Liberalisation and management of the private non-bank corporate capital account: the Philippine experience

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1. Introduction

The Philippines taps foreign capital to augment domestic savings and support the country's huge development financing requirements. External capital account transactions have been liberalised since the early 1990s but certain prudential requirements are imposed, particularly on those involving the purchase of foreign exchange from the banking system, in order to optimise the utilisation of banks' foreign exchange resources and help maintain the convertibility of the peso. These requirements have also tempered the growth of foreign borrowings, particularly at the short end of the maturity spectrum, thereby dampening the adverse effects of external shocks such as the 1997-98 Asian financial crisis. This paper presents the Philippines' current policies and rules and regulations governing foreign exchange transactions with a special focus on the management of private non-bank corporate foreign borrowings.

2. Policy framework for foreign exchange transactions

Central Bank Circular no 1389 dated 13 April 1993, as amended, contains the consolidated rules and regulations governing the country's foreign exchange transactions. After more than 40 years of varying foreign exchange controls, the Circular laid out a liberalised regulatory environment for foreign exchange transactions following the country's adoption of a floating exchange rate system, the implementation of a series of structural and other reforms in the financial sector, and the decision to move towards greater integration with the global economy.

On the current account, all types or merchandise imports/exports are allowed except for certain items that are either regulated or prohibited for reasons of national interest and by legal provisions. There are no duties on exports while those on imports have been progressively reduced pursuant to commitments under international and regional trade/economic cooperation agreements. The Philippines is an Article VIII member of the International Monetary Fund (IMF) and is committed not to impose restrictions on current account payments without the approval of the IMF.

On the capital account, there are no restrictions on the inflow of foreign investments except in areas included in the Fourth Regular Foreign Investment Negative List dated 24 August 2000. Foreign investments are preferred over foreign borrowings as a source of foreign capital and the government provides tax and other incentives for those that invest in specified areas such as in companies registered with the Board of Investments. Registration of the foreign investment with the Bangko Sentral ng Pilipinas (Bangko Sentral) is not mandatory but gives the investor or its designated representative authority to purchase foreign exchange from the banking system to fund capital repatriation and remittance of dividends/profits/earnings derived on the registered investment.

Outward investments are also allowed without the need for prior Bangko Sentral approval if funded by the investor's own foreign exchange resources or with foreign exchange purchased from the banking system up to the specified limit.

In the case of foreign borrowings, prior approval of the Bangko Sentral is needed for all public sector borrowings, irrespective of maturity, creditor or source of foreign exchange for servicing the borrowings. Private banks also require prior Bangko Sentral approval for their foreign borrowings, except for normal interbank transactions.

Meanwhile, non-bank private sector entities are, in general, free to contract foreign loans provided that they do not intend to fund payments of principal and interest on the obligations with foreign exchange purchased from the banking system; otherwise, the prior approval of and/or registration with the Bangko Sentral are required (for details and exceptions, see Section 4).

In general, the policies on foreign borrowings also apply to foreign currency borrowings from offshore banking units as well as from banks with foreign currency deposit units operating in the Philippines.

There are no restrictions on the disposition of foreign exchange receipts of residents (eg from exports and salaries earned from overseas employment). Residents have the option of selling these receipts for pesos to banks or outside the banking system, or retaining or depositing them in foreign currency accounts, whether in the Philippines or abroad. However, purchases of foreign exchange from banks and bank-affiliated foreign exchange (forex) corporations are subject to certain documentary requirements to evidence the presence of a valid underlying obligation. The objective is to optimise the use of the foreign exchange resources of the banking system and promote stability in the foreign exchange market.

3. Institutional/legal framework for external debt management

The management of external debt involves the concerted efforts of various government agencies led by the Bangko Sentral (see Box 1 for the institutional setting). As overseer of the country's foreign exchange system and tasked with maintaining international reserves sufficient to meet any foreseeable net demands on it for foreign currencies, the Bangko Sentral is required by law to regulate foreign borrowings to keep external debt service requirements at manageable levels (see Box 2 for legal bases for the Bank's role in external debt management). It performs these tasks through the Monetary Board, its highest policymaking body, and the International Operations Department which, inter alia, handles the day-to-day activities of debt management.

