

## Nestor A Espenilla, Jr: Of BFFs and growth

Speech by Mr Nestor A Espenilla, Jr, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the 60th Charter Anniversary Symposium of the Rural Bankers Association of the Philippines, Manila, 23 October 2017.

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There is so much insight in your chosen theme: “Rural Banks: My BFF – My Best Financial Friend”.

First, it captures a paradigm shift. It recognizes that for there to be successful delivery of banking services, cultivating personal relationships with clients is not just desirable... it is necessary. To be effective, we must be client-centric... customer centric, sensitive to their needs and even their limitations.

Second, the use of the term, “BFF” – an acronym used by the younger generation for “Best Friends Forever,” signifies that RBAP is becoming more hip (nakiki-uso). This may have something to do with the fact that Mr. Giovanni D. Gabriento is one of the youngest presidents ever to lead the association..... The term BFF was first used by millennials when communicating via text and instant messaging. Times are changing and we must adapt to remain relevant and to be successful. I am excited to share with you, the BSP’s initiatives with respect to financial technology and digitalization.

Finally, perhaps whether or not you are aware of it... the theme rural banks as “Best Financial Friend” perfectly captures the essence of the industry’s close and unique relationship with the communities it serves. That rural banks can, and are poised to be the public’s best financial friend, speaks much about your role in furthering financial inclusion and growth! This is an exciting prospect and sets a positive tone for the morning.

It is my pleasure and honor to greet everyone and express my sincerest congratulations on the 60th Charter Anniversary of the Rural Bankers Association of the Philippines... Dear industry professionals, officers and members of RBAP led by President Giovanni Gabriento, honored guests, ladies and gentlemen, magandang umaga sa inyo.

### ***Small but Terrible BFF***

It is often that we find our BFFs in school – be it in grade school up until college. We share experiences with them, go through storms and the struggles of growing ... trust develops... so much so that even when you part ways and meet again, it’s as if there were never any distance of time nor place between you.

This brings me to you... our potent rural banks, our partners in National development. We have gone through many challenges together over the years. Some very trying indeed. But still we stand together.

Rural banks take up less than 2% share of the total banking system assets. But with your consistent reliability, close familiarity with your clientele, and extensive regional footprint, you play a very significant role in spurring countryside development and the advancement of financial inclusion. Your clients are comfortable with you, and you are familiar with them. Given your extensive geographical presence, you are indeed better placed to help advance inclusive growth efforts and attend to the financial service needs of our communities.

I mentioned that Rural Banks may be deemed small compared to the larger banking system... but throughout the economic and political upheavals which have punctuated Philippine history, the industry has been steadfast in developing rural economies and promoting community

enterprise through good service and sound practices.

Over a span of 20 years, the industry registered unprecedented growth in terms of banking office, assets and capital.

A year before the Asian Financial Crisis, rural banks had 1,514 offices. Your network has since expanded to 2,667 offices as of June 2017, mostly in the provinces, in spite of many painful bank closures.

From P47 billion in resources as of end-1996, rural banking has become a P224 billion industry.

Total capital accounts of P7 billion in 1996 has ballooned to P42 billion, underscoring your shareholders' commitment to rural banking through the years.

Not only is the rural banking system bigger, it has also become much better today. Be that in asset quality, liquidity, capital adequacy, or profitability.

The industry's return on assets (ROA) and return on equity (ROE) ratios are comparable to the commercial banking system's averages. Its average capital adequacy ratio of 18.3 percent is better than the banking system's 15.5 percent.

The industry has demonstrated strength and resilience which have been proven over time. This has in turn fostered deeper and more meaningful relationships with your customers. You can leverage on these critical factors to harness business opportunities in order to serve rural bank clients and reap mutually rewarding benefits.

