Amando M Tetangco, Jr: Financial stability and financial inclusion – two facets of the same policy objective

Speech by Mr Amando M Tetangco, Jr, Governor of Bangko Sentral ng Pilipinas (the central bank of the Philippines), to the Financial Sector Forum at the Asian Development Bank, Manila, 7 February 2012.

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Officials of the Asian Development Bank, resource persons, forum participants, my colleagues in government and in the financial market, ladies and gentlemen, good afternoon.

I am happy to join you this afternoon and have this opportunity to discuss two policy issues which command prime attention today. For this reason, this session is a timely intervention, providing us a venue to further our appreciation of the dynamics between inclusion and stability.

Let me start with financial inclusion.

Our foray into this policy objective has been driven by our socio-economic profile. Spread over 17administrative regions, the Philippine archipelago is prone to physical fragmentation. With the population typically drawn along ethnocentric lines, we have as much diversity as distinction.

The economics of this divide is evident in our income distribution. Data from our Family Income and Expenditure Surveys (FIES) will show that on average only 20 percent of family saving is generated by 80 percent of families. This disparity was the case in the 1997 FIES and it still is the case in the latest (2009) FIES.

In the banking market, limited family saving is validated by the metric of having 3 deposit accounts per 5 Filipinos nationwide. This is quite low in absolute terms specially when compared with the rest of the region.

What is worse though is that only 26% of the adult population use banking services. This suggests that the 3 deposit accounts likely belong to repeat customers.

To compound matters, about 37% of municipalities still do not have banking offices. Quite expectedly, the majority of banking offices are in the cities and first and second class municipalities. These information are significant because they reflect the basic gap in the footprint strategy of the banking community *vis-à-vis* the population.

Left as they are, the numbers do give us strong reasons to intervene with a formal policy on financial inclusion.

This call for intervention is premised on socio-economic diversity. This is again another important consideration because it is a reminder that it is diversity which financial inclusion must precisely address.

From this perspective, financial inclusion is about tailor-fitting a response for a defined problem. It is about advancing the financial, social and economic well-being of those who are otherwise “excluded”. The same supervisory principles as those in the mainstream market continue to apply but the execution allows for the proportionate application of regulatory requirements. In this way, we provide for flexibilities in policy aspects where rigidities would deter the creation of markets.

This is precisely what we have done in the Philippines. To-date, we have crafted 20 regulatory issuances specific to the financial inclusion framework. These 20 fall under 5 key aspects:

1. Wider range of products;

2. Expanded physical network;

3. Extended virtual reach;

4. Enhanced transparency and disclosure;

5. Lower barriers to customer acquisition[1]

We believe these ensure effective implementation of financial inclusion.

In providing for a wider range of products, for example, we recognize that the financial service needs are quite varied. Toward this end, the BSP has recognized credit facilities of up to Php300,000 for such instruments as micro-enterprise loans, micro-agri loans and, housing microfinance loans. To make this micro ecosystem thriving, we complement the credit facilities with needed auxiliary products such as micro-deposits and micro-insurance product lines. The combination of all these product lines allows for a free flow of funds within an environment that is specifically structured for small-ticket item transactions.

We recognize that access is a major concern, particularly with 37% of municipalities not having a banking office. To address this, we introduced the concept of microfinance banking office (MBO). MBOs are operationally attached to a full-service branch but can be established in hard-to-reach areas. On their own, they serve as a launch pad for a range of product lines from loans, to savings, remittances, to e-money conversion, bills payment, pay out services and even foreign exchange purchases on a limited basis.

MBOs are separate from the electronic money ecosystem which we introduced a couple of years ago. Using technology that is readily accessible by the retail market, we are able to bridge the physical gaps in banking with a technology-driven network. This covers several facets including fund transfer facilities, retail payments and even partnerships with merchants.

Pricing is certainly another key element. Contrary to some perception, financial inclusion operates on market terms and does not require any special pricing concession.

To make this effective, we believe it to be important that the financial consumer is provided with accurate information on pricing. By expanding the provisions of the Truth in Lending Act, the pricing approach has been standardized to avoid possible misrepresentation. Beyond pricing, we are also of the belief that the consumer would be better protected if he is informed of the different investment options available to him as well the macro and microeconomic factors that are likely to impact on the value of his chosen investments[2].

None of the above would be possible, however, if specific regulatory barriers are not addressed. Through the recent issuance of updated Anti Money Laundering rules and regulations, we are able to strike a balance between prudential requirements and realistically not having direct knowledge of those in under-served areas. To address this difficulty, our new rules rely on 3rd parties already embedded in the communities to fulfil the face to face requirements of the Know-Your-Customer threshold[3].

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1 A specific example would be allowing banks to rely on customer identification by agents that are located in underbanked communities. There is decreased transaction cost in customer retention and record keeping.

