Amando M Tetangco, Jr: Philippine banking – reaping the rewards from prudent reforms

Speech by Mr Amando M Tetangco, Jr, Governor of Bangko Sentral ng Pilipinas (the central bank of the Philippines), at the 2nd Asian Banker Philippine International Banking Conference, Makati City, 6 September 2012.

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Colleagues in banking, fellow stakeholders, ladies and gentlemen, good morning.

Let me begin by thanking the organizers for holding the 2nd Asian Banker Philippine International Banking Conference…. When you have a 2nd (after a 1st) you create a series…It's like the Rocky Series (for those who can still remember), or Harry Potter (to those of this generation), or Batman Series or the Ipad… the 1st one was a good experience and you want to have more of the same… The organizers did a good job the first time around… Today, they again provide a venue for us to take a closer look at the issues that confront us, as they relate to the Philippine banking system. And, we look forward, perhaps to a broader Asian Summit in the Philippines at an opportune time in the near future.

Let me therefore now focus on today's agenda. I will not give you a litany of numbers to prove that the Philippine banking system has remained strong in contrast to other jurisdictions. The positive performance indicators are quite familiar to you. For instance, you all know that system resources have been growing, funded by increased balances of deposits and more loans extended to borrowers.

Let me, however, share with you storylines that are not cited often enough… On the deposits side, growth was faster in the years after the height of the crisis than the years before. Between 1999 and 2007, deposits grew a little over 8% per year. But from 2007 – at the time that the mortgage crisis was already unfolding in the US – Philippine system-wide deposit balances increased by 13.40% per year all the way to 2011… On the loan side, the numbers are even more dramatic. Loans have been growing at a 10.62% pace per year in the last 4 years (2007 to 2011) when it was growing by only 3.67% p.a. in the 8 years from 1999.

Add to this, the fact that increased loan portfolio was not a case of liquidity chasing after every credit exposure. A simple look at the numbers will show that the NPL ratio has actually been falling since the turn of the century just as the coverage ratio has been rising. For universal and commercial banks, our latest number is an NPL ratio of 2.06% and a coverage ratio of 135%.

All of these metrics converge into the capital adequacy ratio which is the central, though not exclusive, metric under the Basel Accord. The often-cited statistic is that our banks have consistently maintained, on average, capital ratios well above the regulatory thresholds. On a consolidated basis, system CAR is hovering at 17%, of which 14 percentage points pertain to the Tier 1 ratio.

Most will leave the system review to the measures that I just shared. However, it is important for the BSP to make a point about access to the banking market because financial inclusion is much more than just a buzz word to us. Today, we have a wider reach not only from the significant increase in physical banking officers (which surged from 21,394 at end 2007 to 26,057 at end 2011) but also through ATMs (which grew from 7,155 to 10,659 over the same period) and the active use of technology through our mobile banking framework. Indeed, it can be said that we now have a wider footprint of banking services that caters to the needs of our differentiated public.

Ladies and gentlemen, all of these positive developments neither happened overnight nor happened on their own. We believe that they reflect the enabling environment which we have invested in with the active support of and coordination with market stakeholders. While we can itemize each and every circular and policy prescription we have issued, I believe that we can categorize them into six main areas.

- I would start with governance. This is most critical because without these overarching guidelines, the conflicts of interest inherent in finance would prove to be untenable.
- Risk management comes to mind next because of our deliberate shift from transactions review to a risk-based supervisory framework.
- Microfinance and financial inclusion are advocacies which we have pursued well before it became popular to do so.
- To complement the prudential framework, there needed to be improvements in the delivery of banking services.
- We certainly could not and would not neglect contributing to the development of the capital market.
- As the other facets involved direct improvements of market components, we have not forgotten the needs of the banking public either for redress mechanisms or for financial education.

Each facet is a critical component without which our prudential framework will have major deficiencies. Taken collectively, they represent the foundations upon which we envision a thriving banking market that is responsive to the evolving needs of its public.

