



Reforms in the Philippine Financial System: A Comprehensive Response

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**23rd General Meeting and Seminar
of the Asian Bankers Association
3 October 2006**



Bangko Sentral ng Pilipinas

Presentation Outline

- + Banking Sector Outlook
- + Financial Reform Agenda
- + Conclusion



BANKING SECTOR OUTLOOK



Bangko Sentral ng Pilipinas

Selected financial indicators

✚ Expansion in assets, deposits, capital accounts

- Total resources continued to grow to P4.5 trillion at end-June 2006. Universal/commercial banks (U/KBs) accounted for the bulk of the total assets with around 89 percent share.
- Asset growth was supported by banks' deposit generation and sustained capital deepening initiatives.
 - Deposits grew year-on-year by 10.4 percent (P3,221.0 billion as of end-June 2006 vs. P2,917.4 billion a year ago).
 - Capital accounts amounted to P519.5 billion, up by 0.9 percent from last year's P515.0 billion.



Selected financial indicators

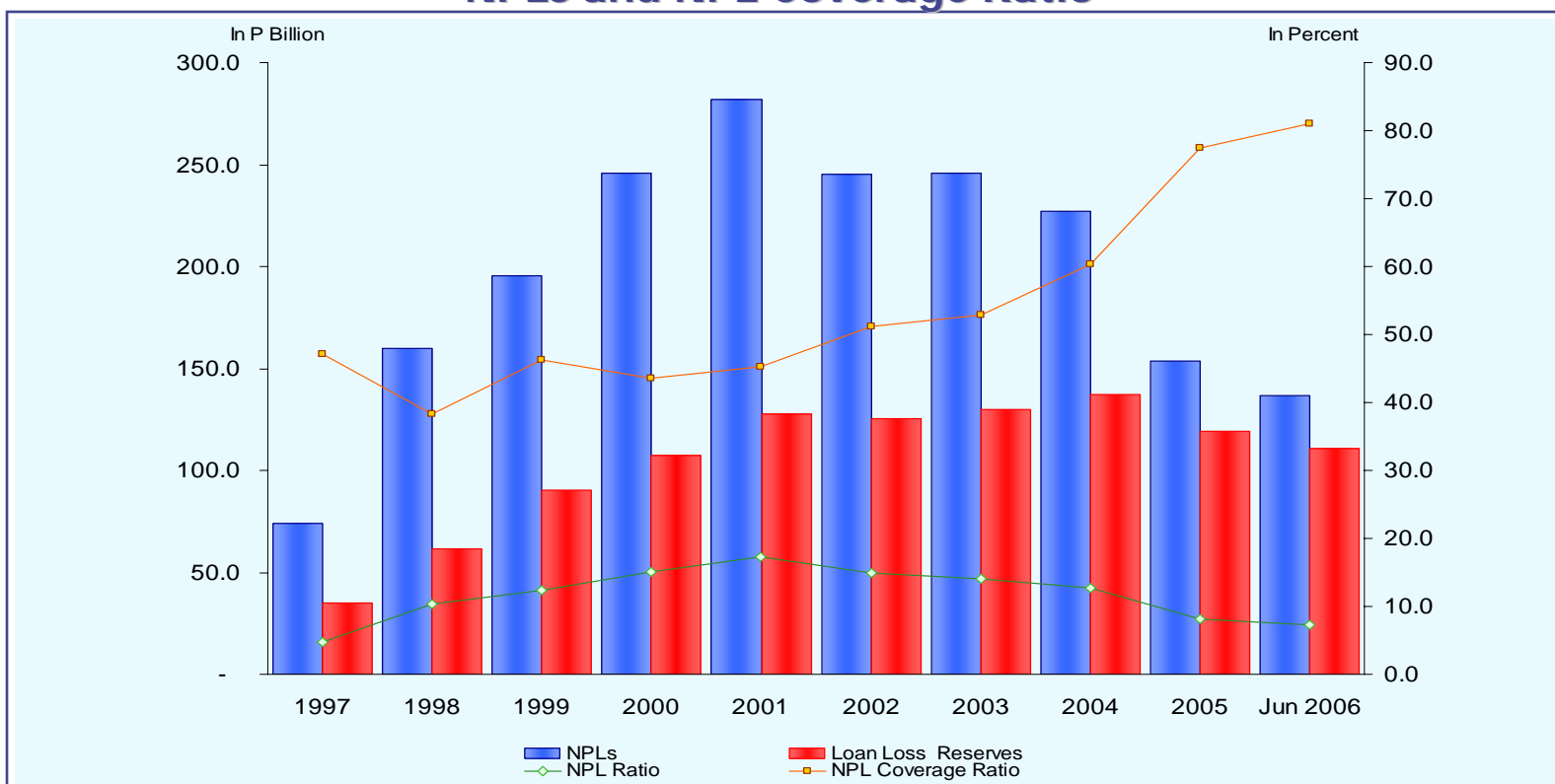
- Banking system remains adequately capitalized.
- Capital adequacy ratio (CAR) recorded at 17.6 percent on a consolidated basis as of end-September 2005
 - exceeds the 8 percent international benchmark and the 10 percent minimum regulatory standard set by the BSP, a good indication of the banking system's capability to cover risky assets.