2 To date, the BSP has conducted under its BSP Economic and Financial Learning Program 90 Public Information Campaigns, 48 local and 11 international Financial Learning Campaigns for OFWs and their families, 9 Financial Expos, 11 Financial Learning conferences for Microfinance Clients and the Unbanked.

3 An example of authorized third parties under the new rules are covered institutions such as money changers, pawnshops and remittance agents which have been accredited by specific banks in the head offices to perform KYC functions for them in the underbanked communities.

The net effect is an enabled environment. Today,188 banks provide microfinance services. We estimate that one million households are serviced with an outstanding portfolio of about Php 7 billion as of September 2011.

When compared with the Php 7.17 trillion total resources of the banking system as of November 2011, the portfolio for financial inclusion is modest. However, this same portfolio was not formally in existence only a decade ago and it is in that context that we measure the strides taken, which then reflect greater significance.

With all of the above initiatives and changes, a natural question to ask is whether financial inclusion impinges upon financial stability. After all, inclusion requires specialized rules for a specialized market constituency.

However, the link between inclusion and stability – or more appropriately, between reducing exclusion and increasing instability – may not be unique. This makes it difficult to be precise. Nonetheless, two possibilities may be considered.

First, financial market failures are often premised on information asymmetries. Incorporating new agents into the formal market will likely increase information asymmetries. This is more so the case with stakeholders whose access to and use of information is not the same as those in the mainstream market.

Second, there is regulatory arbitrage. The “tailor fitting” of guidelines that is inherent to financial inclusion may create an unintended imbalance in incentives. This becomes a point of arbitrage, if not market pressure.

These two scenarios are certainly possible. As we evaluate these possibilities, it bears repeating that the tailor-fitting of regulations observed for the inclusion framework is not meant to compromise governance standards.

What it simply does is introduce flexibilities so that we can impose proportionate oversight where and in the manner that this is needed.

Beyond this, it does become an empirical issue. At the most basic level, the risks in financial inclusion are transactional, of smaller value and often specific to a target constituent.

For the Philippines, the concern is the extent to which the financial inclusion portfolio can affect the banking system which is currently 100x its own size.

The answer lies in the concept of contagion. This is largely idiosyncratic to a jurisdiction and empirical in nature more than anything else. Different jurisdictions will face different parameters and different pressures due to contagion.

Where then do all of these take us? Should we not pursue inclusion when the numbers say so? Should stability be the primordial concern around which all other policy objectives must subsist?

If we go back to first principles, markets are made when two parties with opposing views and different needs come together to agree to transact with each other. It is for this fundamental reason that markets thrive on servicing the needs of savers versus borrowers and those of depositors versus investors. However, when the markets are too fragmented and their constituents are effectively segmented, instead of offering a venue for disinterested counterparties to come together, market failures could arise.

Moving forward then, it would stand to reason that financial stability would thrive when the market framework allows for the different stakeholders to participate. Financial stability can thrive when different needs are recognized, but addressed as appropriate and governed under the same overarching core principles of market governance and prudential oversight.

This is nothing more than financial inclusion. Stripped to its core, inclusion is a participatory framework to work toward a holistic market and break down barriers between bankable and unbanked, serviced and under-served. Once such a holistic market is upon us, we would have created the environment where stability can more likely be sustained.

More than nice words, the Philippines stands by this framework.

First, on inclusion, we are proud of our humble achievements and the recent pronouncements from external institutions give us reason to move further and forward. For three years in a row (2009–2011), the Economist Intelligence Unit's global survey on microfinance has ranked the Philippines as number one in the world in terms of policy and regulatory framework for microfinance. The World Economic Forum and other international bodies have also recognized our strides in using innovation to increase access to financial services.

Second, on stability, we believe that our financial system has performed well under the most difficult global conditions in recent memory. Beyond the positive review from our recent FSAP and the analyses from various other external agencies, including credit rating bodies, the fact remains that the Philippine financial system has been consistently expanding through the past decade.

It is our view that the strength and stability of the financial system and the expansion and development of our financial inclusion program are not merely co-incidental but rather complementary. They do not just run in silent parallel, but they run as a shared purpose.

From only Php 2.6 billion in December 2002 serving around 390,000 borrowers, the financial inclusion portfolio as of September 2011 is over Php 7 billion with nearly a million borrowers.

What makes this impressive is not its nominal amount. Rather, it is the fact that the portfolio growth translates to an annualized expansion of 12% per annum. In contrast, banking system resources over the same exact period have grown by 8.4% per annum [from Php 3.48 trillion in December 2002 to Php 7.04 trillion in September 2011].

Though much remains to be done, we have moved forward to make economic activity much more participatory through inclusion. In the process, we have broadened the coverage of the financial net by not limiting it to those who are already naturally bankable.

The process does not end here. Financial inclusion and financial stability can and do complement each other and we will continue to stand by this framework.

Well beyond the numbers, we believe that the Filipino public is definitely better for it.

Thank you very much and good day.