



Microfinance/fellowship meeting, Brgy. Parola, Tondo, Manila
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Towards a Resilient & Inclusive Financial Sector

Towards a Resilient and Inclusive Financial Sector

The financial sector intermediates claims between savings and investors. The credibility and stability of financial institutions and the relative attractiveness of various financial instruments to borrowers and lenders alike determine how much saving will be mobilized, how much it stays in the country to be invested, and how this is to be allocated among the various firms and industries. Together with the state of confidence and long-term expectation, therefore, the stability and performance of financial institutions such as banks, equity and bonds markets, insurance companies, and other financial entities have an indirect but vital bearing on investment and the growth of output and employment in the country.

Assessment

The Philippine financial system manifested its strength with a steady improvement in the balance sheet of the banking industry, the issuance and listing of corporate bonds, and the underwriting of insurance contracts.

The Philippine financial system manifested its strength over the past decade, including the period of recent global financial crisis. After significant dislocations in prior crises in the 1980s and 1990s as well as the 1997 Asian Financial Crisis, the system saw a steady improvement in the balance sheet of the banking industry, the issuance and listing of corporate bonds, and the underwriting of insurance contracts. Moving forward, however, the system will need to address concerns about the sustainability of its performance if it is to contribute significantly to development.

Parallel to these, policymakers pursued broad-based financial sector reforms centered on restructuring the banking sector, institutionalizing corporate governance reforms, improving risk

management and strengthening the supervisory oversight of financial regulators¹ in the early 2000s. Together with improved macroeconomic conditions, the steady inflow of remittances from OFWs, a minimal investment exposure to foreign structured products and a low dependence on exports, these reforms allowed the financial system to avoid the worst difficulties encountered by other economies during the 2007-2008 financial crisis.

The financial system's performance has been positively reviewed by third parties.² Stress tests conducted on banks also confirm the strength of the banking system's capitalization even with extreme test parameters. For inclusive finance advocacy, local supervisory initiatives have also been repeatedly acknowledged

¹ These include the re-establishment of *Bangko Sentral ng Pilipinas* (General Banking Law of 2000 or RA 8791) as the supervisor of the banking sector, *Securities and Exchange Commission* (Securities Regulation Code of 2001 or RA 8799, as amended) as the supervisor of the corporate sector and domestic capital market, *Insurance Commission* (PD 612) as the supervisor of the insurance and pre-need industries and *Cooperative Development Authority* (RA 6939) as the supervisor of cooperatives in the Philippines. The CDA Charter was enacted on March 10, 1990 and subsequent enhancements were similarly pursued in early 2000s but amendments of the Charter are still pending in Congress.

² This is evident from the Financial Sector Assessment Program (FSAP) report of the International Monetary Fund (IMF) in early 2010.

by international institutions.³ These external validations of the improvements in the financial sector culminated in the sovereign ratings or outlook upgrades from some the major ratings firms.

Current Structure of the Financial System

The Philippine financial system is primarily bank-based rather than capital market-based. The banking sector, whose total assets accounted for more than 80 percent of the total resources of the financial system⁴ and of GDP in 2010, plays the primary role in financial intermediation and is the main source of credit in the economy.

Across banking groups, universal and commercial banks continued to hold the lion's share of key balance sheet

accounts of the banking system on account of their market maturity, branch network and capitalization. The comparative market shares of key banking groups are summarized in Table 6.1.

Meanwhile, the market share of nonbank financial institutions remains relatively small, accounting for about 18 percent of total assets of the financial system and 17 percent of economic output in 2010. The Insurance Commission (IC), for instance, reports that only 13.9 percent of the Philippine population has private life insurance coverage. In 2008, the private insurer's penetration rate or the proportion of the premiums to the country's GDP was only 1.1 percent. Among the reasons cited for the low insurance coverage is the lack of priority being placed on insurance products by the citizenry and the low financial literacy level among low income households including the informal sector.

The Philippine financial system is primarily bank-based rather than capital market-based.

Table 6.1 Comparative Market Shares of Key Banking Subgroups in the Philippines as of end-September 2010*

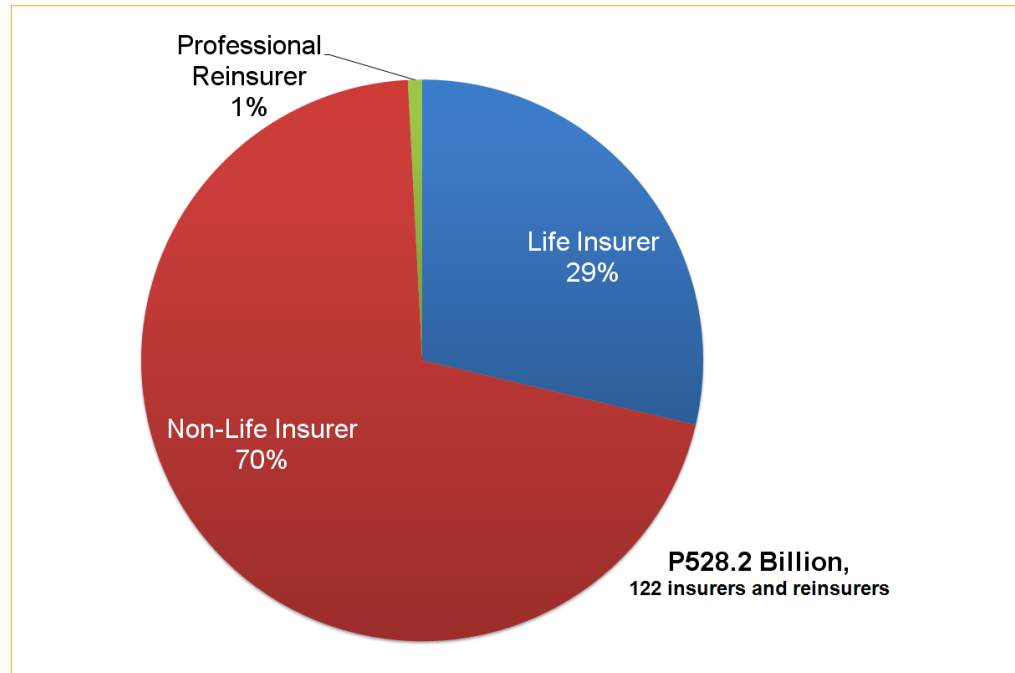
Period	Bank Category	Selected Performance Indicators					Physical Composition		
		Assets	Core Loans (TLP net of IBL and RRP with BSP)	Deposits	Capital	Net Profit	Head Office	Branches	Total
End-September 2009	Universal and Commercial Banks	88.5	83.8	88.2	86.8	91.3	4.8	57.3	52.4
	Thrift Banks	8.7	11.6	9.2	9.2	3.3	9.2	16.1	15.4
	Rural and Cooperative Banks	2.8	4.6	2.5	4.0	5.4	86.1	26.6	32.2
	All Banks	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
End-September 2010*	Universal and Commercial Banks	88.3	83.8	87.8	87.9	90.2	5.0	57.4	52.8
	Thrift Banks	9.0	11.9	9.6	8.5	5.7	9.6	16.6	16.0
	Rural and Cooperative Banks	2.7	4.3	2.5	3.6	4.1	85.5	26.0	31.2
	All Banks	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

*Preliminary data; as of End-September 2010

³ The Economist Intelligence Unit (EIU), for example, has ranked the country's inclusive finance policy framework as the best worldwide.

⁴ Excludes the assets of BSP. Likewise, other nonbank financial institutions not under BSP supervision such as investment houses and financing companies without quasi-banking functions and/or trust authorities or are not subsidiaries or affiliates of banks and quasi-banks, lending investors, insurance companies and other government financial institutions (GFI) such as the Social Security System (SSS) and Government Service Insurance System (GSIS) are excluded in the computation of total assets of the financial system due to data constraints.

Figure 6.1 Comparative Market Share of the Insurance Industry as of end-December 2009



The insurance industry's total assets reached P528.2 billion as of end-December 2009 with 122 market players. Life insurers captured the bulk of the insurance market at 79% while nonlife insurers at 19% and professional reinsurers at 2 percent.