### ***BFFs – There When You Need Them***

Positioning yourselves as BFFs in your respective communities leverages on your core strength of being a trusted and close banking partner. You have institutionalized sustainable systems and processes to bring about life-changing "BFF" experiences to those whom you serve. Thus, you are a powerful force attracting more Filipinos into the banking system. Through your services, you have allowed families and small businesses to grow, to become more productive, and to reach their dreams.

The numbers affirm RBAP's adherence to your mission of promoting financial inclusion and the general welfare of rural communities:

- Almost 97 percent of the industry's network is based in rural areas providing rural banks with a deeper and more holistic understanding of the distinctive characteristics, conditions and needs of rural clients.
- A 2015 report from the Philippine Statistics Authority (PSA) shows that 9 regions of the country posted poverty incidence among families at levels significantly higher than the national average of 16.5 percent. BSP data shows that rural banking offices in these regions are quite significant, with 3 of these regions having RBs as their primary banking presence.
- The industry's commitment to promoting financial access is evident. The number of deposit accounts amounting to P10,000 or less make up 70.6 percent of the banking system deposit accounts. This set of small deposits make up 87.1 percent of your deposit accounts.
- Almost half of your loans (47 percent) are extended to assist agriculture and micro, small and medium enterprises (MSMEs). In the process, you are the "go-to" partners of rural borrowers and MSMEs. In fact, RBs exposures to the agricultural sector and MSMEs far exceed that of the total banking system's over-all compliance with these

requirements.

### ***Trust Builds Relationships***

Relationships are often tested, and when relationships survive potential and actual threats, they rise nearer and nearer to the level of BFF status. Right now, the industry is facing rising competition from large banks, foreign banks and even non-banks. This will impact the way you price your loans and deposit products, and ultimately affect your accustomed net margins.

These challenges can and should be met by more determined adherence to sound corporate governance and risk management practices. To earn and keep trust in this business, good governance should emanate from the top, permeate across the organization, and manifest in the actions of all officers and staff. The entire organization has a collective responsibility to ensure that strategic objectives are achieved while controls and risk management systems remain effective.

You intimate familiarity with clients provide you with a competitive edge. Rural banks should be proud of their deep understanding of their customers' financial needs and underlying credit worthiness. This information can be used to design financial solutions to foster mutually beneficial relationships. That's what BFFs are for, right?

### ***You've Got a Friend in BSP***

As the industry faces increased challenges, it can be assured that the BSP has its back. Years of prudence and discipline, something we worked on together, have created buffers and defenses that would stand it in good stead.

To boost the resilience of rural banks, the BSP promotes a policy framework geared towards achieving a robust banking system that will foster broad-based inclusive growth. We continue to promote effective risk management, a stronger capital base, and improved corporate governance standards. These are all embodied in an enhanced bank regulatory framework that is responsive to local conditions while being consistent with international best practices.

We are mindful that the future of banking entails a change in the way even rural banks interact with clients. Thus, we support responsible and prudent digital financial innovations. In an increasingly virtual and digital environment, your partnership with financial technology firms, coupled with your close client relationships, present boundless opportunities for growth.

To further promote common interest and cohesion within rural banks, we encourage pooling of resources among your members to gain access to shared and reliable infrastructures, such as common platforms for technology solutions for the benefit of your members.

Finally, the BSP is formulating policies and regulations to guide banks to take on a risk-based approach to cybersecurity management. The BSP has also stepped up a more proactive monitoring of the virtual environment while promoting the resilience of the entire financial ecosystem.

### ***BFFs in Credit: Building Viable Ecosystems and Financial Infrastructure***

Last week, I was in the 43rd Philippine Business Conference and Expo. I was asked about how the BSP encourages banks, including rural banks, to provide relevant financing programs, and to become reliable partners of micro, small, and medium enterprises. This question can very well be extended to include individuals, farmers, and fisher-folk.

In the BSP, we believe that to uplift marginalized segments, the answer should not be framed purely from a financing standpoint. Why? For one, these sectors are unable to reach their full potential due to a range of barriers. These involve low productivity and efficiency, the inability to

adapt processes to different stages of business growth, a lack of investments in technology, and challenges in gaining market access.

