks in the Philippines has gone a long way in the last 10 years.
- Despite the limits set by the existing legal framework, the BSP continues to upgrade its supervision and examination approaches in line with internationally accepted standards.
- The BSP also strives to improve banking practices through the issuance of relevant regulations.
- However, critical changes to the BSP Charter are necessary to achieve further improvements in the practice of banking supervision in the Philippines.
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