Meanwhile, the number of companies listed in the Philippine Stock Exchange (PSE) grew to 259 companies in 2011 from just 12 companies in 2003. Despite the rise in the number of listed companies, market capitalization as a percentage of economic output remained small (except Indonesia) compared to other ASEAN-5 economies. In 2009, market capitalization dropped to 45.8 percent of GDP from 54 percent in 2002. This reflects that the market remains illiquid and the free float of listed companies in the PSE still limited.

Mutual funds, with market size likewise smallest in Asia,⁵ are managed by broker-dealers and investment companies where largest of them in terms of asset size are either subsidiaries or affiliates of banks.

In view of this unbalanced development of the financial sector, the country's M2-to-GDP ratio⁶ of less than 50 percent over the last decade has been below the ASEAN-5 average and second lowest to Indonesia since 2006 (Figure 6.2). Meanwhile, Malaysia and Thailand have financial depth ratios of more than 100 percent.

The domestic capital market and non-bank sector composed of investment houses, securities brokers or dealers, financing companies and insurance companies also remain small compared to regional peers.

⁵ Cf: April 2010 FSAP Report: An Update on the Philippines

⁶ This refers to the measure of broad money which consists of currency in circulation, peso demand deposits or M1 and peso savings and time deposits. This is the ratio of which over economic output is a common measure of financial depth.

Table 6.2 Philippine Stock Exchange-Listed Companies as of February 25, 2011

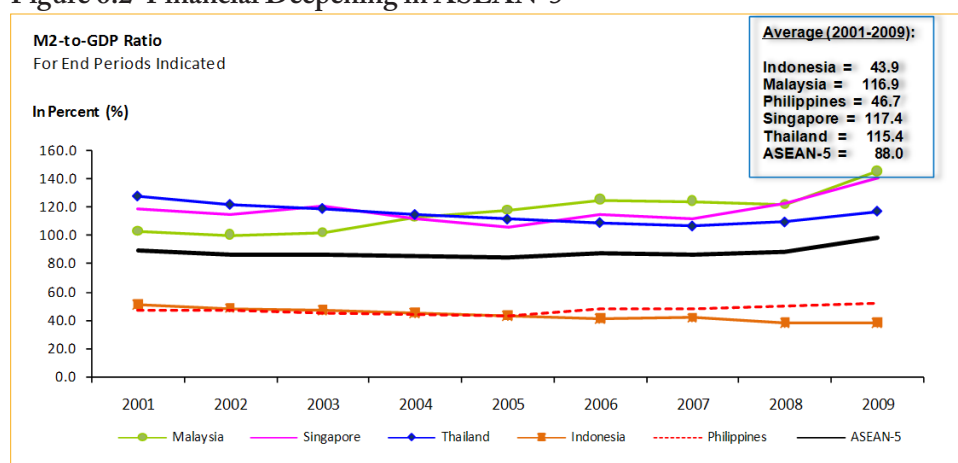
Company Group	Total No. of Firms per Sector
Banks	16
Chemicals	8
Construction, infrastructure & allied services	16
Diversified industrials	10
Diversified services	10
Education	3
Electricity, energy, power & water	13
Food, beverage & tobacco	23
Holding firms	41
Hotel & leisure	8
Information Technology	11
Media	5
Mining	17
Oil	5
Other financial institutions	14
Preferred	1
Property	41
SMEs	2
Telecoms	6
Transport	9
Total	259

Foreign participation in the financial system remains limited. The banking sector was liberalized and opened to foreign participation following the enactment of the Foreign Banks Law or RA 7721 in 1994. Since then foreign banks have been allowed in principle to establish branches with full banking authority, to invest in up to 60 percent of the voting stock of a new banking subsidiary, or to invest in up to 60 percent of the voting stock of an existing domestic bank.⁷ The first mode of entry has been closed, however, while the second is also suspended pending a moratorium on the establishment of new banks, except for those engaged primarily in microfinance. In practice, foreign banks may only pursue the third route of foreign entry, which is the acquisition of 60 percent voting interest in an existing domestic bank. Notwithstanding the liberalization of the banking sector, foreign banks to date account for only 11.9 percent of the banking system's total assets⁸ although they have a stronger foothold in country's credit card business.

Foreign participation in the financial system remains limited.

Source: Philippine Stock Exchange

Figure 6.2 Financial Deepening in ASEAN-5



Source: IMF Statistics, NSCB

⁷ Article 99, Chapter XIII of the Cooperative Code of the Philippines (RA 6938) limits the ownership of a cooperative bank to duly established and registered cooperatives in the Philippines, including another cooperative bank.

⁸ Section 3 of the Foreign Banks Law or RA 7721 limits the aggregate share of foreign banks to 30 percent of banking system's total assets.

Table 6.3 Structure of Financial Systems in ASEAN-5 (Averages: 2000-2009)

Economy	Domestic Credit Provided by Banking Sector	Equity Market Capitalization (% GDP)	Foreign Currency Bonds Outstanding
Indonesia	54.0	26.6	2.0
Malaysia	129.6	135.7	16.2
Philippines	56.9	45.8	25.9
Singapore	91.0	182.2	25.3
Thailand	130.2	55.8	6.1

Source: IMF, World Bank and Asian Bonds Online

Table 6.4 Extent of Bank Access – Customer Reach: 2010

Country	Deposit accounts per 100,000 people	ATMs per 100,000 people	Branches per 100,000 people
Indonesia	504.7	14.4	7.7
Malaysia	2,063.3	54.0	11.4
Philippines	499.1	14.3	11.8
Singapore	2,236.3	49.8	10.5
Thailand	1,448.8	71.3	11

Source: World Bank

The current geographical distribution of financial service providers shows a growing concentration in the high-income and urbanized areas of NCR, Central Luzon and CALABARZON.

The current geographical distribution of financial service providers shows a growing concentration in the high-income and urbanized areas of NCR, Central Luzon and CALABARZON (Cavite, Laguna, Batangas, Rizal and Quezon). Bank density is heavily skewed towards these three regions and the nationwide density ratio of five banks per city or municipality has been largely unchanged for the last decade. Consequently, about 37 percent⁹ of municipalities in the Philippines do not even have a banking office and can be considered either unserved or underserved with respect to a broad range of critical financial services such as credit, savings, payment transfers, remittances and insurance. Compared to the ASEAN-5, the Philippines lags behind in terms of customer reach (Table 6.4).

The agenda to develop a robust capital market is of long standing, and has been previously analyzed extensively, yet many of the critical components remain unresolved. To attain the objective of a regionally-responsive development-oriented financial system, there must be a clear acceptance that a thriving capital market is not an optional appendage but a crucial complement to the traditional bank deposit-loan market. The local bond market continues to be dominated by government securities and is largely fragmented, with the presence of too many tenor buckets and a longer maturity profile¹⁰ compared to other ASEAN economies (Figure 6.3).

⁹ The ratio may be lower if the client reach of non-bank microfinance institutions (MFI) and non-government organization/civil society organization (NGO/CSO)-oriented cooperatives are included.

¹⁰ Largely used as a debt management tool of the government to ensure liquidity for its deficit financing needs.

