Amando M Tetangco, Jr: Strategic challenges ahead for banking and for thrift banks

Speech by Mr Amando M Tetangco, Jr, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the 2015 annual convention of the Chamber of Thrift Banks, Makati, 7 April 2015.

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A Growing economy and a steady banking industry

The Philippine economic story remains one of growth. The macroeconomy has had 64 consecutive quarters of expansion which has been achieved while keeping prices stable. On the external front, we have been able to sustain current account surpluses for more than a decade due to strong structural flows from remittances and BPO receipts. As a result, our GIR has increased to USD 81.3 billion as of end-February 2015.

Buoyed by investors' confidence on the country's sound macroeconomic fundamentals, the Philippines attracted a record-high of USD 6.2 billion last year in foreign direct investments.

The success of the Philippines thankfully has not gone unnoticed. We cherish the investment grade status bestowed by international credit rating agencies because it opens opportunities for the country as an investment destination. This is one major reason why we pushed for what later became Republic Act 10641 and we are now seeing the strong interest of foreign banks to enter into our market. They serve as potential catalyst of more investments from their home countries.

Alongside the favorable macroeconomic environment has been the expansion of the banking industry. The numbers do change but we have seen the resources[1] of the Philippine banking industry grow at a steady pace due to the continuous increase in deposits from the public.

This build up in deposits is critical in two respects. First, it reaffirms the confidence of the public to entrust their savings into the banking system and also shows the improved economic condition of the population that eventually translates into saving. The second reason is that it of course fuels the availability of more loanable funds and we have noted that the increased credit exposures have been without deterioration in asset quality.

Re-positioning thrift banking in a changed environment

All the positive developments have certainly put us in a good position. They provide us the momentum to move forward but they will not necessarily guarantee further success. Markets are constantly in a flux and the strengths of the past need to be further enhanced to meet the challenges of the future.

This is why we continuously amend and upgrade our regulatory environment. The BSP has always been an ardent supporter of global best practices. But we have equally been careful to apply the substance of the reforms and not just be bound to the form of the changes. We stand ready to make the difficult decisions when and where we have to, while committing to continuous dialogue to mold and manage the reform agenda.

The banking landscape is itself under a phase of major remodelling, the "new normal" as many refer to it. This new normal, where newer risks are being identified and mitigated while older risks are being approached in a different manner, really calls for a strategic re-thinking

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[1] The total resources of the Philippine banking system rose by 11.91 percent to Php 11.2 trillion as of end-December 2014 from Php 9.8 trillion in 2013.

of what is possible, what is likely, and how these can be effectively pursued under more stringent norms of risk management, corporate governance, and consumer protection.

From what we see, each and every bank must invest in this re-thinking process. Thrift banks, however, face the unique situation of being confronted with a question of both scale and scope.

If you choose to differentiate yourself from other banks via scale, this certainly raises the intriguing question of how a thrift bank competes alongside the bigger universal/commercial banks or the smaller rural/cooperative banks.

If you offer similar products and services as those of U/KBs, the conventional thinking is that they would have the advantage of scale and scope economies. Within the framework of allocating risk capital to various risk exposures, this difference in scale and scope would be particularly telling.

If you position yourselves against rural and coop banks, one expects that they would have the advantage of being more entrenched with the community at a scale that is aligned with community needs.

Either decision has a direct bearing on your cost structure, your profitability and, therefore, your viability. Being smaller in markets where size (i.e., capital) and footprint (i.e., network) matter makes it very difficult to compete. And yet, choosing to be bigger may also not serve you well if you operate in those markets where grass root relationships matter most.

Re-focusing on a niche

All these notwithstanding, there is a strategic issue facing thrift banks besides size of operation and this one is about the choice of target markets.

If we revert to the Thrift Bank Act of 1995 , it says there that TBs are supposed to:

"Promote economic development, and expand industrial and agricultural growth. At the same time, TBs should place within easy reach of the people the medium to long-term credit facilities to businesses engaged in agriculture, services, industry, and housing at reasonable cost."

Parsing through this mandate, it talks simply of lending term funds to various economic sectors, whether in the agriculture, industry or services sector. One can argue that this is true of any bank, whether universal, commercial, thrift, rural or coop banks. If this is the case then, the distinctive feature of thrift banking as provided by law is that of mortgage financing.