4. Specific policies on private non-bank corporate foreign borrowings

Prior to the 1990s and consistent with existing controls on foreign exchange inflows and outflows, all foreign borrowing proposals had to be approved by and registered with the old central bank. Each purchase of foreign exchange from the banking system for debt servicing was likewise subject to prior central bank approval. With the liberalisation of foreign exchange transactions, private sector borrowers were, in general, given the option not to undergo the approval and registration process provided that they are not purchasing foreign exchange from the banking system for debt servicing purposes. This approach is consistent with the freedom Philippine residents now have in the use of their foreign exchange receipts, which were previously subject to a mandatory surrender requirement.

Circular no 1389, as amended, identifies the areas/economic activities eligible for foreign financing. Such areas are based primarily on the projects listed in the country's annual Investment Priorities Plan, medium-term development plan and medium-term public investment programme. The objective is to channel proceeds of foreign borrowings to priority areas for development such as infrastructure, agriculture and fisheries, build-operate-transfer projects, export-oriented activities, and socialised (low-cost) housing.

To regulate the country's debt service burden, existing rules require that short-term foreign borrowings intended to be serviced with foreign exchange to be purchased from the banking system shall finance exclusively foreign exchange costs of eligible projects payable to foreign beneficiaries. Exceptions would be borrowings for export-related requirements of direct and indirect exporters which may finance both local costs and foreign exchange costs payable to foreign beneficiaries. Medium- and long-term borrowings may finance both local costs and foreign exchange costs payable to foreign beneficiaries excluding working capital requirements.

Box 1

Institutional arrangements for debt management in the Philippines

Bangko Sentral ng Pilipinas. The central bank is vested with the responsibility of formulating guidelines to regulate and monitor foreign borrowings and to ensure that obligations are obtained on reasonable terms and that they are within the country's capacity to pay. It derives its mandate from the highest law of the land, the Philippine Constitution, as well as other legislation/executive issuances (see Box 2).

Department of Finance. The agency is responsible for raising funds for the national government from tax and non-tax revenues. As such, it handles the programming and execution of the national government's foreign borrowing activities, including the extension of guarantees for borrowings by other public sector entities such as government-owned/controlled corporations, including government financial institutions.

Investment Coordination Committee (ICC). This is a cabinet-level inter-agency body that evaluates the technical, financial, economic and social feasibility/viability, including the impact on the environment and institutional development, of major capital projects intended to be financed by official development assistance, whether in the form of grants or loans. The Committee also reviews the fiscal, monetary and balance of payments implications of these projects as well as projects under build-operate-transfer (BOT) and similar financing arrangements whose total costs exceed specified floor amounts. The current membership includes a member of the Monetary Board of the Bangko Sentral ng Pilipinas and the heads of the following offices/departments: Finance, Budget and Management, Trade and Industry, Agriculture, Energy, Environment and Natural Resources, the Office of the President, the National Economic and Development Authority and the Coordinating Committee for Private Sector Participation. The ICC Cabinet Committee is supported by a Technical Board and a Secretariat.

Inter-agency Committee on the Review of Foreign Loan Documents. Chaired by the Bangko Sentral ng Pilipinas, the Committee reviews the draft loan and guarantee agreements including all related documents for proposed foreign borrowings to be contracted or guaranteed by the public sector. Through this review the Committee aims, inter alia, to: (a) determine compliance with the terms and conditions of enabling Monetary Board approvals and other applicable foreign exchange regulations and, when necessary, negotiate for the improvement of said terms and conditions; and (b) ascertain possible implications for related contracts and discuss/resolve these with proponents or lenders. The Committee's clearance of the covering loan and guarantee agreements and related documents is one of the conditions required for Bangko Sentral final approval of public sector loans. The Committee is composed of representatives from the Bangko Sentral, the Department of Finance, the Department of Justice, and the borrowing agency concerned.