Condition and Performance

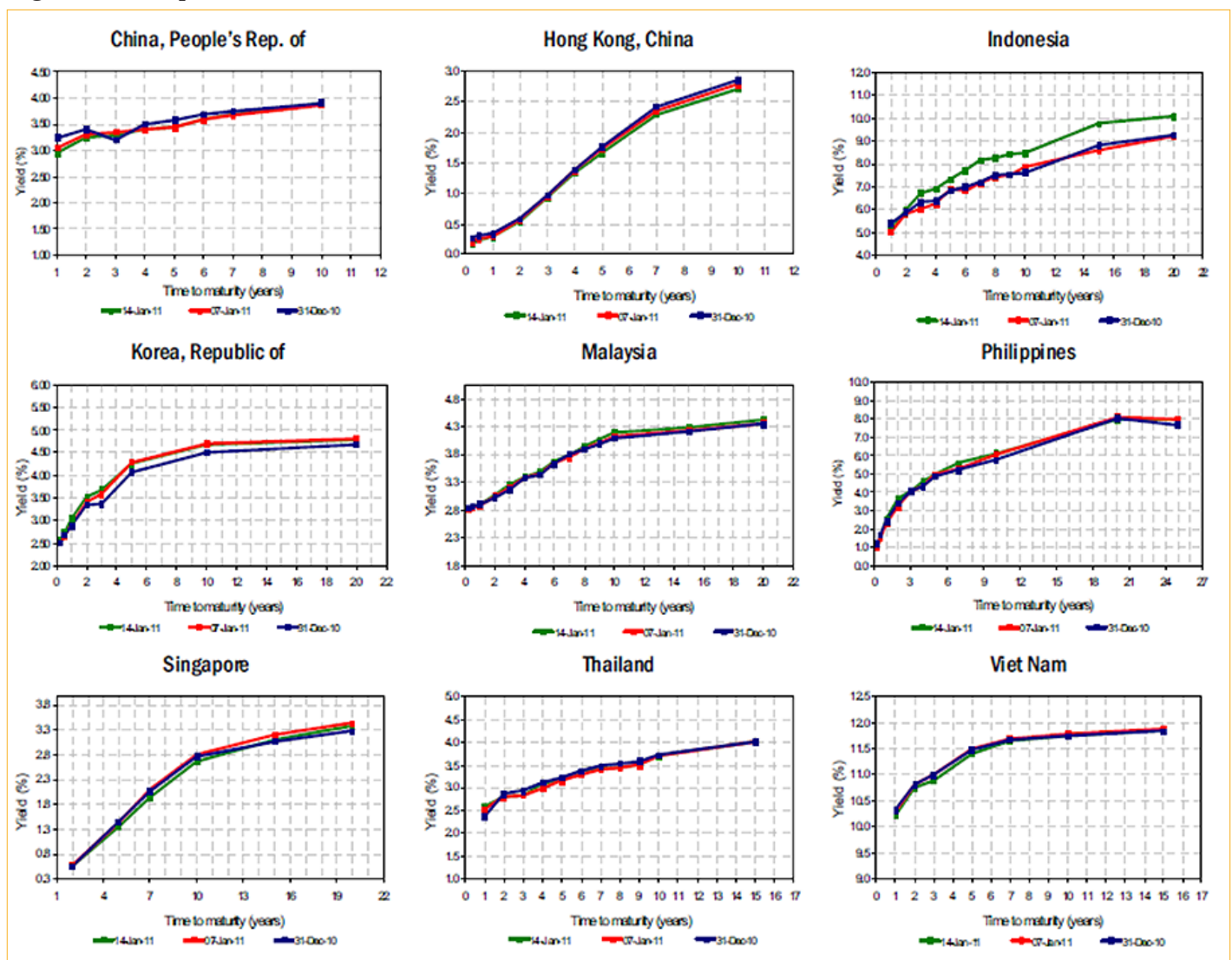
Banking Sector

The Philippine banking system, which remains the core of the financial system and primary source of credit for the economy, continues to manifest sustained resilience for the last decade at par with its ASEAN-5 neighbors.¹¹

Key performance indicators (Figure 6.4) showed steady growth in assets, lending, deposits and capital accounts. While credit expansion has been modest, averaging 6 percent in over a decade, this was due less to a lack of liquidity in the system and more to developments in the capital market that allowed some highly rated companies to tap alternative funding. Alongside this, credit underwriting standards were strengthened, which ultimately allowed

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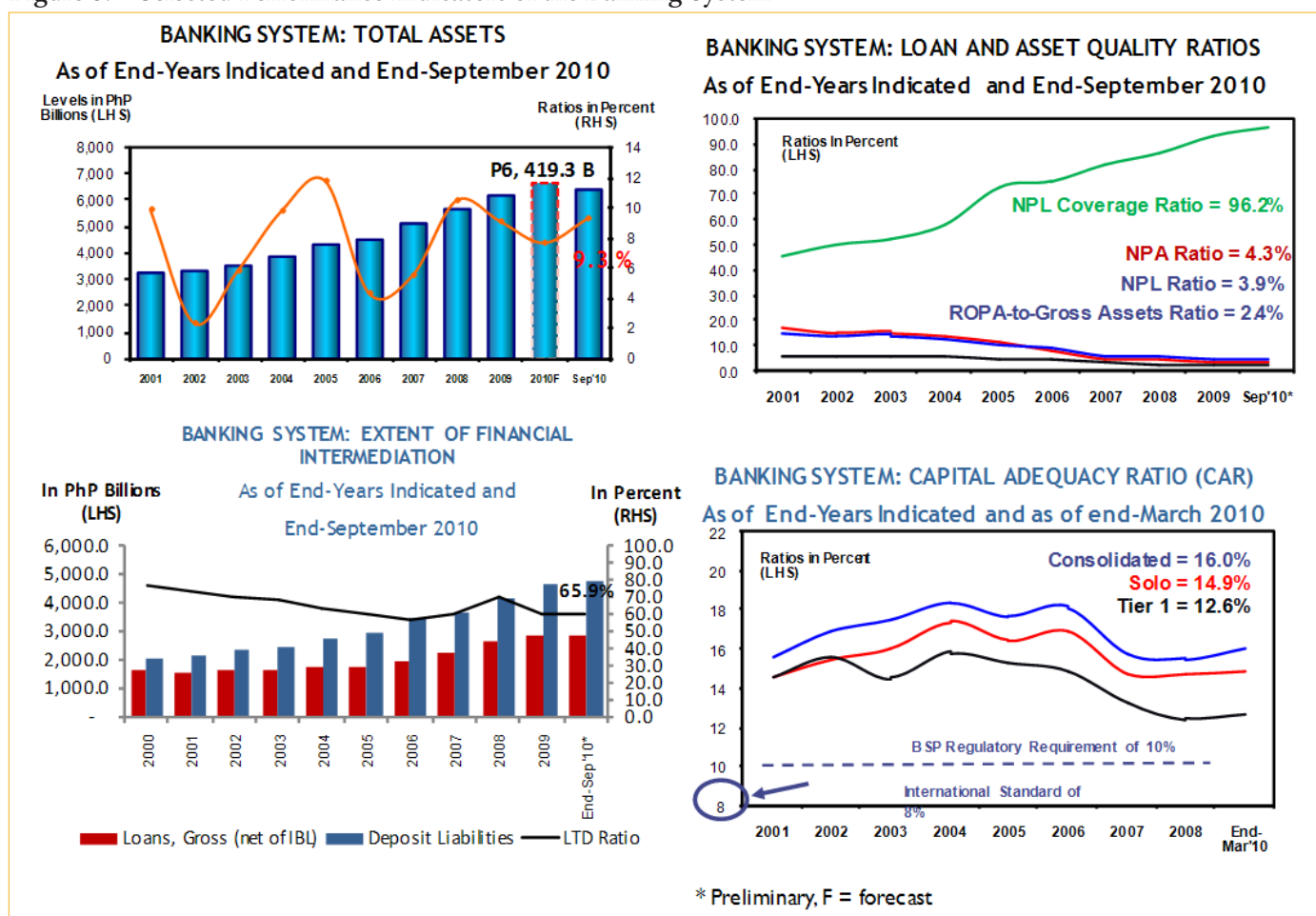
Figure 6.3 Comparative Benchmark Yield Curves, ASEAN+3



Source: Bloomberg, Asian Bonds Online

¹¹ Cf. Attachment 1

Figure 6.4 Selected Performance Indicators of the Banking System



Source: Bangko Sentral ng Pilipinas

The country's stock market also showed signs of recovering from depressed global market sentiments in 2007-2009.

banks to improve their asset quality and maintain prudent loan-to-deposit ratios. Bank solvency remains above the BSP regulatory requirement of 10 percent and the international standard of 8 percent; the country fully adopted the risk-based capital adequacy framework¹² under Basel II in 2007. Core earnings grew together with modest, credit expansion and a general improvement in asset quality.