Selected financial indicators

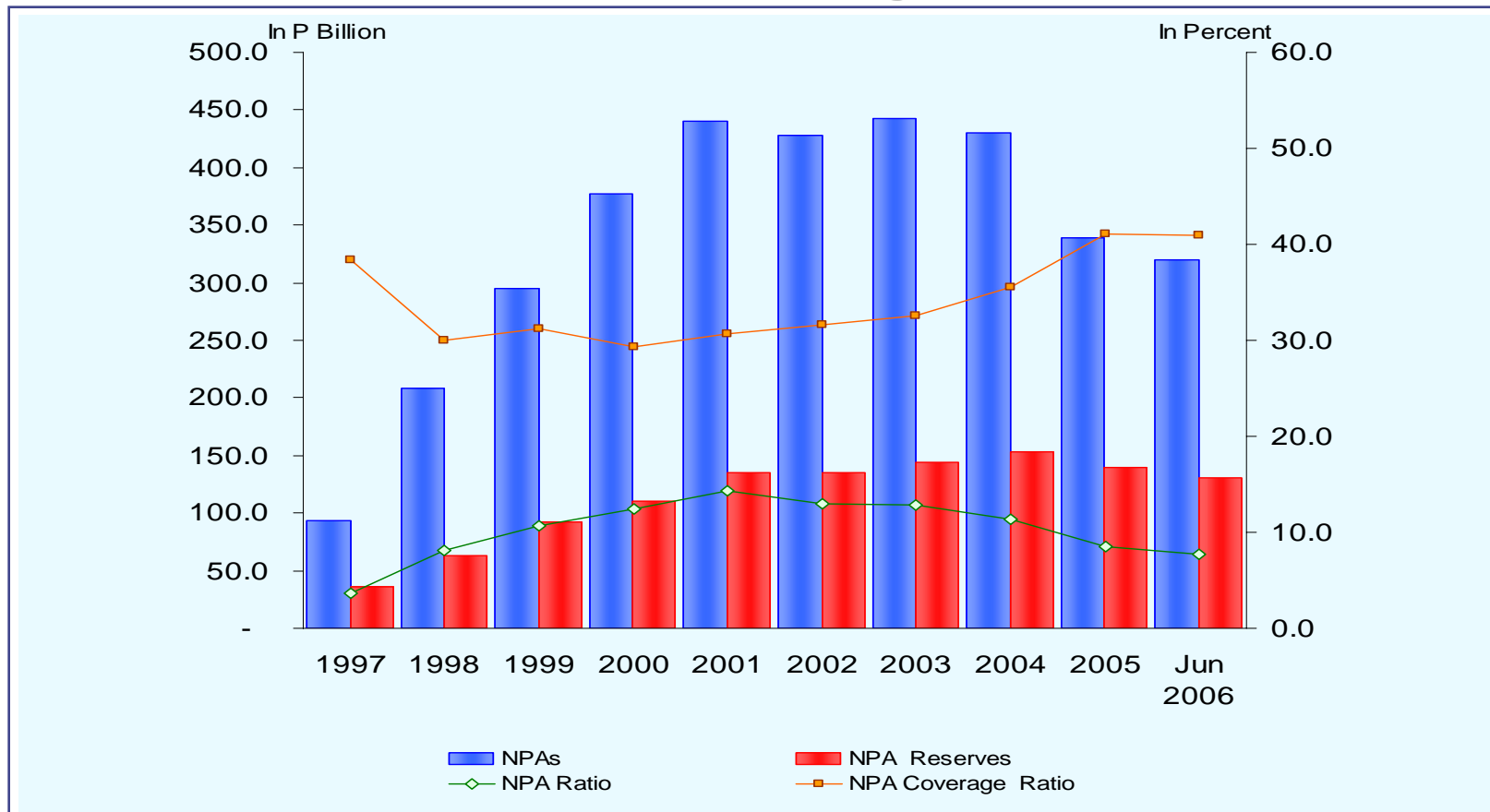
Asset quality has substantially improved.

Universal and Commercial Banking System
NPLs and NPL Coverage Ratio



Selected financial indicators

Universal and Commercial Banking System NPAs and NPA Coverage Ratio



Going forward

- ✚ Immediate challenge is to sustain momentum for financial stability
- ✚ A number of issues will need to be dealt with for the banking system to remain sound and for it to fully seize growth opportunities
- ✚ Banking system will need to appropriately respond in step with market changes.



FINANCIAL REFORM AGENDA



Financial System Reforms

**Twin
objectives**



Promote a strong
banking system



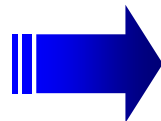
Develop the domestic
capital market



Financial System Reforms

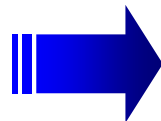
Towards a strong banking system

Goal



- + Fortify the banking system's capability to cope in an environment of increasing sophistication and complexity

Agenda



- + Reinforce cleanup of banks' balance sheet
- + Strengthen banks' capital position
- + Improve corporate governance practice
- + Promote risk-based supervision



Financial System Reforms

✚ Reinforcing cleanup of banks' balance sheet

Overriding concern – accumulated stock of NPAs in the banking system



NPA level amounted to P520 billion at end-June 2002

Policy Response

- Asset disposition under the Special Purpose Vehicle (SPV) Act of 2002

Total assets transferred to SPVs reached P96.7 billion or roughly 18.6 percent of the P520 billion NPAs as of end-June 2002.

