Amando M Tetangco, Jr: Moving the economy forward through banking

Speech by Mr Amando M Tetangco Jr, Governor of the Bangko Sentral ng Pilipinas, at the Annual Convention of the Chamber of Thrift Banks, Manila, 12 March 2010.

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Mr. Pascual M. Garcia III, President of the Chamber of Thrift Banks, the new officers and trustees of the chamber this 2010, the various member banks comprising the CTB, our colleagues in banking and from media, ladies and gentlemen, a very pleasant good morning.

It is a pleasure to join you again for your annual convention. On a personal note, it certainly feels good to be back in circulation, both literally and figuratively. As many of you may know, this is my first speaking engagement after my leave of absence. Indeed, industry events such as CTB's annual convention are simply too important to miss. And while the BSP has always valued directly interfacing with stakeholders, I must say that events over the past month have only renewed my keen interest to learn from others, as opportunities present themselves, knowing now (more than ever) that change can come rather quickly.

The economy and the Philippine banking industry

Indeed, change is clearly the mantra today. The global economy is in the midst of a massive restructuring of the market landscape. And while we have witnessed encouraging signs of recovery, there are recurring reminders that all is not yet well. Moving forward, change beckons but we must jointly share the task of choosing the changes that we desire and laying the foundation for instituting these collective changes.

Change though can never be absolute. Moving forward means that we appreciate where we are, and what we have. When considered against the economic dislocations transpiring at the global stage, the Philippines performed well in both 2008 and 2009. As we expected, last year's growth was modest but we certainly stayed positive and did not venture into a recession. More importantly, other key economic measures suggest that all was not bad:

- Lower inflation at 3.2%;
- Higher systemic liquidity;
- Larger BOP surplus at USD5.3 billion;
- More remittance at USD17.3 billion despite predictions of sharp reversals;
- All-time high Gross International Reserves at USD44.2 billion which translates to almost nine (8.98) months of coverage for imports of goods and services (vs. 5.95 months' worth at end 2008); and
- A better portfolio balance of our external debts with only 1 out of every 10 dollars of debt now due in the short-term.

At the heart of the country's better fortune during this global crisis is a banking system that continued to manifest resiliency and strength in 2009. Unlike previous crises, we continued to mobilize deposits and funded new loans. Credit quality for the system as a whole in fact has been improving with NPL ratios declining, while coverage ratios generally increasing. Thus, despite the global financial turmoil, our Capital Adequacy Ratio for the Philippine banking system (on a consolidated basis) has remained largely stable at around 15.68%.

The challenge of managing risk

My point in all these ladies and gentlemen is that macro-financial indicators cannot exist in a vacuum and must be seen in the context of the prevailing environment. For banking markets worldwide, managing financial risks has been the unifying theme for several decades now. We see this, for example, in the issuance by the BIS via the BCBS Core Principles, the Basel Accord and the array of best practice documents on specific types of risks.

The net effect is that the international order has achieved uniformity in the treatment of banks as institutions that generate and mitigate risks. Instead of differentiating one bank type from another, the stylized framework distinguishes across financial risks with much less concern with how we categorize banks.

As you are well aware, we employ the same approach here. Thrift banks for example have been accorded the ability to conduct activities that previously were limited to commercial and universal banks. In the last 2–3 years alone, the Monetary Board approved, among others:

- Your ability to apply for a end-user derivatives license (circ 594);
- Your ability to issue foreign currency LCs (circ 650);
- Limited trust operations (circ 583); and
- Investments in readily marketable foreign-currency denominated debt instruments for those with FCDU license (circ 565 and 575).

All of these help diversify your operations. Yet, these do not come free and they bring with them the need for more prudent exercise of individual bank judgement.

There is no greater challenge today than to do a better job at identifying financial risks and prudently managing these on our respective balance sheets. The difficulty is that these risks are themselves quickly evolving and may typically be layered across transactions in ways that often are neither obvious nor transparent.