This of course begs the question. If we have a prudential framework in place, which appears to have withstood the most intense of global shocks, is there anything else that needs to be done? The answer is… definitely, there is still much more that needs to be done. And as in the past, we look to those of you in the market to join us in the work ahead.

There are, however, challenges. First, the policy questions before us are evolving. Second, conduct and the performance standards that market participants must adhere to are also shifting. Then, traditional financial relationships aren't necessarily still true. Finally, time-honored policy transmission mechanisms no longer seem to hold in the past.

In response to these challenges, BSP has had to realign our own policy framework – to go beyond considering price stability as a sole objective to one that nurtures financial stability alongside price stability. We have also had to view banking policy not only from the perspective of ensuring the soundness of individual banks but also the soundness of the system as a whole. We are deliberately developing capacity so that we are able to weigh issues holistically, with the view to achieving the broader objective of financial stability.

Falling from this, we put in place a suitable governance structure. First, we adopted a formal definition of financial stability to get our work agenda moving. Our definition essentially focuses on four areas: (1) governance (2) market infrastructure, (3) functioning financial system and (4) thriving economic growth. These four have to be in place, symbiotic of one another for stability to be achieved.

Second, to execute this agenda, we created a Financial Stability Committee which I have the pleasure to directly oversee. With me in this committee are six of our most senior BSP officers. The work itself is run through specific committees. Key to our success is our capacity to think of the issues comprehensively even though we are traditionally structured along the three established pillars of Philippine central banking.

I can tell you right now that making this new paradigm work is not a superficial challenge. We understand the difficulties this early but we nonetheless persevere. Having the governance structure in place is certainly not a panacea. We recognize that the work agenda is complex and far reaching. Key reform initiatives that we have identified include Basel 3, Corporate Governance, Consumer Protection and Financial Education, Financial Market Infrastructure and Crisis Preparedness. These initiatives are on our radar screen today in the context of unifying the prudential architecture of financial stability. None of these is trivial, each one of these requires a keen eye for details and a broader appreciation of how each interconnects with another, and each is essential in the pro-active management of any underlying pressure points that may be brewing.

Let me also say that we do not underestimate how weaknesses in the West will leave their imprints upon Asia, upon us. Although better off than other jurisdictions, economies in our region are also experiencing an economic slowdown. Coupled with the deleveraging in Europe, Asia will feel some of the repercussions, either from re-leveraging, capital inflows and/or stronger local currencies.

These are not insignificant macroeconomic policy issues and they certainly will be formidable macro-prudential policy concerns. For us there is that added issue of domestic liquidity that is building up and looking for suitable outlets. Some say it's a positive problem that is preferable to the case of liquidity drying up. That may be true, but to central bankers, it is still a concern, positive or otherwise.

In retrospect, we believe that the Philippine banking system is in a position of strength. Such strength has been achieved through the reforms that we have invested in the past and whose benefits have come to fruition. Moving forward, we expect to further evolve with the needs of the public at large as well as the institutions that we oversee.

Ladies and gentlemen, let me reiterate – there is a role for the market in this framework. BSP does not expect to do the work alone. We stand not only as your banking regulator or monetary policy authority. We are your partner, and as in any partnership, we expect the different stakeholders to bear their proportionate load.

Whether it is in managing financial risks or in exemplifying acceptable conduct in market operations, the market has a definitive role. Stability is easier to achieve if we consider the bigger picture and not be shortsighted by our own bottom lines. Capital market development is certainly a shared responsibility because it is a collective gain. And providing for an inclusive financial market, with appropriate support for financial consumers, is itself a clear winning bet for tomorrow.

Together, we have taken what was perennially a difficult financial market situation in the late 90s into an environment that has withstood global shocks. Ladies and gentlemen, today, OUR market is on every investor's radar screen.

I ask all of you: where do you want this market to be as we hold the 3rd, 4th and 5th Philippine International Banking Conference and perhaps the 1st, 2nd and 3rd Asian Banking Summit?

I have every reason to believe that we all share the same answers. Let us then do our part as we lift the Philippine banking system further forward as a responsive platform for the needs of the Filipino in the Asian, if not global, platform.

Thank you very much.