Taking a more general view, the niche of Philippine thrift banking is consumer finance and MSMEs. By targeting specifically these markets, TBs should have a better sense of the amount of risk capital that is needed for a projected level of risk exposure. It also allows for more focused consideration via specific regulatory issuances. In Circular 855, for example, the BSP talks of underwriting credit without being locked into specific forms of collateral. Our periodic stress tests have a specific section on consumer finance vulnerabilities while the recent introduction of REST sets our own framework on the credit risks of real estate exposures.

Consumer protection issues – redress mechanisms, financial literacy initiatives and outright better disclosures – are equally relevant. Our Circular 857 provides the minimum standards of conduct we expect from market players while setting the framework for a periodic review and complaints handling.

These are all critical as you consider your niche. But ASEAN integration is certainly another key consideration.

The ASEAN Banking Integration Framework or ABIF was formally launched only a couple of weeks ago. This means that we now enter the phase of administering the guidelines so that

Qualified ASEAN Banks (QABs) can operate within the region in the next couple of years. There will be other occasions where we can fully elucidate the details and operation of ABIF. But central to the framework is the idea of developing ASEAN for ASEAN for which consumer finance appears to be a key facet.

About a tenth of the world's population resides in ASEAN. While the global life expectancy rates have increased from 66 years old in 1990 to 71 years old in 2012, ASEAN has extended this to 73 years old on average. With 30 to 35 percent of ASEAN population at or younger than 15 years old, this extra 2 years becomes even more material over the next few decades. In addition, ASEAN saves nearly 31 percent of its GDP. This rate is 11 percentage points higher than the rest of the world. This extra 11% in saving is not small as it is larger than the GDP of many countries.

As time moves forward, ASEAN's young population provides a rich opportunity for increasing demand for financial services. The same population will require financing for consumer requirements in housing, auto loans, credit cards and other personal needs – the very market that the Philippine thrift banking industry currently defines as its "space".

Finally, the MSME sector, which accounts for 99.6 percent of the total number enterprises in the country and more than one-third (or 35 percent) of our GDP and employs 65 percent of our workforce, is without a doubt vital to our economy. By positioning yourselves to grow this sector, the dividends will go beyond yourselves. Growth in this sector will have significant multiplier effects in generating employment and raising the standard of living of more of our people. By positioning to serve this sector, TBs can be true catalysts of broad-based and sustainable inclusive growth.

Strategic directions and final thoughts

Ladies and gentlemen, I started my remarks by stating that ours remains a story of growth. I suggested, however, that we need to be strategic in facing the new normal of banking. Banks have to look carefully at the evolving environment, including the reforms, and how they can strategically position themselves in a changing market environment.

The banking mindset today and five years hence are not the same as those from a decade ago. Banks must adopt the best practice standards, adapt to the changing market conditions, and adjust their strategic mindset accordingly.

This strategic landscape of adopt-adapt-adjust is, however, not a game of absolute size but one of relative fit. In other words, finding your niche.

You asked me to comment on the state of thrift banking in the Philippines. The reality of course is that the industry is a dichotomy. Those that are part of a banking group enjoy the scale that the group offers. This route offers a way to create a wider footprint and carves out the consumer finance business line from the U/KB parent to the TB subsidiary/affiliate.

For the TBs that are stand-alone, you are effectively much more geared to your community market. The concept of a community can readily be defined more liberally in both product line and counterparty. But the crux is that the discipline of target market must take precedence. And it takes precedence by taking particular cognizance that you are typically smaller than the TBs which are part of a banking group.

Ladies and gentlemen, what all this says is that the future rests with your choices.

While we have, as a country and as a banking industry, done well, we are at that proverbial fork in the road where strategic decisions will have to be made. Resources have always been relatively scarce but our new banking framework requires of us to be more conscious of the unseen risk, the allocation of scarce risk capital, and remaining competitive as a corporate entity but with a heightened sense of governance. These are the strategic issues.

Eleanor Roosevelt once said that “Great minds discuss ideas; average minds discuss events; small minds discuss people”.

The likely “events” have crystalized before our eyes. It is now time to venture into the market of strategic ideas, not only to discuss but more so for the greater minds to lead the way towards a better banking future.

Thank you and good morning.