This is certainly no small task. Using the four new activities I mentioned that thrift banks may conduct as examples, these expose you to greater amounts of credit risks in trade finance (FCY LCs), market risks in derivatives (as end-users) and in the FCDU books (for the investments in FCY debt securities) while operational risks arise in the limited trust.

All of these will clearly add pressure on both your risk culture and compliance program. These two aspects are not buzz words to which we pay mere lip service. Behind them are real responsibilities that the bank must explicitly bear. In effect, you choose whether or not you wish to take this business road. Once that choice is made, the burden of prudently managing risks is no longer a choice. It becomes a shared responsibility – among banks and between the regulator and the regulated – because we are all accountable for attaining financial stability.

The challenge for thrift banks

For thrift banks, the immediate challenge is to consider the evolving dimensions of financial risks as you further develop within your niche markets while prudently exploring new possibilities in due course. The expansion of your balance sheet in 2009 – deposits grew 12% while gross loans grew by 8.6% – confirms that resources are being mobilized and can be deployed.

Following your mandate to provide medium to long term peso financing, we expect you to remain pro-active in residential real estate undertakings and auto loans both of which thrift banks dominate. Loans for Small and Medium Enterprises (SMEs) have consistently represented one-fifth of your industry's exposure and represents a niche that the economy relies on you to nurture and develop. The families of our overseas workers are another market that you could further expand services to[1]. To fully tap into the needs of the SMEs and OF families, however, you will need to cover the vast expanse of the Philippine archipelago with your network of over 1,300 banking offices. Currently NCR and Calabarzon are the main hubs of thrift bank operations and this leaves the rest of the economy as an upside potential.

Further to this, the BSP has adopted a liberalized branching policy which you can avail of to reach a broader market constituency. I urge you also to further consider and subsequently deploy technology so that you can bridge the geographical divide of our archipelago. E-banking is also now a reality and you can parlay this to truly provide credit and saving access to a holistic Philippine market.

I am happy to note that you have taken advantage of our policy initiatives to improve the reach of banking services. I understand that last year, thrift banks have deployed an additional 95 ATM units, bringing the total thrift banks' ATM units to 959 nationwide. In addition, there were 15 thrift banks that started to engage in electronic and mobile banking activities as of end-December 2009.

From the policy side, we welcome receipt and continue to evaluate your proposals such as the ability to extend long-term foreign-currency loans, the possibility of a more pro-active use of FX swaps and engaging in bancassurance.

In considering all these possibilities, I trust that you and I agree that the underlying thread will still be the alignment of your risk culture and compliance program to the demands of these expanded business lines.

Here, it is worth pointing out briefly that there are performance differences which the industry may want to further look into. For example, while the Philippine banking system consolidated CAR was 15.68% in June 2009 (latest available), the thrift banking industry was at 11.47%. Whereas the system as a whole reflected an NPL ratio of 3.66% in December 2009, the comparable metric for the thrift banking industry was at 7.27%. Don't get me wrong. The BSP does appreciate the gains that the thrift banking industry has achieved through time. But change beckons change and we must continue to strive to work towards further gains where possible.

Another area of change is certainly the most revered facet of a democracy. As it has often been observed, elections entice institutions to forestall business plans, opting instead to "wait and see" before charting their business future. For banks, this strategy will render you as a passive observer which precisely is the role that will be most detrimental to economic activity. This will not benefit anyone and can only hurt everyone. I urge you then to stay focused on your target markets and fulfil the needs of the banking public through the political transition. We were strong enough to weather a global financial meltdown; surely, a political transition should be less of an issue.

In closing ladies and gentlemen, let me point out that adversity brings with it hope of new opportunities while relative triumph can only invite further trials. The adversities of our past have made us stronger and it is now up to us to show that we can meet the challenge of continuing trials.

I urge all of us present here to seize these opportunities to move forward. I encourage the banking industry to be the stimulus for the real economy. I challenge the thrift banks to feverishly build on your gains. Let us collectively lead the way towards broader-based, accelerated and sustained economic growth.

Thank you and good morning.

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[1] In 2009, about $23 million of OF remittances were coursed through Thrift Banks.