In this regard, we support a whole-of-government approach. For example, the Department of Trade and Industry talks about the 7Ms of successful entrepreneurs. The BSP, given its natural mandate specifically focuses on one of the Ms, which is the money side of it... In this regard, we believe that barriers to financial access such as cost, information asymmetry, and lack of infrastructure can be addressed through market-based policies and cooperative arrangements. This can be done without necessarily compromising our focus on our core mandate of promoting financial stability.

We have adjusted regulations to make them friendlier to credit-granting. We have set out comprehensive risk management guidelines under Circular No. 855 precisely to provide the industry the flexibility to reach markets that are not so easily served by “in-the-box” solutions. We encourage you to take full advantage of this flexibility to design customized credit products and reduce the focus on collateral in providing credit.

The BSP is not requiring banks to demand collateral from borrowers. Rather, the regulations put forward that banks improve their understanding of clients’ businesses, conduct meaningful credit and cash flow analysis, and use good judgment in gauging ability and willingness to pay. If we get this right, this will address a fundamental issue since small businesses and individual borrowers especially in the agricultural sector often lack real estate collateral even if they have adequate sources of repayment.

Another approach we have taken is to support efforts to build financial infrastructure and viable ecosystems that will sustain lending to micro and small businesses. This includes establishment of a credit information system, efficient secured transaction registries and a well-run credit guarantee system. The BSP is working on all these fronts and will continue to engage and support these important initiatives.

Recently, we also issued guidelines on agricultural value chain financing (VCF) to facilitate credit to the agriculture sector. This opens up credit provision to all the players in an organized value chain. This Framework aims to promote VCF as an effective, organized means of channeling funds to the agri-fisheries sector, promoting their financial inclusion. By encouraging linkages among various players in an agri-value chain, the credit risk of participating smallholder farmers and fisher-folk can be reduced and facilitate their access to more credit.

The BSP is likewise conducting a VCF study on various SME sectors. The study aims to identify various VCF models for SMEs that work in the Philippines, explore potential regulatory incentives to further encourage SME financing and other types of support to various levels or players in the SME value chain, and enable SMEs to be financially included and enjoy the benefits of participating in the value chain.

We continue to pursue financial inclusion initiatives to make banking services more accessible. Part of our strategy is the deepening of financial education and consumer protection initiatives, as well as leveraging technology to have greater scale in banking.

Further, we hope that the industry can already take advantage of recent rules allowing banks to use third party cash agents as a cost-efficient service delivery channel. Also, the BSP has reduced the Know-Your-Customer rules for certain low-risk accounts, including the use of technology to facilitate frictionless customer on-boarding.

### ***Digital Financial Inclusion***

As mentioned at the onset, technology is fast changing, with consumer preferences becoming more demanding... In this regard, the BSP is committed to upgrade the country’s retail payment

system, promote electronic retail payments, and facilitate inter-operability for faster settlement of transactions. The launch of the National Retail Payment System (NRPS), in partnership with industry stakeholders, will help us achieve this vision of a “cash-lite” economy.

The banking system, particularly rural banks catering to retail clients in distant areas, will realize that the NRPS will provide a strategic highway for providing valuable financial services in all areas – remittance, bills payments, savings, credit, insurance and investments.

### ***BFFs and Partners***

As you toast your decades of commitment to your members, I wish to express the BSP’s continuing commitment to upholding the safety and soundness of the banking system, especially our rural banks... undoubtedly one of our most valuable partners in financial inclusion. I am confident that the RBAP and the rural banking industry will continue to reinforce our efforts towards achieving our common vision of delivering a high quality of life for all Filipinos, and that we would be BFFs in the relentless pursuit of growth and development.

Maraming salamat po! On behalf of the Monetary Board and the BSP, I congratulate RBAP on this milestone anniversary. Mabuhay ang RBAP! Mabuhay ang Pilipinas!