National Economic Development Authority. As the country's central economic planning body, the Authority coordinates the preparation of the country's medium-term development plan and the medium-term public investment programme. These define the development financing requirements of the country and the priority areas for development in support of the country's medium-term economic and social objectives.

Board of Investments. An agency attached to the Department of Trade and Industry, the Board draws up an annual Investment Priorities Plan (IPP) that identifies preferred sectors for investment in specific regions of the country. The IPP lists the activities that are eligible for incentives, with a view to influencing the flow of investments into activities and locations where financing needs are greatest.

4.1 Foreign currency borrowings by residents

The following require Bangko Sentral approval, irrespective of the source of foreign exchange for debt servicing: (a) loans guaranteed by government-owned/controlled corporations and/or government financial institutions; (b) loans covered by foreign exchange guarantees issued by local commercial banks; and (c) loans to be granted by foreign currency deposit units and specifically or directly funded from, or collateralised by, offshore loans or deposits.

Prior Bangko Sentral approval has been waived for some accounts such as short-term trade credits, loans covering importation of freely importable commodities covered by letters of credit, open account or document against acceptance arrangements, and parent company loans for funding eligible projects/purposes. Upon compliance with Bangko Sentral registration requirements, these loans shall be eligible for servicing with foreign exchange to be purchased from the banking system.

Rules on short-term loans for trade financing have also been simplified by waiving the approval/registration requirement for loans against the lending programmes of foreign banks that have been duly noted by the Bangko Sentral.

Box 2

Legal bases for the external debt management responsibility of the Bangko Sentral ng Pilipinas

The Philippine Constitution of 15 October 1986 requires, inter alia, prior concurrence of the Monetary Board for all foreign loans to be contracted or guaranteed by the Republic of the Philippines. It also provides that foreign loans may only be incurred in accordance with the law and the regulation of the monetary authority.

The Letter of Instructions no 158 dated 21 January 1974 requires all foreign borrowing proposals of the government, government agencies and government financial institutions to be submitted to the central bank for approval in principle by the Monetary Board as to purpose and credit terms, inter alia, before commencement of actual loan negotiations. Actual negotiations for such credits shall be conducted by the Secretary of Finance and/or the central bank Governor or their duly authorised representatives as chief or co-chief negotiators together with representatives of the borrowing entity concerned.

The Foreign Borrowings Act (*Republic Act no 4860* dated 8 September 1966) provides, inter alia, that the central bank shall promulgate and enforce such measures as may be necessary to reduce external debt service requirements.

The New Central Bank Charter (*Republic Act no 7653* dated 10 June 1993) provides that the Bangko Sentral shall maintain international reserves adequate to meet any foreseeable net demands for foreign currencies, paying special attention to the volume and maturity of the foreign exchange assets and liabilities of the various sectors in the Philippine economy. The Bank is empowered to collect data and other information necessary for the effective discharge of its functions and responsibilities.

Executive Order 352 ("Designation of Statistical Activities") dated 1 July 1996 assigned to the Bangko Sentral ng Pilipinas the responsibility of compiling balance of payments accounts and monetary and banking statistics. This is in accordance with a system of designated statistics enabling the identification and generation of the most critical statistics required for social and economic planning/analysis.

Administrative issuances from the Bangko Sentral ng Pilipinas (eg circulars, circular letters and memoranda to all agent banks) embody the policies and related implementing rules, regulations and clarifications that the Bank deems necessary to achieve its primary objectives of maintaining price stability and the convertibility of the Philippine peso. Circulars contain policies and major rules and regulations that are of interest not only to Bangko Sentral supervised institutions but also to the general public and are therefore required to be published in the Official Gazette or in two newspapers of general circulation. They take effect 15 calendar days after publication.

4.2 Foreign currency borrowings by non-residents from banks in the Philippines

Commercial banks licensed to operate under the expanded foreign currency deposit system are authorised to extend foreign currency loans to non-residents provided, inter alia, that the foreign exchange for servicing the loans shall not be sourced from the banking system.