Equities Market

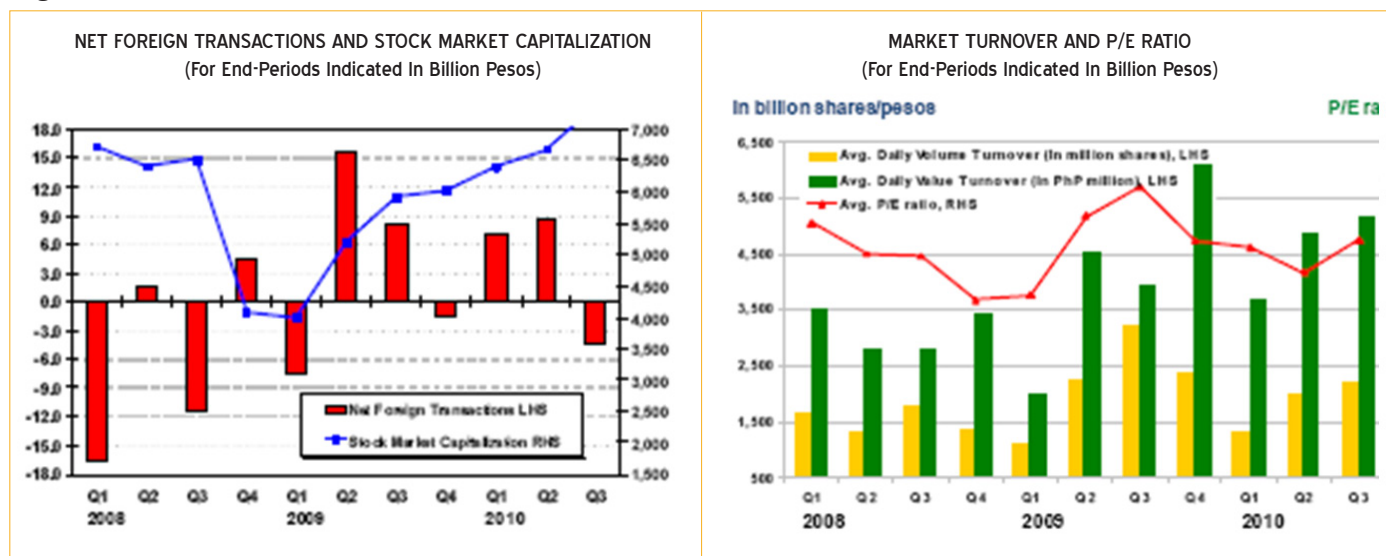
The country's stock market also showed signs of recovering from depressed global market sentiments in 2007-2009

particularly during the worst period of the U.S. subprime crisis in 2008. The Philippine Stock Exchange index (PSEi) surged 37.6 percent to close at 4,201 points at end-year 2010, the fourth biggest annual percentage increase in the last ten years.

For its performance in 2010 alone, the PSEi advanced by 1,148 points year-on-year from its level of 3,053 in 2009. During this period, the PSEi peaked at 4,413 points on November 5, 2010 while its lowest level was recorded at 2,788 on February 9, 2010. The broader All-Shares index

¹² Prior to the banking system's adoption of Basel 1, Philippine banks were required to maintain a net worth-to-risk assets (NWRA) ratio of at least 10%. On July 1, 2001, the NWRA ratio was replaced by a 10 percent BIS-type risk weighted capital ratio when the banking system adopted the Basel 1 framework for bank capital (BSP Circular No. 280)

Figure 6.5 Selected Stock Market Performance Indicators



Source: Philippine Stock Exchange

also rose by 56.7 percent to 3,006 points in 2010 from the previous year's 1,910. All sector specific indices also increased, led by the Holding Firms index followed by the Industrials, Property, Financials, Mining and Oil, and Services, in declining order.

Other stock market indicators similarly showed positive sentiments on the local bourse with an uptrend in overall stock market capitalization and average price per earnings ratio.

Fixed Income Market

Total volume traded at the Philippine Dealing and Exchange Corporation (PDEX) for 2010 amounted to PhP5.4 trillion year-to-date (YTD), more than double its previous YTD's level of P2.6 trillion. This is composed of treasury bills, fixed income notes, retail treasury bonds, zero coupon bonds and special purpose treasury bonds.

On March 16, 2010, PDEX trading volume reached an all time high of

PhP53.8 billion (daily average) in its five-year history.

However, government securities accounted for 99.2 percent of all fixed income instruments in the FIE. It is composed of treasury bills (8.9%), fixed income notes (78.8%), retail treasury bonds (11.5%), zero coupon¹³ bonds and special purpose treasury bonds.¹⁴ Meanwhile, corporate bonds made up the remaining 0.8 percent.

Foreign Exchange and Bond Markets

Overall, the domestic financial market remains generally stable and has started to realize gains from improving market and investor sentiments. The peso strengthened against the US Dollar while sovereign credit spreads tightened during this period (Figure 6.6).

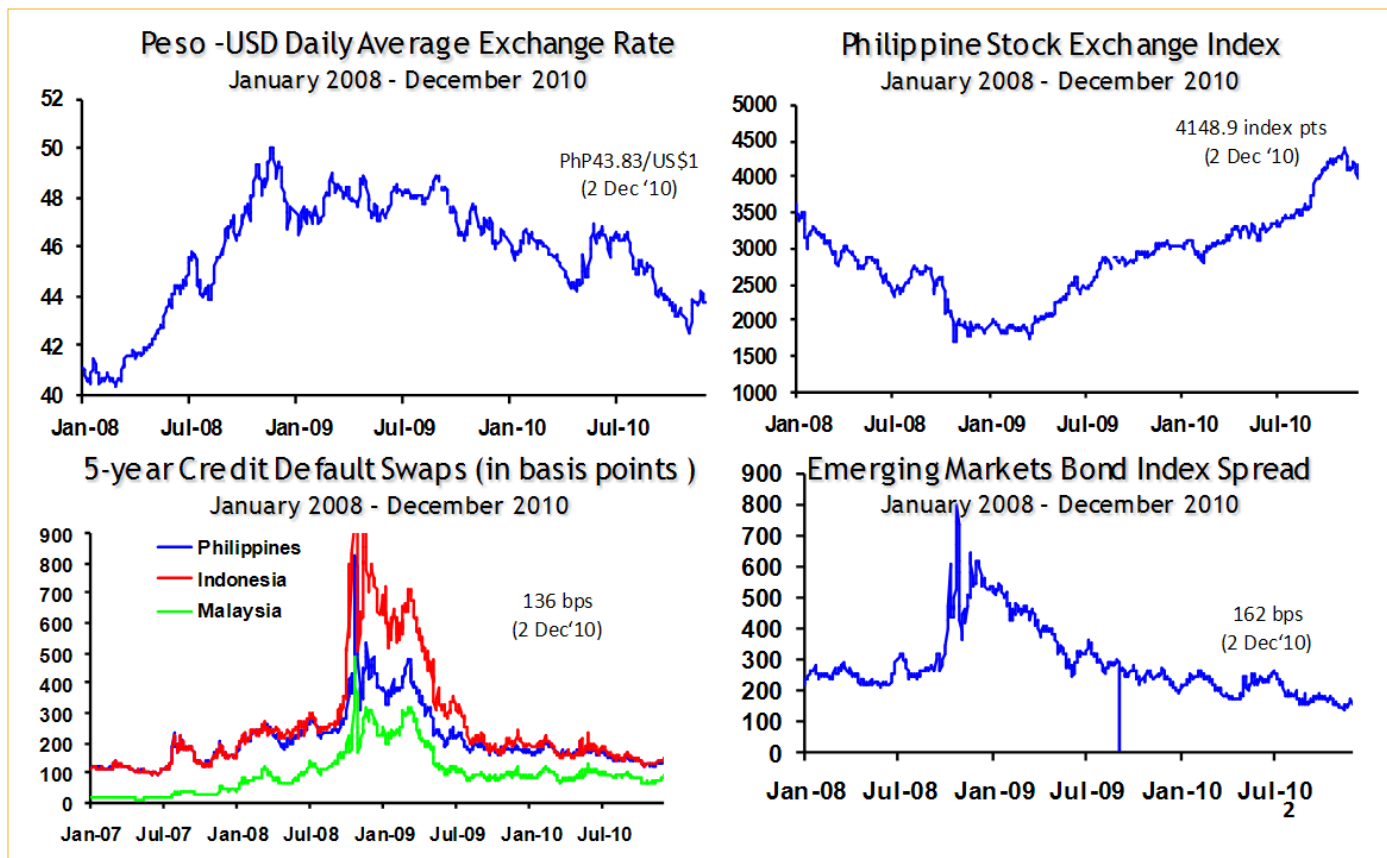
Also, Figure 6.6 summarizes the performance of Philippine financial markets post crisis and improved investor sentiment as evidenced by the general

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¹³ Negligible share

¹⁴ Negligible share

Figure 6.6 Summary of Financial Market Performance



Source: Bangko Sentral ng Pilipinas, Bloomberg and Philippine Stock Exchange

strengthening of the peso against the US dollar, rebound of the domestic equities market and tightening of sovereign debt spreads.

