

Nestor A Espenilla, Jr: Providing an enabling environment at the crossroads of digital transformation

Speech by Mr Nestor A Espenilla, Jr, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the Annual Convention of the Association of Philippine Correspondent Bank Officers (APCB), Puerto Princesa, Palawan, 30 June 2018.

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Thank you Association of Philippine Correspondent Bank Officers (APCB) for the opportunity to speak and share the BSP's initiatives. ACPB President Arthur Vincent Chung, members, key players and stakeholders in correspondent banking, ladies and gentlemen, Good morning!

Your theme, "Digitalization and the Future of Correspondent Banking", is very relevant. Digitalization and the integration of finance and technology or "fintech" are fast revolutionizing the banking and the global financial services industries. Digital innovations drive increasing demand for new and better financial products and services. Globally, consumers and clients expect quick and immediate response rates, and faster and shorter transaction and payment processes. There is also a rise in public confidence in making electronic payments and in using digital channels, a clear culture change!

So how do we keep up? While correspondent banks are concerned with digitalizing its services and leveraging on technology to facilitate cross-border trade, remittance flows and payment and settlement transactions, the BSP is also on its toes. The BSP under the strategic direction of "Continuity Plus Plus" is committed to providing a strong macroeconomy and an enabling operating environment for you, our regulated and supervised entities and market players.

At the BSP, we recognize the potential of new digital technologies. We are keenly aware that financial institutions that leverage on technology are granted greater opportunities to diversify. Technology use allows them to widen the products and services offered. We note that technological change is exponential, allowing the emergence of an even greater variety of services. We anticipate that with greater use, needs of financial consumers evolve and become more sophisticated.

We at the BSP anticipate the emergence of a new competitive space where service innovation must be encouraged. We allow room for new business models, technologies, industry wide collaborations and partnerships to be developed.

Not only does technological change and digitization facilitate efficient, real-time settlement of financial transactions, but they promote greater financial inclusion as well.

As regulators, our primary goal is to provide an appropriate and enabling regulatory environment. We seek to encourage innovation while effectively managing ensuing risks. We continue to design and implement a regulatory framework that will support the market infrastructure and which will also promote market discipline. The safety and integrity of the financial system is our primordial consideration.

The Current Fintech Landscape in the Philippines

The current fintech landscape is complex. It is characterized by a multitude of payments, insurance, deposit-taking, lending, capital-raising, investment management and financial market infrastructure linkages.

As of end-2017, payments had the largest market share of the fintech landscape. Forty-four

percent of players offered innovative solutions to facilitate payments and settlement transactions. Of the recorded 60 players, about 27 percent have direct interactions with the BSP or its supervised financial institutions either as a BSP registered, licensed or supervised entity.

We advise that since technology is portable, scalable and cost-attractive, market players and regulators alike must remain vigilant and watchful of the rapidly evolving nature of fintechs and how it is revolutionizing digital banking in the Philippines.

The BSP's Regulatory Sandbox

Regulatory policies and standards must evolve alongside emerging technologies and the digital transformation of the banking system.

The BSP espouses a flexible “test-and-learn” approach to financial innovation. We call this, the “regulatory sandbox.” Essentially, the sandbox provides a testing ground for new business models to guide us as regulators, in assessing potential risks. The ultimate objective is to be aware of the risks, to employ mitigating actions as needed, and also allow room for market players to leverage on new technologies.

Guided by the sandbox approach, the BSP ensures that regulation is calibrated according to the defined activity's identified risks. The approach also encourages dialogue and multi-stakeholder collaboration among fintechs and various financial sector players. The purpose is to achieve a “whole-of-government approach” to ensure policy consistency and prevent regulatory arbitrage.

Ultimately, fintech innovations must work for the benefit of consumers. This would include the underbanked and unbanked sectors. In this regard, digitalization has great potential to promote inclusive growth. With financial inclusion as the goal, as regulators, we need to ensure that the design and deployment of digital financial solutions meet the highest standards of transparency, product suitability, security and confidentiality.

With this in mind, we have further refined existing regulations to more effectively respond to digitalization of banking services, fintech developments and emergence of technology-related risks while remaining supportive of financial innovation. Some of these regulations have significant impact on correspondent banking.

Staying Competitive in the Midst of Digital Revolution

The rapid evolution of digital technology, particularly the widespread use of smart phones at the turn of the new millennium, revolutionized financial product and banking service delivery. Customers now have unprecedented access to a wide array of electronic platforms. Included in these are virtual financial services platforms, which allow customers to perform banking transactions and make payments anytime, anywhere, and at their own convenience.

Recognizing that electronic banking expands client reach and improves financial access, as early as 2000, we allowed banks to engage in electronic banking.

In parallel, we have implemented a cash agent model. This provides an innovative service delivery channel through combining e-banking self-service online and real-time transactions, with cash-in, cash-out (CICO) provided by third-party cash agents.

Emerging digital solutions, products and services, push banks to keep pace with increasing competition posed by even non-bank players. Non-bank players offer financial products and services with thoughtfully designed user interfaces. One recent development with significant impact to correspondent banking is the rise of blockchain or distributed ledger technology (DLT).

Hence, correspondent banks must embrace this wave of innovation and rethink strategies. To grow markets in the midst of competition, new customer solutions through efficient operations should be delivered.

Technology-based solution providers suggest that blockchain or DLT could be harnessed to alleviate some correspondent banking issues. This can be achieved by enabling better risk management, reducing costs, and providing an alternative payment platform, especially in terms of transferring small-value payments.