4.3 Local currency borrowings by non-residents from banks in the Philippines

Banks are prohibited from extending Philippine peso loans to non-residents. This is aimed at curbing undue speculation in the foreign exchange market and at further reinforcing the policy requiring peso deposits of non-residents to be funded from inward remittance of foreign exchange.

5. Loan approval and registration process

Bangko Sentral approval for a loan proposed by a private sector borrower (that is intended to be serviced with foreign exchange to be purchased from the banking system) must be obtained before the covering loan documents may be executed and the funds disbursed. The application for loan approval must be accompanied by certain prescribed documents, eg borrower profile, loan profile and project profile; drawdown and amortisation schedules of the proposed borrowing; and annual cash flow projections for the duration of the proposed loan.

The Bangko Sentral's evaluation process involves a thorough review of the proposed borrowing, starting with the determination of the eligibility for foreign financing of the proposed purpose/project.

Having established the eligibility of the purpose/project proposed for foreign financing, the Bangko Sentral focuses its evaluation on the financial terms and conditions of the proposed borrowing, such as the loan amount, maturity, interest rate, default rate, upfront fees, and principal and interest payment schedules, and verifies if these are comparable with the terms of similar loans approved in the past as well as the prevailing credit terms for other emerging market borrowers. It also looks at the borrower's cash flow projections before and after availment of the proposed loan to determine its capacity to service the loan on due dates. The Bangko Sentral then estimates the impact of the proposed borrowing on the country's future debt service burden (measured as total principal and interest payments on outstanding foreign loans) as well as the ratio of the debt service burden to the sum of the country's projected exports of goods and services and receipts of income for the same period.

In order to ensure compliance with the terms and conditions of the Bangko Sentral approval, private sector borrowers are required to register Bangko Sentral approved foreign loans following receipt and use of borrowed funds. The borrower is required to submit copies of the signed loan documents as well as proof of disbursement and utilisation of loan proceeds, and these are reviewed by the Bangko Sentral to verify if the loan was disbursed and proceeds used for the approved purpose. A Bangko Sentral Registration Document (BSRD) is issued only after full disbursement of the loan and review of the utilisation of the loan proceeds. The BSRD authorises the borrower to buy foreign exchange from local banks for servicing of the registered obligation on scheduled due dates. (Purchase of foreign exchange from banks to cover any payment not consistent with the loan terms reflected in the BSRD as well as any amendment to loan terms requires prior Bangko Sentral approval.) On a case by case basis, and to minimise pressures on the foreign exchange market, the Bangko Sentral may authorise staggered purchases of foreign exchange to fund large debt payments, such as for bonds that involve bullet payments.

The Bangko Sentral notes partial utilisations of the approved loan to enable the servicing of the noted portion with foreign exchange purchased from the banking system. Pending registration of the loan, specific authorisation from the Bangko Sentral is required for each principal amortisation and/or interest payment on the noted portion of the loan to be funded with foreign exchange purchased from the banking system.

6. Transparency, disclosure and market discipline

External debt and related statistics are compiled by the International Operations Department of the Bangko Sentral on a quarterly basis. The data, which are presented in US dollars, are reported to the Monetary Board with a corresponding press release also on a quarterly basis. Summary statistics on external debt (including debt service burden and selected debt ratios) are also published in the Bangko Sentral Annual Report and in the Monthly Selected Philippine Economic Indicators. Data are also posted on the website of the Bangko Sentral: www.bsp.gov.ph.

In 1971, the Bangko Sentral adopted yearly aggregate ceilings (with quarterly sub-ceilings) on medium- and long-term foreign borrowing approvals (with original maturity of more than one year). There is no sub-ceiling for the public sector but there is a sub-ceiling on total loan approvals with maturities from over one year up to five years. In addition, there is a ceiling on the stock of short-term debt contracted or guaranteed by the public sector to help keep the size of external debt and debt service payments falling due each year to manageable levels. The loan approval ceilings, which have generally been observed, take into account the following: (a) programmed borrowings by major public and private sector borrowers for the year that were submitted to the Bangko Sentral; (b) the stock of external debt; and (c) the projected debt service requirements of existing as well as new borrowings programmed for the year.

