

## **Amando M Tetangco, Jr: Banking on governance for growth and stability**

Speech by Mr Amando M Tetangco, Jr, Governor of the Central Bank of the Philippines (Bangko Sentral ng Pilipinas), at the Rural Bankers Association of the Philippines (RBAP) 2009 National Annual Convention, Manila, 15 May 2009.

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Ladies and gentlemen of the Rural Bankers Association of the Philippines led by Mr. Tomas Gomez IV, outgoing President, and Mr. Omar Andaya, incoming President of RBAP, supporters and advocates of our rural banking sector, colleagues from the Bangko Sentral, special guests, members of media, ladies and gentlemen, good morning.

We at the Bangko Sentral ng Pilipinas join you in celebrating 56 years of rural banking in the Philippines. This is 56 years of partnership with local communities in invigorating countryside development – a fruitful partnership that has seen our rural communities grow and develop alongside rural banks.

Indeed, key indicators for the rural banking sector show steady growth even in the midst of the global financial crisis and the closure of a number of rural banks engaged in unsafe and unsound banking practices.

Among others, the operating network of rural banks continues to increase. As of end December 2008, the network of rural and cooperative rural banks, consisting of head offices and branches, was at 2,148, higher than 2,133 in 2007. While there was a net decline in the number of head offices from 727 to 703 as a result of closures and mergers, this was more than offset by the increase in the number of branches. The net effect is a larger network capable of delivering banking services directly to a wider market.

In addition, rural banks are exhibiting greater innovation and dynamism by seizing opportunities presented by technology. The industry enhanced its banking services delivery with the installation of more Automated Teller Machines (ATMs): from only 83 in 2007 to 113 as of end December 2008. A number of rural banks have also ventured into electronic banking to beef up delivery of financial services: the number of rural banks offering e-banking services such as cash cards and mobile banking have increased to 47 in 2008, from only 5 banks in 2005.

It is important to note that the increasingly broader and deeper reach of rural banks, comes at a time when bank deposits in all but one of the regions were on the rise. Consolidated deposits of 6 million savers with rural banks as of end December 2008 reached more than P 107 Billion, allowing the rural banking sector to provide more loans for agriculture as well as micro, small and medium enterprises. Our figures indicate that nearly half of the rural banks' total loan portfolio of P106.6 billion in December 2008 went to agri-gra loans.

I am also pleased to note that loans granted by rural banks in 2008 went up in 13 of our 17 regions.

The business of rural banking has likewise been profitable with net income after tax at more than P 3 Billion in 2008, slightly higher than the 2007 level.

A clear indicator of the rural banking sector's strength is its strong capital position: its capital adequacy ratio at 13.8% as of September 2008 remains well above the BSP's mandatory standard of 10%. Of course, your CAR remains a bit lower than that for our thrift banks and universal/commercial banks. Still, 13.8% CAR of rural banks compares well with the overall CAR of the banking sector in Malaysia with at 12.6% and Korea with 11.2%.

And so, ladies and gentlemen, let us celebrate the continued growth and development of the Philippine rural banking sector with a long round of applause!

Nevertheless, these positive indicators must not lull us into a false sense of complacency. The rural banking industry achieved these by maintaining business discipline. And clearly, rural banks stand to perform even better if all members of RBAP will work on having even stronger capital positions, become more vigilant in managing liquidity and credit risks, and faithfully adhere to the good governance tenets of fairness, accountability and transparency.

I am happy to know therefore that we are on the same page, so to speak, as your convention theme this year is “Banking on Governance.”

As declared by the Organization for Economic Cooperation and Development (OECD), good corporate governance is key not only to the integrity of corporations, financial institutions and markets it is also central to the health and stability of our economies. Further, an OECD study released this year entitled “Corporate Governance Lessons from the Financial Crisis” concluded that to an important extent, the current financial crisis can be attributed to failures and weaknesses in corporate governance arrangements.

The choice of governance as the central theme for your convention is therefore timely as it is compelling. I take this as a message of the deep commitment of rural banks to good governance principles, strong capital buildup, and better liquidity and risk management. Surely, if you walk your talk, rural banks will continue on a growth track.

Indeed, we can learn a lot from the current global financial turmoil and economic downturn. While it has become evident that no economy is immune from its effects, we are also seeing that economies that had the political will to pursue much-needed reforms and built up buffers are more likely to fare better than others.

Among others, the Philippines is in a relatively better position today in terms of growth prospects compared to many other economies, including advanced economies. Our resiliency springs from the continuous implementation of reforms calibrated to strengthen our banks, our financial system and our economy.

Thus, while other countries have sunk in recession, our domestic economy still expanded at a respectable 4.6% growth rate in 2008. The outlook for this year remains positive, although at a markedly slower pace. In fact, some analysts believe the Philippines will be one of only three or four countries in Asia that will grow this year.