- Recent initiative – Joint Venture Agreements (JVA) between banks and real estate development companies



Financial System Reforms

Strengthening banks' capital position

- The Philippines is sufficiently aligned with the capital requirements on credit and market risks under Basel I.

Relative to Basel II –

- Revised risk-based capital adequacy framework for the Philippine banking system shall take effect on 1 July 2007.

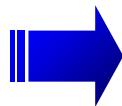


Financial System Reforms

Strengthening banks' capital position

Pillar 1

(minimum capital requirements)



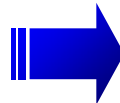
- Some elements of Basel II have already been incorporated in our existing capital framework:
 - ✓ lower risk weighting for highly-rated sovereigns/banks/corporate entities
 - ✓ higher risk weighting for non-performing exposures
 - ✓ standardized capital requirements for investments in securitization
- One of the forthcoming changes includes introduction of an operational risk capital charge



Financial System Reforms

Strengthening banks' capital position

Pillar 2
(internal capital adequacy assessment process)



- BSP circulars that establish basic guidelines for:
 - ✓ managing eight principal types of risks: credit, market, interest rate, liquidity, operational, compliance, strategic, and reputational risks
 - ✓ managing risk in the provision of information technology support to the organization
- Revised Prompt Corrective Action (PCA) Framework – to encourage banks to take early action to align capital with actual risk exposures



Financial System Reforms

- Strengthening banks' capital position

Pillar 3 (market discipline)

Pillar 3 framework requires banks to disclose qualitative, as well as quantitative information on risk exposures in their annual reports. These include:

- ✓ components of bank capital;
- ✓ capital requirements for the different risk types; and overall capital adequacy ratio;
- ✓ risk management policies and processes;
- ✓ breakdown of risk-weighted assets by risk types



Financial System Reforms

✚ Improving corporate governance practice

- Greater adherence to the updated standards on transparency, accountability and fairness/equity.
- Special seminar on corporate governance for all bank directors
- Defining the duties and responsibilities of a bank director and the board of directors collectively
- Enforcing fit and proper standards for bank directors and officers
- Requirement for banks to establish a compliance system
- Emphasis on the role of independent external auditors
- Creation of critical committees on governance, risk oversight and audit
- Enforcing more stringent regulations on internal audit



Financial System Reforms

✚ Improving corporate governance practice

- Adoption of prescribed international accounting standards in 2005
- Issuance of new financial reporting package (FRP)



Financial System Reforms

✚ Promoting risk-based supervision

- Full implementation of risk-based examination and consolidated supervision
- Launching of structured training program for BSP examiners - enhance capacity of the BSP examiners in performing risk-focused examination
- Strengthening ties with co-regulators both locally and abroad – involvement in the Financial Sector Forum (FSF)



Financial System Reforms

Towards a robust domestic capital market

- Creation of a sound market infrastructure and its supporting settlement and clearing systems and custodial arrangements
- Promotion of new debt and equity instruments
- Expansion of institutional players
- Advocacy of key legislative measures



Financial System Reforms

✚ Delivery of securities

- Requirement on securities sold by a bank or non-bank financial institution (NBFIs) to be delivered either to the purchaser or to his designated third-party custodian
- To ensure that said securities have not been the subject of multiple sales and undocumented repurchase agreements.

✚ Accreditation of third party custodians

- Prequalification criteria for banks and NBFIs that will operate as securities custodians
 - minimum CAMELS ratio of "4"
 - minimum CAR of 12 percent
 - adequate technological capability to offer securities custodianship and registry



Financial System Reforms

+ Market infrastructure

- Establishment of a Fixed Income Exchange (FIE)

➡ centralizes trading of securities for enhanced transparency and efficient price discovery

+ Expansion of the menu of financial products

- ✓ Traded papers like unsecured subordinated debts (as tier 2 supplementary capital), long-term negotiable certificates of deposits or LTNCDs, documented repos, and securitization structures create market-oriented opportunities for banks and other players and deepen the capital market
- ✓ Hybrid capital instruments
- ✓ Unit investment trust funds (UITFs)



Financial System Reforms

✚ Credit rating agencies

- Key role played by rating agencies in guiding investors towards informed decision-making and in ensuring the proper disclosure of investment information



Financial System Reforms

- ✚ Legal and regulatory framework

- Support for vital legislative measures that will aid capital market development

 - ➡ Credit Information System Act

 - ➡ Revised Investment Company Act



- ✦ Reform agenda: a work in progress
- ✦ BSP is mindful of the challenges and will continue to take on a proactive role to address them, mainly through the pursuit of genuine reforms in the financial system.



Thank you!