The Bangko Sentral also implements measures to prevent bunching of debt, to improve the maturity profile of the country's external debt, and to obtain borrowings at lower costs. These are communicated to major borrowers in advance of any borrowing proposal or as part of the conditions for Bangko Sentral approval of proposed foreign borrowings. Companies with approved loans are also required to submit annual audited financial statements to monitor the borrower's liquidity and solvency positions. In general, private sector companies are required to limit their outstanding borrowings (domestic and foreign) to a maximum of three times their equity (or a total debt-equity ratio of no more than 75/25) to avoid over-leverage.

Private sector borrowers, especially those with huge financing requirements, often consult with the Bangko Sentral on the requirements for loan approval, current policies/rules and regulations, and the proper timing of their borrowings/bond issues in order to avoid undue competition in the capital market from other large borrowers that could adversely impact on credit terms.

To strengthen their ability to deal with adverse shocks, inter alia, banks are required to set aside a general loan loss provision, as well as specific loan loss provisions for certain categories of loans. Banks licensed to operate foreign currency deposit units are also required to maintain a 100% asset cover on all foreign exchange liabilities and to keep 30% of that cover in liquid assets. These requirements serve to limit banks' foreign currency lending and prevent exposure to excessive foreign exchange risks. The Bangko Sentral also utilises the Credit Bureau rating and Top 500 Borrowers report of its Supervision and Examination Sector as part of its off-site examination of individual bank exposures as well as to detect early warning signs of liquidity and solvency risks among the top corporate borrowers.

The Securities and Exchange Commission (SEC) is responsible for the prudential supervision and regulation of capital markets. In the performance of its functions, the SEC requires all companies listed on the Philippine Stock Exchange to fully disclose material facts that would affect investment decisions by the public, and to exercise due diligence in ensuring that information released by prospective borrowers is accurate and comprehensive. It also requires all corporations, whether listed or unlisted on the stock exchange, to submit annual financial reports.

Both the Bangko Sentral and the SEC impose administrative and monetary sanctions on supervised firms/institutions for violations of rules and regulations promulgated by them in the exercise of their respective functions.

7. Debt monitoring system

To address the data requirements of internal and external users, the Philippine external debt management system has been designed to cover all data categories, ie: (a) by borrower (public, private, bank and non-bank); (b) by original and residual maturity (short-term, and medium- and long-term); (c) by creditor; (d) by currency; and (e) by country of creditor. Borrowings of foreign-owned companies operating in the Philippines are reported as part of external debt.

Data are obtained principally from regular reports from borrowers, banks and selected creditors while initial information on foreign borrowings by large corporations that did not apply for Bangko Sentral approval are secured from news articles in local and international publications. The Bangko Sentral requires, as a condition for approval of private sector borrowing proposals, the submission of monthly reports on the status of Bangko Sentral approved loans and transactions on those loans (disbursements, principal and interest payments) using the prescribed format. Borrowers that did not seek prior Bangko Sentral approval of their loans are also required to submit monthly reports using the same prescribed format for statistical purposes in order to allow the compilation of comprehensive statistics on external debt.

Debt statistics are regularly reviewed and compared with those released in other publications such as the BIS-OECD *Statistics on External Indebtedness,* the BIS's *International Banking and Financial Market Developments* and the World Bank's *Global Development Finance*.

8. Summary

The Philippines maintains a liberalised policy on external current and capital account transactions. However, private non-bank corporate borrowings generally require the prior approval of and/or registration with the Bangko Sentral if the foreign exchange required for debt servicing will be purchased from the banking system. External debt management involves the concerted efforts of a number of government institutions led by the Bangko Sentral, which derives its mandate, inter alia, from the Constitution.