A key factor that could sustain the country’s growth is the strength of domestic demand. Personal consumption, which accounts for more than two-thirds of the Philippine economy, has been historically firm, with private spending resilient across business cycles. As you know, the Bangko Sentral’s monetary policy, as measured by recent benchmark policy rates, is supportive of sustained growth.

Easing inflation also provides a welcome boost to households’ purchasing power. Inflation as of April this year was at 4.8%, down from 6.4% in March. Our forecast for average inflation this year is projected at 3.4%, which is well within our inflation target range of 2.5-4.5%.

In addition, our remittance figures are holding up. Remittances coursed through banks reached a record high US\$1.47 billion in March 2009, representing a 3.1% year-on-year growth. This brought the cumulative remittances in the first quarter to US\$4.1 billion, or an annual growth of 2.7 percent.

Remittances are expected to be resilient as workers with permanent resident status continue to rise; this suggests a welcome shift from yearly contract renewals to more long-term employment. Based on actual data for January-February, the deployment of both skilled and professional workers has remained on the uptrend, generating with it higher consolidated earnings for overseas Filipinos. And while there have been reported layoffs, the numbers are quite small compared to the total number of overseas Filipinos.

We also expect further growth for the business process outsourcing sector in 2009 as recession in the global economy is seen to encourage outsourcing to streamline costs.

This scenario should challenge our rural banks to work better on growing your business and clientele so that you can capture a bigger share of our expanding economy, particularly in the resilient countryside.

How, then, should rural banks move forward?

In our view, it is critical for rural banks not to waver in their resolve to pursue reforms that would ensure strength and stability of your banks. In this context, your banks' risk infrastructure is a key component that will allow you to identify and act on risks that may arise; credit risks and liquidity risks are particularly important.

In the case of risks, a proactive approach is preferable over remedial management. For instance, credit risk can be mitigated by generating high quality information and acting prudently based on this information. On the other hand, it is important in managing liquidity risk to strike the appropriate balance between actively deploying funds through loans and investments and in retaining enough of a defensive position so that liquidity is available when the need arises. Again, this poses its own challenges for rural banks because of the narrower exposures from focused lending to a local community.

Another important aspect is your commitment to maintain strong capital positions not simply for compliance but for prudent control of leverage. Management should ensure that your banks have sufficient buffer whenever risks turn into losses, through careful allocation of scarce capital to alternative exposures. While we will not dictate your allocation, your adherence to maintain capital adequacy above our regulatory floor rate of 10% reflects commitment toward prudential control and financial governance.

On our part, we at the Bangko Sentral will continue with banking reforms that will encourage improvement of capital positions and broaden the avenues for better risk management. We will move forward with the implementation of consolidated and risk-based supervision; the enhancement of corporate governance and disclosure standards; and fostering transparency in financial reporting. If you recall, these initiatives which we have vigorously implemented in recent years are instrumental in instilling order and depth in the banking system ahead of the onset of the global financial crisis.

The Bangko Sentral will also maintain its policy approach of enabling banks, particularly rural banks, to increase the scale and scope of their operations. This is a win-win strategy: first, it will enhance your banks' bottom lines and, second, it will support Bangko Sentral's inclusive banking policy to reach out to the unbanked and those who remain unserved by the financial sector.

This is the rationale behind Bangko Sentral's liberalization of bank branching; receptiveness to product and technological innovations in banking services; and approval of a broader range of services for rural banks such as FCDUs and investments in ATMs to provide more services and products to their clients.

The recent issuance of the E-money Circular (Circular 649) is another significant step toward inclusive financial services. This Circular provides the regulatory framework for the electronic money business, promotes innovations in fund transfer mechanisms, and paves the way for competitive growth in the industry. To build on this clear framework for electronic money facility, we are reviewing regulations for third party agent networks to ensure the success, efficacy, safety, and soundness of the system. Here, we envision a vast network of retail agents that will provide broad access to financial services even to the previously unbanked.

I see rural banks playing a significant role in this very exciting development. Apart from your branches, other banking offices, and ATMs, you will be able to leverage this vast network of outlets to deliver your financial services to a broader market. This is one area we should

consciously develop together. Once fully developed, this system should be a cost-effective and efficient channel to serve the many bankable yet unbanked Filipinos.

Indeed, the future holds much promise and opportunities for rural banks. With our coordinated efforts and joint commitment to good governance, integrity and stability, rural banks are certain to take a competitive and strategic place as effective channels for a truly inclusive financial system and catalysts for sustaining balanced growth and development in the countryside.

Again, my congratulations to the distinguished ladies and gentlemen of our rural banking sector. United under RBAP, may you continue to grow and develop as efficient empowering channels for enhancing economic activities and improving the quality of life in the countryside.

Mabuhay ang ating mga rural banks! Mabuhay ang Pilipinas!

Maraming salamat po sa inyong lahat.