Nestor A Espenilla, Jr: Navigating the digital frontier

Speech by Mr Nestor A Espenilla, Jr, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the Chamber of Thrift Banks Annual Convention, Makati City, 10 April 2018.

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President Gregorio B. Anonas III, officers and trustees of the Chamber of Thrift Banks (CTB), colleagues from the banking industry, fellow Monetary Board Members, fellow BSPers, Deputy Governor Chuchi G. Fonacier, friends from media and financial services industry, guests, ladies and gentlemen, good morning.

I am honored to be your keynote speaker in this year's annual convention and induction of the new set of Officers and Trustees of the CTB. This is my first speech with CTB since becoming Governor last year. A lot of things have changed since then including physical change as well.

I assure you that my focus of the heart and mind remains the same.

Your theme, "Banking on Disruptive Technologies", strongly resonates with me because of the BSP's openness to financial innovation and digital technology.

The digital transformation of the financial services industry is the new frontier. New technologies such as mobile banking, social networking, big data, and cloud computing are advancing quickly and causing "disruptions" in the industry. To remain competitive and relevant, and to optimize benefits, banks need to understand the trends, identify growth opportunities and establish synergies with new players and industries and with each other.

It is my pleasure to share how we can collectively navigate the opportunities and challenges of disruptive technologies in the age of digital banking.

The domestic economy on even keel

We confidently face change on the back of strong economic fundamentals. First, the Philippine economy is robust and resilient against internal and external shocks. At present, we are sailing through 76 quarters of consecutive economic growth. In 2017, gross domestic product (GDP) grew by 6.7 percent in real terms. This makes the Philippines one of the fastest growing economies in Asia! Real GDP per capita grew by 5.0 percent in 2017.

This economic growth is driven by strong several engines. Sustained growth in consumption spending, strong outturn in exports performance and increased public spending propelled broad-based expansion in the economy.

The Government's "Build, build, build" program leads to higher contribution of social services and public spending. Growing tourist arrivals, rising business process outsourcing receipts, the boom in real estate and construction, a growing trade with partner nations, and the steady stream of remittances from Overseas Filipinos (OF) support current domestic economic expansion.

Increasing domestic and foreign investments provide assurance of sustainable growth. We have posted record high foreign direct investments for two years in a row: USD 8 billion in 2016 and USD 10 billion in 2017.

On the external front, the country's balance of payments is firmly under control and is supported by a GIR level of USD 80.1 billion as of end-March 2018. This level assures payment for 7.8 months' worth of imports of goods and services for the economy under the worst case scenario.

The movement of the peso remains market-driven and supported by sound macroeconomic fundamentals. High demand for the dollar can be attributed to higher import payments, residents' outward investments, and public and private sector debt repayment. These developments are fundamentally healthy, aid the country's competitiveness and strengthen the economy in the long run.

The latest inflation outturn for March 2018 at 4.3 percent led to an average of 3.8 percent for the first quarter of 2018. This remains within the Government's target range of 2 to 4 percent. Recent inflation reading shows an elevated path in 2018, with baseline forecast nearing the high-end of the target range before decelerating to the midpoint in 2019. We are closely monitoring the situation.

Amidst the pick-up in inflation, we will carefully evaluate the appropriateness of a measured policy response to firmly anchor inflation expectations so that inflation targets will continue to be met in 2018–2019.

Thrift banking industry remains an anchor of stability

Amidst increased competition and evolving technologies, the thrift banking industry has exhibited sustained stability, resilience and commitment to support inclusive growth –

- Thrift banks resources stood firmly at P1.17 trillion at end-2017, mostly funded by retail deposits, indicative of continued trust and confidence in the thrift banking industry.
- Thrift banks continue to support MSMEs, real estate development and consumer financing, with a loan portfolio equivalent to about 71 percent of industry assets. Nevertheless, the industry's asset quality remains solid, with the NPL ratio at 4.7 percent in 2017 and NPL coverage at 67 percent .
- Retained earnings boosted the industry's overall capital position as the capital adequacy ratio (CAR) stood at 16.7 percent as of end-2017. This is higher than the BSP standard and the global norm. This is evidence of the industry's commitment to build adequate buffers for risk-taking.
- Net Income of P17.9 billion in 2017 yielded 12.7 percent return to shareholders. This came about from the steady growth in net interest income (NII) and more cost-efficient operations.

These performance results should encourage the industry to stay on its healthy course.

Fostering stronger partnership for sustainable growth

At this juncture, I would like to express gratitude to CTB for its exemplary dedication and commitment in supporting BSP's mandate and advocacies. Notable is CTB's pivotal role in the industry's adoption of the ULAMA and the Lendr platform. For this, CTB was chosen as the Outstanding Strategic Industry Partner in the 2017 Awards for BSP Stakeholders.

We reaffirm our continued partnership with CTB in the pursuit of prudential reforms, particularly risk and corporate governance standards.

We recently issued the minimum prudential liquidity requirements for stand-alone TBs and other small banks. The Minimum Liquidity Ratio (MLR) will promote resilience to liquidity shocks.