Challenges

Notwithstanding the improvements previously cited, some policy and structural issues continue to deter the further development of the financial system. If the financial system must be positioned to serve the current and future needs of the public, these issues must be resolved:

To nurture a thriving financial system, the challenge is to mobilize local saving and deploy the resources as may be needed throughout the archipelago.

Institutionalized Generation of Savings and Mobilization of Resources

As an archipelago the country must live with demographic and economic diversity across regions.¹⁵ To nurture a thriving financial system, the challenge is to mobilize local saving and deploy the resources as may be needed throughout the archipelago. This provides for a regionally-responsive, development-oriented financial system that nurtures saving at its source while recognizing how some regions may have greater credit needs than others. Further strengthening the financial inclusion framework and its infrastructure support are key elements in providing the necessary financial services and in bridging the spatial gaps between regions.

¹⁵ Attachment 2

Available Savings are Primarily Lodged in Short-Term Instruments

Economic priorities and projects normally require long-term funds but available savings is placed mostly in short-term instruments such as savings deposits¹⁶ and treasury bills. This tenor gap cannot be addressed by a simple pricing solution. There is a need to develop an outright long-term funds market. Put differently, savers must be provided the opportunity to become investors, and this will require an enabling environment that includes prudential guidelines, infrastructure support, a robust capital market and a national financial education program.

Lack of a Thriving Capital Market

The business of finance is impossible without the dynamics of trading. To establish an outright long-term funds market, the capital market must undergo fundamental changes. This includes defining a credible valuation benchmark, providing for forward markets, strengthening the cash market, and addressing the fragmentation of the government securities market. The latter raises the inherent tension between the market development function of government securities versus the mandate to minimize the cost of government debt financing.

Improving the Financial Governance Framework

Rapidly changing market conditions and the public's evolving requirements increase the pressure on the governance structure of the market. The supervisory framework must proactively stay ahead of these market pressures. Regulatory

and supervisory authorities must ensure that their mandates are aligned with international best-practice and standards applicable in a domestic context. In the current regime of multiple regulators, the authorities must ensure consistency and comparability across their respective governance frameworks. Some of these will require legislative intervention while the rest will depend heavily on the working relationship between regulators and regulated entities.

Fls Concentration in Urban Areas

The uneven distribution of regional income and savings has led to the concentration of financial institutions and delivery of financial services in high-income and urbanized areas. Bank density, for instance, has remained at five banking offices per city or municipality for the last decade, leaving some 37 percent¹⁷ of the country's municipalities either unserved or underserved.

Need for Legislative Support in Critical Reform Areas

Critical financial sector reforms cannot be implemented by financial supervisors alone. Legislative support is necessary to provide for the required legal and regulatory environment for these reform objectives. Close coordination with Congress as well as active participation in the legislative process remain pivotal.

These policy and structural issues are known to most stakeholders. What is missing, however, is a holistic framework that ties them into a common strategic and tactical plan. This is ultimately a challenge of orderly execution and the need for an uncompromising commitment among stakeholders to adhere to the plan.

¹⁶ Attachment 3

¹⁷ Exclusive of client reach of non-bank MFIs and NGO/CSO-oriented cooperatives.

Strategic Framework

Vision for the Financial Sector

A regionally responsive, development-oriented and inclusive financial system which provides for the evolving needs of its diverse public. It is guided by the following precepts:

- Bottom-up development
- Top-down infrastructure support
- Prices that fully reflect relevant information
- Enabling environment for the effective management of risks

Medium-Term Development Plan for the Financial Sector (MTDPFS)

An array of reforms in the domestic financial system will be pursued to further deepen the financial system through a balanced development of the banking system and capital market. These shall be anchored on a conducive policy and regulatory environment, progressive adoption of international standards and best practices,¹⁸ good governance, and transparency for the effective delivery of financial services.

Key Reform Objectives and Targets

Over the medium term, the government aims to (a) achieve a 7 to 8 percent growth in the country's economic output beginning 2011, with a minimum of 5 percent growth annually for six years, (b) increase per capita income to US\$3,000 over the six-year period and (c) reduce poverty incidence by 10 percent per year.

In line with the national agenda and with Plan targets, a broad range of financial sector reforms will be pursued to further deepen the financial system and enable it to contribute to sustainable and inclusive growth. This shall be achieved by effectively mobilizing and intermediating funds within a framework of inclusive finance to best address the evolving needs of all constituents. Key reforms will focus on: (a) promoting savings generation at the regional level but institutionalizing deployment of resources at national level; (b) developing an enabling environment for long-term savings; (c) strengthening the governance framework of the financial system in line with international standards and best practices, and (d) establishing a strong legal framework for financial sector development.

Specific Reform Strategies

A. Promote a regionally responsive and inclusive financial system through institutionalized savings generation and resource mobilization.

The high-growth trajectory set for the macroeconomy puts pressure on the financial system to generate the necessary resources to support heightened economic activity.

This provides the strongest justification for positioning the financial system to be regionally-responsive and development-oriented.

In order to engender sustainable and equitable growth, those in the margins of society must be part and take benefit from the nation building process. As things stand, their access to financial services has

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¹⁸ With prior consideration to applicability on domestic conditions.

been limited by physical incapacity,¹⁹ geographic distance, high cost of credit and stringent documentary requirements. Consequently, these sectors remain vulnerable and their need for consumption smoothing persists.

One way to address this is through the promotion of inclusive finance wherein everyone has access to all financial services including, but not limited to deposit account services, credit services, remittances, and insurance services.

To this end, the Philippines has already made great strides in its effort to make financial services available to everyone not only through banks and insurance firms but also through other institutions such as cooperatives and microfinance nongovernment organizations. Moreover, technological innovation in mobile and electronic delivery channels has also helped in improving efficiency and availability of financial services. All these have been made possible through the establishment of an enabling policy and regulatory environment that encourages a market-oriented approach to the provision of financial services to previously excluded segments of the population like the enterprising poor.

These notwithstanding, there remains to be room for improvement for Philippine financial inclusion and the following reform strategies shall be pursued to attain this:

1. Establish a conducive and regulatory environment that balances financial inclusion objectives with financial stability goals.

- a) Institutionalize market-based policy through issuance of law anchored on the greater role of the private sector in the provision of financial services and market-oriented interest rates with the National Strategy for Microfinance as a foundation.
- b) Craft a national financial inclusion strategy²⁰ that officially defines financial inclusion, the medium-term strategies to be undertaken and the responsibilities or accountabilities of all stakeholders both government and private.

2. Promote the use of alternative products and delivery of financial services in underserved and unserved areas of the country such as:

a) Microinsurance²¹

The promotion of microinsurance products and services, for instance, aims to expand the delivery of simple and affordable risk protection oriented financial products to the less privileged and the informal sector against financial distress and other unfortunate events i.e., typhoon devastation on crops.

Specific action plans include the following:

- Formulate performance standards for microinsurance;

¹⁹ Refers to persons with disability (PWD)

²⁰ National Strategy for Microfinance was formulated in 1998 and initiatives to institutionalize microentrepreneurship for poverty reduction and inclusive economic development were reemphasized as a policy statement in the latest speech of President Benigno S. Aquino III before the PinoyME People Powered Markets on 22 February 2011.