In this connection, the BSP is working closely with market innovators and industry players to explore tie-ups of correspondent banks with DLT providers. We believe that collaboration and strengthening partnerships with other fintech players is a way to boost digital capabilities of correspondent banks.

We recently approved a project under the test-and-learn approach. The project will facilitate creation of a real-time domestic and overseas remittance corridor without the need to establish a central operator. This will prove beneficial to our remittance sector which relies heavily on correspondent banking for the safe and efficient settlement of transactions.

The Bankers Association of the Philippines (BAP) is also spearheading a project to develop digital IDs powered by blockchain technology.

Establishing a Safe and Efficient Retail Payments System

In 2015, the National Retail Payments System (NRPS) was launched. The NRPS will help create a safe, efficient, affordable, interoperable, and reliable retail payments system in the country. The NRPS and the resulting envisioned payment ecosystem will serve as a platform for fintech innovations. Industry players can utilize fintech solutions and provide services within an organized, commercially-viable and efficient retail payments system.

Since its launch, critical milestones reached include: (1) establishment and operationalization of the industry-led payment system management body (PSMB); (2) transitioning of the batch interbank fund transfer service of the Philippine Clearinghouse Corporation (PCHC) into PESO Net, the first multilateral automated clearing hours in the country; and (3) the launch of InstaPay which allows 24/7 low-value electronic fund transfers.

Enhancing the Regulatory Environment for Money Service Businesses (MSBs)

Meanwhile, the regulatory framework on the operations of money service businesses or Money Service Businesses (MSBs) has been rationalized. Specifically, the customer due diligence requirements to re-balance financial integrity and financial inclusion objectives of policy reform were enhanced.

Under our amended anti-money laundering (AML) rules (which covers MSBs) customer due diligence/Know-Your-Client (KYC) requirements were relaxed for low-risk customers/accounts/transactions. This is provided certain conditions are met to ensure that residual money laundering/terrorist financing (ML/TF) risks are adequately managed.

Regulating the Use of Cryptocurrencies/Virtual Currencies

The rise in cryptocurrency or virtual currency (VC) presents an immediate threat to correspondent banking. This is because it allows peer-to-peer transfer of value without going through intermediaries or central counterparties. The BSP recognizes that VC systems can

revolutionize financial services delivery, particularly for payments and remittances.

Thus, we established a framework to regulate VC exchanges and similar entities operating in the Philippines. Under the new framework, VC exchanges are classified as Remittance and Transfer Companies (RTCs). They are subject to registration, minimum capital requirements, internal controls, regulatory reporting and compliance with the anti-money laundering rules and regulations.

In particular, we keep close track of the use of virtual currency for trading and fund-raising through initial coin offerings (ICOs) and the emergence of private digital currencies and Central Bank-Issued Digital Currencies (CBDCs).

We are collaborating with other regulators for a harmonized regulatory approach on ICOs and VC trading activities. We are also working closely with BSFIs on their respective plans to launch private digital currencies and other pioneering VC technologies. Presently, we are looking into the issue of CBDCs and what it means for the supply of credit and the impact on the financial system.

These initiatives take time and warrant thorough consideration. In all this, the BSP is carefully monitoring emerging technologies to balance the rewards of innovation against the overall safety and integrity of the financial system.

Promoting Enhanced Cybersecurity in the Philippine Financial System

There is also a need to address cybersecurity on a broader scope. This is a must for a digital, financial ecosystem to thrive.

To respond to this challenge, we established a framework that provides parameters and best practices to identify, prevent, detect, respond to, and recover from cyber-attacks. In November of last year, we issued information security guidelines. These require BSFIs to manage information security risks within acceptable levels through a dynamic interplay of people, policies, processes, and technologies.

In this regard, the board and senior management of BSP-supervised financial institutions (BSFIs) play a critical role. As the ones ultimately responsible for their respective institution's risk oversight and governance, the board and senior management of BSFIs must safeguard information security.

Exploring RegTech Solutions

Fintech products and services are susceptible to cyber threats, money laundering, and other fraudulent activities. Cognizant of this, regulatory technology or RegTech solutions have emerged as an important technological supplement to existing regulatory and supervisory tools. This allows the effective address of regulatory challenges in the financial services sector.

The BSP is currently investigating and will pilot RegTech solutions to streamline supervisory functions, particularly to address regulatory compliance and reporting requirements of supervised financial institutions.

Engaging in Regional Cooperation Agreements

Lastly, we are enhancing our cross-border presence through multi-sectoral and regional collaborative engagements. Last November 2017, the BSP entered into a Fintech Cooperation Agreement with the Monetary Authority of Singapore (MAS). Under this agreement, both countries

can share information about emerging fintech trends and developments and work on fintech projects together.

Concluding Remarks

As key players in the financial system, we trust in the continued partnership of APCB. To fully reap the rewards of financial innovation, we need to strike a balance between optimizing the benefits of digitalization against the overall safety and soundness of the financial system.

Digital transformation in correspondent banking is not a future event. It is a present reality. Recognizing this, we need not be apprehensive. Instead, we must start working together, always keeping a positive mind-set.

In closing, I emphasize the importance of sustained collaboration among stakeholders. This is needed to create a safe, efficient and reliable digital environment. As new technologies like mobile banking, social networking, big data, and cloud computing advance, so must banks need deeper and wider understanding of trends. Stakeholders would do best to identify growth opportunities and establish synergies with new players and industries and with each other to remain competitive and relevant.

I look forward to joining this afternoon's panel discussion.

Thank you very much and good morning.