To differentiate risks among bank borrowers, we are currently studying adoption of the risk-based pricing framework for bank loans. This will encourage good borrowers to avail of more loans because of the lower interest on account of their good credit standing. Moreover, the proposal aims to reduce potential systemic risk from competitive pressures that may result in lower interest rates even for customers with poor credit quality.

Parallel to this, the BSP fervently hopes to on-board all Filipinos into the financial system. To make banking services more accessible, we issued the framework for basic deposit accounts. We trust that thrift banks will be at the forefront of opening basic deposit accounts. We trust that thrift banks will be at the forefront of opening basic deposit accounts. Part of our strategy is the deepening of financial education and consumer protection initiatives, as well as leveraging on available digital technology to have greater scale in banking.

Charting the course towards digitalization

A FINTQ Inclusive Digital Finance Report for 2017–2018 highlighted the huge opportunities for financial service providers to innovate financial products and services that offer the greatest potential in transforming the country's financial landscape.

Thrift banks can take advantage of these opportunities. Smaller institutions can leverage on cloud technology and shared services to lower operational costs. A rural bank has already launched a pilot project on cloud-based core banking solution. Thrift banks can certainly leverage on similar solutions. The opportunities are huge. However, the risks have to be carefully considered and managed.

On a grander scale, the BSP has set its sights on the digitalization of the financial system. We are working closely with the industry in implementing the National Retail Payment System (NRPS) to establish a safe, reliable and affordable retail payments system. The goal is to enable businesses and consumers to make payments and transfer funds electronically from one account to any other account using any digital device. The envisioned inter-operable payment ecosystem is going to be a platform for fintech innovations. Thrift banks should be part of this!

The launch of Instapay, the country's second retail payments clearing house after the PESONet, is scheduled on 23 April 2018. Industry players are already signing up to provide real time electronic payments to clients.

The BSP remains committed to establishing a regulatory environment that allows innovations to flourish. Our 'test and learn' approach or regulatory sandbox remains useful in dealing with increasing digital financial innovations in the market.

While the BSP is embracing growth opportunities from fintech innovations and related digital transformation for the banking system, we are mindful of attendant risks and any unintended consequences. Thus, we have regulations aimed at mitigating effects of technology-related risks, to promote financial integrity, transparency in financial transactions and consumer protection.

Some of these are:

- An enhanced regulatory framework for pawnshops and money service business (MSBs) to ensure that even non-banks are properly supervised for effective compliance with AML and internal control rules and guidelines.
- Circular 950 allows covered institutions to implement reduced Know-Your-Customer (KYC) rules for certain low-risk accounts and use technology to facilitate frictionless customer on-boarding.
- Circular 940 allows banks to use third party cash agents as a cost-efficient service delivery channel. With cash agents, banks will be able to leverage on innovative digital banking solutions to on-board clients even in hard-to-serve areas.
- Under Circular 944, the BSP regulates entities that use Virtual Currency (VC) as the underlying instrument for remittance.
- Circular No. 949 provides guidelines to ensure that risks resulting from social media use are adequately assessed and managed.

- Circular No. 982 provides an enhanced information security framework to consider cybersecurity controls. This calls for a renewed focus on information security in line with technological developments and innovations, dynamic risk profiles, and a rapidly evolving cyberthreat landscape.

You can be assured that the BSP is on constant surveillance mode for fintech activities by new market players. We are monitoring industry developments on crowd-funding and peer-to-peer lending. While crowd-funding has the potential to expand financial access for new businesses and MSMEs, there is also heightened risk of investor and consumer abuse. We are ready to take regulatory action if necessary to maintain fair and healthy competition.

The BSP is also actively engaging regulators from other jurisdictions for possible information sharing specifically focused on fintechs. Currently, the BSP has a FinTech Cooperation Agreement with the Monetary Authority of Singapore which provides a framework for collaboration by referring promising FinTech firms, sharing of emerging trends and developments, and facilitation of cooperative work on FinTech projects.

We ourselves are exploring adoption of RegTech solutions to strengthen BSP's risk-based regulatory and supervisory activities.

We are piloting two RegTech solutions to automate some of BSP's work, enhance analytical staff capability, create greater accountability and amplify "customer voice" in the policy-making process. These include an application programming interface (API) system to improve supervisory reporting; and an automated complaint-handling system.

Finally, to cope with all the rapid change, the BSP is undergoing strategic reorganization to enhance our mission focus, foster better collaboration and promote better accountability. Even in the BSP, disruption is occurring to improve and transform our capabilities, structures and more importantly, our culture.

To make the BSP more capable, agile, and stakeholder-oriented, we are reviewing our nautical charts to reach the objectives of becoming a more credible central bank, of having dynamic stakeholder engagement, of achieving organizational agility, and of possessing organizational capability.

Closing remarks

Ladies and gentlemen, disruptive technology is gradually reshaping the financial services industry. It offers opportunities as well as challenges for all. Let us embrace it. Manage it. And make it work for all Filipinos, and your customers.

Anchors away! We are with you in the journey.

Again, congratulations to the new set of Officers and Trustees of CTB. Mabuhay ang Pilipinas!