²¹ The Microinsurance Regulatory Framework (MRF) was launched in January 2010 to provide a policy and regulatory environment that will facilitate the participation of the private sector in providing risk protection for the poor and ensure that the rights and privileges of the poor are protected.

- Foster public-private partnership on microinsurance product development; and
- Institutionalize microinsurance financial literacy program.

b) Credit Surety Fund Program (CSF)

The CSF is a program that involves the creation of a trust fund contributed by cooperatives from a province and its provincial government intended primarily to make micro, small and medium enterprises (MSME) bankable by giving them access to formal sources of financing by means of a surety cover as a substitute for collateral.

c) Microhousing

According to data from the Housing and Urban Development Coordinating Council (HUDCC), the projected housing needs of the Philippines plus projected new households by 2010 is 655,821.

It used to be that banks are not able to compete with the rates provided by government housing programs because they are subsidized, but lately, the government has been trying to shift towards a market-oriented housing finance system. Thus, the development of micro-housing finance schemes could help alleviate the situation of the homeless poor.

3. Explore other facets of inclusive finance framework such as agent banking and use of nonbank financial institutions as delivery channels.

In pursuit of this specific reform objective, there is a prior requirement

to promote evidence-based policy making and impact measurement by establishing a systematic method of collection, monitoring and analysis of financial inclusion related data to address the need for accurate, reliable, and consolidated statistical data on various financial inclusion issues and required innovations. This shall integrate existing financial inclusion statistics as well as address gaps in the current statistical environment through information exchange and cooperative arrangements with other concerned agencies.²²

4. Adopt a holistic approach to financial literacy and consumer education.

5. Encourage the continuing development of new loan products and other banking services aimed to address the special needs of the poor, women and persons with disability (PWDs).

Unlike other borrowers, the target market for microfinance products²³ such as those belonging to the agriculture sector might have cash flows that are different from those observed from the usual borrower. Likewise, there is a wide variety in the purpose of their loan application: consumption smoothing, financing for educational needs and funds for migration purposes such as placement fees, document processing fees. Hence, these warrant the introduction of financial products specifically designed for this group of borrowers.

In terms of the delivery of financial services, the need to expand the number of ATMs and other banking products including announcements or

²² These include the National Confederation of Cooperatives (NATCCO), CDA, APPEND and other microfinance or cooperative related organizations involved in the inclusive finance agenda.

²³ Based on existing laws and BSP regulations, microfinance loans are those granted to farmer-peasants, artisanal fisherfolk, workers in the informal sector, migrant workers, indigenous groups of people and cultural communities, differently-abled persons, senior citizens, victims of calamities and disasters, youth and students, children and urban poor.

financial literacy materials in Braille²⁴ to cater to the unique requirements of the blind remains a going concern. At present, most ATMs have a dot on the number “5” digit (middle digit in a 3x3 matrix consisting of nine numbers) of the ATM console to guide the visually impaired and only a small number of ATMs has the digits “1-9” in complete Braille. There is also a need for bank forms to be available in Braille or to be read aloud by a dedicated staff to a blind client. For the physically challenged, greater compliance of institutions, including banks to install facilities and devices within their premises that enhances the mobility of disabled persons pursuant to Batas Pambansa Bilang (BP) 344 needs to be ensured. This includes the installation of appropriate ramps and lowering the keypad console of ATM machines to aid the access of depositors who are in wheelchair.

B. Develop an enabling environment for long-term investments.

In order to encourage long-term savings and investment, the following specific reform strategies shall be pursued:

1. Develop auxiliary markets through forwards and cash markets.

The development of the domestic capital market cannot be fully consummated only by the presence of liquidity and higher investor participation reflected in the volume of transactions. A capital market that promotes price discovery mechanism, that allows investors to manage resources efficiently, and that provides the avenue to protect investments, is the necessary infrastructure to provide alternative financing to the country’s economic development. Toward this

end, there is a need to develop auxiliary market through forwards and cash markets.

Specific reform shall be pursued to:

- a. Institutionalize repurchase agreements (repos) and securities lending and borrowing (SLB) as a second-layer platform for the trading of government securities (GS). Repos and SLBs provide another means for short-term financing and can provide the inventory of GS to avoid failed trades. Putting this in place would require an efficient infrastructure that would ensure proper tagging of securities (i.e., once used in a repo or SLB, it cannot be used for subsequent transactions unless released by the contracting parties) and would need common ground rules to govern the securities trading.
- b. Develop a derivative forwards market to formalize the mechanism for investors to hedge their investments and manage their risk exposures. With the presence of a derivatives market, the volatility currently generated by abrupt spot trades can be addressed and provide the market with the necessary time to adjust to the required future volumes while using the forward rates as a valuation guide.

2. Establish a reliable capital market infrastructure

The flow of resources from those with excess funds to those with better use for funds will not be fully consummated in the absence or the lack of infrastructure that would ensure the sanctity of transactions, the protection of capital as well as encourage their economic use. It is therefore desirable to set in place a reliable market infrastructure as

²⁴ The Braille system, developed by a blind Frenchman Louis Braille in 1825, is a widely used method of reading and writing for the blind.

foundation for saving and investment. This would require the development of legal and regulatory frameworks to govern the exchange of capital which entails crafting of appropriate enabling laws to encourage savings, disseminate credit information, strengthen regulatory supervision and protect the rights of investors.

As an archipelago, a market infrastructure that can integrate the physically segregated markets across regions is important. Technology is available to allow for a central board that can present a uniform price for an issue regardless of the location of the purchaser.

Thus, reforms shall be undertaken to create a market infrastructure that provides for the following: (a) default arrangement; (b) elimination of clearing and settlement risks; and (c) availability of access to other retail clearing or settlement processes.

3. Support faster integration of the financial system into the ASEAN region.

Increased exposure to the Asian-wide financial markets can serve as an additional momentum to further deepen the domestic financial markets. It can also encourage the rapid growth of the country's economy by improving the efficiency of savings allocation and providing additional financing to the domestic industries and businesses.

Specific reform strategies on ASEAN financial integration shall be pursued to:

- a) Liberalize financial products and services;
- b) Further liberalize capital account²⁵:

(1) Continue the assessment and formulation of measures or regulations in the Philippines for foreign direct and portfolio investments as well as other foreign exchange flows. This will further removal of restrictions in inward and outward capital flows while ensuring consistency with member countries' national agenda and readiness of the economy and allowing adequate safeguards against potential macroeconomic instability and systemic risk that may arise from the liberalization process; and

(2) Participate in the mutual assessment process, identification and formulation of measures or rules to promote freer flow of foreign direct investments, portfolio investments and other foreign exchange flows, including the strengthening of monitoring and oversight systems to improve the management of large and volatile capital flows under the ASEAN Finance Process.

c) Support the regional capital market development through the following:

- (1) Participate in the region-wide capacity building initiatives²⁶ to collectively enhance liquidity and efficiency in Asian capital markets.
- (2) Further develop long-term capital market infrastructure

²⁵ Cf. eStandards Forum: Business Indicator Report (August, 2010). In its Country Commercial Guide, the US Department of Commerce describes the Philippines as "open to portfolio investment".

²⁶ Participation in regional negotiations should be supported by regular consultations with domestic stakeholders such as the National Government, the private sector and non-government organizations.

comparable and attuned with those in other Asian countries.

- (3) Enhance capital market access, linkages and liquidity by participating in proposed regional initiatives such as the ASEAN Exchange linkages and Bond Market linkages.

- (4) Promote credit ratings comparability between domestic and international credit rating agencies.

- d) Harmonize payment and settlement system.

This specifically includes participation in the harmonization of the payment and settlement systems in the region to facilitate efficient, secure and reliable cross border transactions.

- e) Strengthen regional monitoring and surveillance initiatives.

This generally aims to support the strengthening of regional monitoring and surveillance initiatives within existing regional arrangements through the ASEAN Economic Community Blueprint²⁷ to boost resilience against external shocks.

C. Strengthen the governance framework of the financial system in line with best practices and standards.

Since the global financial crisis, there has been a growing consensus on the importance of international standards and codes, particularly on elements of good governance for financial regulators.

Specific reforms are to:

1. Pursue sustained capacity building for financial regulators.

This shall be done together with the passage of amendments to strengthen the legislative mandates of the BSP, SEC, IC and CDA charters.

2. Harmonize regulatory and supervisory oversight through cooperative arrangements among domestic and international financial regulators.

3. Promote mechanisms and processes such as stronger cooperative arrangements among domestic and international regulators of the financial system to address the growth of financial conglomerates.²⁸

4. Develop the risk-based capital adequacy (RBCA) framework for providers of financial services and products under SEC and IC regulation and supervision.

Risk-sensitive approaches for determining minimum capital requirements for non-bank financial institutions will afford stronger protection to clients, and induce providers to better manage risk.

5. Promote market discipline and price discovery through effective corporate governance framework for all supervised and regulated financial institutions.

- a) Expand the scope of duties and responsibilities of the Board of Directors and officers of supervised and regulated financial institutions of BSP, SEC, IC and CDA to make them fully accountable to shareholders and the public for their decision-making processes.

²⁷ Cf: www.aseansec.org

²⁸ In its 2010 FSAP Report, the IMF cites financial conglomerates as an important feature of the Philippine economy. About 60 percent of bank assets and 75 percent of effective market capitalization of listed companies belong to conglomerates. Cf: International Monetary Fund (April, 2010). Philippines: Financial System Stability Assessment Update. IMF Country Report 10/90. Washington, D.C.: International Monetary Fund

Table 6.5 Legislative and Regulatory Priorities for the Financial System

Phase 1 (2011-2012)	Phase 2 (2011-2014)	Phase 3 (2011-2016)
<ul style="list-style-type: none"> • Cooperative Code • CISA • CIMS • PERA • REIT • MSME • Agri-Agra • FRIA 	<ul style="list-style-type: none"> • BSP Charter • Securities Regulation Code • IC Charter • CDA Charter • Corporation Code 	<ul style="list-style-type: none"> • Financial Stability Framework • Financial Sector Neutrality Tax • Payment System Act • CISL • Chattel Mortgage Law • Central Registry for Movable Assets

- b) Reinforce the proper rules governing the selection and appointment of officers, trustees and members of the Board of all supervised and regulated financial institutions of BSP, SEC, IC and CDA to effectively deal with interlocking directorships and connected party lending at the onset of increasing cross-ownership and growth of financial conglomerates in the Philippines. For government pension funds,²⁹ adopt a merit system including a clear and de-politicized appointment process for the boards of directors of these funds;

- c) Continuously align local accounting and reporting standards³⁰ with international standards and best practices; and

- d) Extend the use of corporate governance scorecard to all supervised and regulated financial institutions in the Philippines to promote a deeper culture of fairness, accountability and transparency in financial transactions and reporting.

D. Establish a strong legal framework for financial sector development.

An enabling regulatory and legal environment for financial sector development must give priority to financial stability, supervisory oversight, inclusive finance and capital market development. These reform priorities, however, require legislative support, which can be achieved only through close coordination with both houses of Congress and through active participation in the legislative process.

Reform priorities shall be phased in every two years based on the following considerations:

Phase 1 - Legislative and regulatory reforms with existing legal and regulatory framework but saddled with some implementations issues between 2011 and 2012;

Phase 2 - Legislative and regulatory reforms in the process of implementation or enacted between 2011 and 2014; and

Phase 3 - Legislative and regulatory reforms in the early developmental stage between 2011 and 2016.

²⁹ Refers to the GSIS and SSS

³⁰ The Philippines aligned its accounting and reporting practices with international accounting standards and international financial reporting standards with the adoption of Philippine accounting standards and Philippine financial reporting standards in 2005.

1. Establish a framework for financial stability to limit the costs of financial distress to the economy in times of crisis by adopting a macro-micro approach to supervision.

Reforms shall be pursued to:

- a) Include an explicit financial stability objective in the charters of financial sector supervisors. This will set a coordinated objective and shared responsibility among supervisors and regulators of the financial sector to keep the domestic financial system in good shape.
- b) Adopt a macro and micro prudential approach to supervision. The existing microprudential approach needs to be supplemented with macroprudential policies to ensure the resilience of the financial system. A consolidated and risk-based approach to supervision should be implemented to effectively supervise financial institutions and the financial system as a whole.
- c) Improve existing macro and micro surveillance tools and technology. There is a need to upgrade examination approaches, revise or update rating systems of financial institutions, and implement necessary infrastructure for data and information warehousing. Technology must be harnessed to improve micro and macrosurveillance of financial sector developments and other financial stability issues. Some innovations that can be immediately explored

are the active use of online surveys in-between examinations for macro and micro economic and financial variables, and the pursuit of new information-sharing agreements with knowledge-based participants such as the nonbank sector such as cooperative, CSO,³¹ NGO, informal, services and other corporate sectors, including inputs from national consultations.

- d) Continue to align the existing regulatory and supervisory framework with international standards and practices. In the banking sector, elements of Basel II that have not been fully implemented, including features of the recently released Basel III reform package, should be adopted to promote convergence with the global regulatory framework for a more resilient banking system.
- e) Provide institutional support for financial stability. Exchange of information and coordination among domestic and overseas regulators should be strengthened. Projects formulated by Financial Sector Forum members should be reinforced. These measures will ensure harmonized regulation throughout the system. The establishment of a more permanent and dedicated institutional support for financial stability shall be explored.
- f) Strengthen financial safety nets, such as the establishment of a crisis management framework for the financial system. A crisis management framework that is anchored on crisis prevention and crisis resolution is essential. This should provide liquidity and restore

³¹ Refers to civic-oriented organizations.

normality in the most expedient and transparent manner during a crisis.

2. Strengthen the supervisory oversight of financial regulators to enable them to keep pace with the increasing sophistication of the global financial services industry.

Specific reforms shall be pursued to:

- a) Strengthen BSP's role as a supervisor of the financial system primarily through the amendment the BSP Charter (RA 7653).
- b) Reinforce the SEC's role as capital market regulator primarily through the amendment of the Securities Regulation Code (RA 8799);
- c) Strengthen the IC as an independent and effective regulator of the insurance industry. An amendment of the Insurance Code (PD 1460, as amended); and
- d) Strengthen the organization and regulatory or supervisory functions of the CDA to cover cooperatives engaged in savings and credit operations. This will be accomplished by amending the CDA's Charter (RA 6939, as amended).

3. Provide a legal framework for the acceptance of movable assets as collateral.

Specific reforms shall be pursued to:

- a) Review and amend the more than century-old Chattel Mortgage Law in the Philippines.³²
- b) Establish a central registry of moveable assets offered as collateral, which are currently recorded in separate registries for real estate

mortgages, chattel mortgages and *quedans*.

- c) Review the rules on other collateral items such as *quedan*.

4. Provide an adequate legal framework to encourage greater investor participation, address financial taxation and effective oversight of the national payments systems.

Specific reform strategies are primarily geared at expanding non-bank initiatives through the passage of some important capital market development bills such as:

- a) A Collective Investment Schemes Law (CISL) to broaden investor participation in the securities market, including participation by Overseas Filipinos;
- b) A Financial Sector Tax Neutrality Act (FinTax) to minimize distortion costs in financial transactions; and
- c) A Payment System Act (PSA) for the effective oversight of the country's national payment and settlement system.

5. Create an environment for the efficient operations of cooperatives in the Philippines following the enactment of the Cooperative Code (RA 9520) on February 17, 2009.

The cooperative sector together with nonbank microfinance institutions³³ has been involved in grassroots development and financial inclusion in the Philippines for the past decade. There is a lack of an effective legal framework and supervisory oversight. However, has led to the fragmentation of developmental efforts and a poor

³² The country's Chattel Mortgage Law or Act No. 1508 was enacted on July, 1906. The law defines chattel mortgage as a conditional sale of personal property as security for the payment of a debt, or the performance of some other obligation, the condition being that the sale shall be void upon the seller paying to the purchaser a sum of money or doing some other act named. If the condition is performed according to its terms, the mortgage and sale immediately become void and the mortgagee is thereby divested of his title.

³³ Microfinance NGOs and microfinance-oriented banks offer loans, savings facilities, housing, community development projects e.g., insurance products in partnership with license insurance companies to less privileged Filipinos particularly in depressed and remote areas in the countryside.

database on the actual performance and contribution of the sector.

6. Empower the IC to effectively supervise and regulate pre-need companies, including, among others, reviewing the management of pre-need companies for better protection of plan holders and beneficiaries following the enactment of the “Pre-Need Code” (RA 9829).

7. Address funding and other operational requirements for the establishment of the Central Credit Information Corporation to improve the ability of financial institutions to access credit history data for debtors, thereby bringing down the money and time cost of loan underwriting following the signing into law of the Credit Information System Act (RA 9510) on October 31, 2008.

Alongside this, there is a need to develop a system to monitor, control and manage collaterals submitted by banks and other financial institutions as security for their loans. One example of such system is the Collateral Information and Management System (CIMS) to be implemented within the BSP, which should allow authorized users to obtain information electronically on the status of collateral documents, particularly the collateral positions of borrower banks and end-borrowers.

8. Introduce alternative savings and investment products through the following specific reforms:

- a) Encourage voluntary personal savings and investments through the establishment of a multi-pillar retirement income structure as embodied in the provisions of Personal Equity and Retirement Account Act of 2008 or PERA

Law (RA 9505) enacted on August 22, 2008.

- b) Address the needs of the resurgent real estate industry by providing funds for infrastructure projects, widening access to investment in real estate projects, broadening the participation of the public, including OFs, in the ownership of real estate, and protecting the investing public from abuses of real estate investment trusts pursuant to provisions of the Real Estate Investment Trust or REIT Act of 2009 (RA 9856).

9. Establish a policy framework in support of the government’s social agenda of reducing poverty through mandated credit to certain sectors of the economy such as MSMEs and the agriculture sector.

Specific reform strategies shall be pursued to:

- a) Strengthen and encourage the growth and development of micro, small, and medium-sized enterprises (MSMEs) in all productive sectors of the economy, particularly rural and agrobased enterprises, through the effective implementation of the Magna Carta for MSMEs (RA 6977, as amended).
- b) Enhance the access of the rural agricultural sector to financial services and programs that increase market efficiency and promote modernization in the rural agricultural sector through the implementation of the Agri-Agra Reform Credit Act of 2009 (RA

10000), passed into law on February 23, 2010.

10. Expand investor and creditor protection mechanisms cognizant of recent demands of modern banking and finance standards through the following specific reform measures:

- a) Introduce improvements in company registration and monitoring rules or procedures, including the institution of stiffer penalties for corporate malfeasance through the amendment of the Corporation Code of the Philippines (BP 68); and
- b) Ensure an effective and efficient rehabilitation of liquidation of debtors as embodied in the Financial Rehabilitation and Insolvency Act (FRIA) of 2010 or RA 10142 which was lapsed³⁴ into law on July 19, 2010.

11. Empowerment of Filipino consumers through strong consumer protection mechanisms and financial literacy or education programs.

- a) Promote greater financial literacy of the population, including those in the countryside and OFW-rich areas abroad by encouraging the participation of nongovernment and private sector organizations in the delivery of financial education programs; and
- b) Strengthen consumer protection by improving the implementation of existing consumer protection laws and regulations on transparency, disclosure, consumer assistance and redress or grievance mechanisms.

³⁴ Op.cit.

Attachment 1 Selected Financial Stability Indicators in ASEAN-5

Country	Consolidated Capital Adequacy Ratio (CAR)	Non-performing Loan (NPL) Ratio of Commercial Banks
Indonesia	8.9 ^{1/}	3.2 ^{1/}
Malaysia	14.4	1.9 ^{1/}
Philippines	16.0 ^{3/}	3.3 ^{4/}
Singapore	16.7 ^{1/}	4.4
Thailand	16.5 ^{2/}	2.3 ^{2/}

Source: Asian Regional Integration Center, IMF and Central Bank websites

^{1/}May 2010; ^{2/}December 2009; ^{3/}As of March 2010; ^{4/}June 2010

Attachment 2 Average Income, Expenditure, Saving and Savings Rate of Families, at Current Prices by Region: 2003 and 2006

Region	2003 (in billions)				2006 (in billions)			
	Income	Expenditure	Saving	Saving Rate	Income	Expenditure	Saving	Saving Rate
Philippines	148	124	24	16.2	173	147	26	15.0
NCR	266	218	48	18.1	311	258	53	17.0
CAR	152	126	26	17.1	192	151	42	21.9
I	124	102	22	17.7	142	124	19	13.4
II	126	99	27	21.4	143	118	25	17.5
III	160	138	22	13.8	198	170	27	13.6
IV-A	184	158	26	14.1	210	186	23	11.0
IV-B	103	84	19	18.4	109	93	16	14.7
V	109	94	15	13.8	125	110	15	12.0
VI	111	98	14	12.6	130	116	14	10.8
VII	121	102	19	15.7	144	124	21	14.6
VIII	103	84	19	18.4	126	104	22	17.5
IX	93	75	18	19.4	125	99	27	21.6
X	109	91	18	16.5	142	117	25	17.6
XI	117	100	18	15.4	135	115	19	14.1
XII	113	85	28	24.8	114	96	18	15.8
XIII	90	78	12	13.3	118	100	18	15.3
ARMM	83	67	16	19.3	89	75	14	15.7

Source: National Statistics Office

Attachment 3 Regions with the Highest or Lowest Saving Rates, by FIES year

FIES Year	Highest Saving Rate	Region	Lowest Saving Rate	Region
1991	25.7	CAR	10.6	Western Visayas
1994	24.8	Eastern Visayas	9.7	Western Visayas
1997	22.9	Western Mindanao*	9.4	Western Visayas
2000	21.2	Eastern Visayas*	13.4	Bicol**
2003	21.5	Cagayan Valley	12.3	Western Visayas
2006	21.9	CAR	10.8	Western Visayas

Notes: *The saving rates of CAR in 1997 and 2000 were close to the highest rate.

**The saving rate of Western Visayas is hardly differed from the lowest rate.

Source: For 1991-2003, Bersales and Mapa (2006); for 2006, FIES data.

Attachment 4 Average Income, Expenditure, Saving and Saving Rate of Families at Current Prices by Income Decile: 2006 and 2009

	2006 (in billion pesos)				2009 (in billion pesos)			
	Income	Expenditure	Saving	Saving Rate	Income	Expenditure	Saving	Saving Rate
Philippines	173	147	26	14.8	206	176	31	14.9
First Decile	32	35	-3	-8.9	41	43	-3	-6.7
Second Decile	51	52	-2	-3.4	64	66	-2	-3.4
Third Decile	65	66	(*)	-0.9	81	81	(*)	0.0
Fourth Decile	81	79	2	2.1	100	97	3	2.7
Fifth Decile	100	95	5	4.6	122	116	6	4.4
Sixth Decile	124	116	8	6.1	150	139	11	7.2
Seventh Decile	156	143	13	8.5	189	171	18	9.2
Eighth Decile	205	181	24	11.5	244	216	28	11.5
Ninth Decile	292	244	47	16.1	342	288	53	15.7
Tenth Decile	622	460	162	26.1	728	535	193	26.5
Bottom 30%	49	51	-2	-0.0	62	64	-2	-0.0
Upper 70%	226	188	38	0.2	268	224	44	0.2

Source: National Statistics Office, 2009 FIES Preliminary Results

Attachment 5 Philippine Banking System, Deposit Mix

Deposit Liabilities	PESO DEPOSITS				FOREIGN CURRENCY DEPOSITS			
	End-June				End-June			
	2010	2009	2010	2009	2010	2009	2010	2009
Total	3,609.2	3,263.3	100.0%	100.0%	1,144.8	1,055.5	100.0%	100.0%
Time Deposits	1,015.6	999.9	28.1%	30.6%	672.9	649.2	58.8%	61.5%
Demand, NOW & Savings Deposits	2,593.5	2,263.3	71.9%	69.4%	472.0	406.2	41.2%	38.5%

Source: Bangko Sentral ng Pilipinas