The Philippine Banking System

Overview

The Philippine banking system sustained its growth momentum and managed to deliver a remarkable performance in 2016 amid lingering uncertainties in global financial markets. Key performance indicators showed further strengthening of banks’ balance sheets with double-digit growths in assets, loans, deposits and capital. During the year, banks maintained ample liquidity to meet their operational requirements and related funding needs. There was also notable rebalancing of banks’ portfolio particularly in cash and credit related accounts as banks shore up liquidity to manage potential market volatilities at the onset of rising interest rates. Banks likewise sustained their profitability arising from strong core revenue from lending activities.

The emerging banking landscape also became more streamlined, technologically responsive and inclusive in 2016 as it expands client reach to cater to the diverse needs of modern Filipino banking clients.

Industry consolidation and digital transformation gradually shaping overall landscape

Industry consolidation and digital transformation of banking services are gradually restructuring the banking system’s overall landscape into a more streamlined, technology-driven and inclusive financial ecosystem. It strives to provide efficient, reliable and affordable delivery of banking products and services to banking clients.

The BSP’s promotion of merger and consolidation in the industry led to the overall streamlining in the number of operating banks which went down to 602 banks at end-2016 (Figure 1). There were five recorded cases of mergers, acquisitions, and consolidations in 2016. Main features of industry consolidation include the strategic partnership between foreign banks and domestic banks. There are also cases where large domestic banks acquire smaller banks in frontier areas to allow the former to explore growth opportunities and business synergies. Lastly, the most common feature of industry consolidation is the merger of rural banks to improve their viability and leverage on each other’s branch network to reach a wider base of clientele. All in all, these types of industry consolidation activities helped shape the landscape of the banking system. While the BSP maintains its policy thrust on merger and consolidation, it endeavored to gradually lift the moratorium on the grant of new banking licenses or establishment of new domestic banks4. This is to provide parallel opportunities for domestic banks following the liberalization of foreign bank entry in 2014.

Since 1998, overall branch network expanded by almost 1.6 times to 10,576 branches. These branches/other offices are normally near or within shopping malls and other commercial places with heavy foot traffic. The growth was supported by the rationalization of branching guidelines which also provide banks with more flexibility in expanding their network to strategic locations.

The advent of digital banking revolutionized the provision of financial services

The rapid evolution of digital technology particularly of smart phones at the turn of the new millennium revolutionized the way banking and financial products and services are delivered. Digital technology provides unprecedented access to customers to a virtual financial services industry which in turn, allows them to perform banking transactions and make payments anytime, anywhere and at their own convenience. From a policy standpoint, these electronic service delivery channels provide a faster and more efficient alternative means to reach a wider base of clientele particularly those in rural communities.

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4 Full lifting of moratorium starts on 01 January 2018 (Circular No. 902 dated 15 February 2016).
Recognizing the upside from electronic banking in terms of expanding client reach and in improving financial access, the BSP allowed banks to engage in electronic banking as early as year 2000\(^6\). Since then, banks engaged in electronic banking grew by more than 12 times to 119 banks as of end-December 2016 from nine banks as of end-December 2000 (Figure 2). Moreover, as of end-2016, the banking system had 19,084 automated teller machines (ATMs).

Parallel to this, the guidelines allowing electronic money (e-money) as an instrument of efficient and affordable delivery of financial services to low-income households in non-urbanized and underbanked areas of the country was issued in 2009\(^6\). Electronic Money Issuers (EMIs) are encouraged to develop business models and explore outsourcing arrangements with qualified Electronic Money Network Service Providers (EMNSPs) to support the growth of e-banking and e-money in the Philippines. Two of the most popular forms of e-money in the Philippines today are SMART Money and Globe’s G-Cash. Further, the increasing use of e-money in the Philippines is exhibited by the continued rise of participating banks and e-money transactions. As of end-December 2016, net inflow of e-money transactions reached P1.1 trillion and 78.2 percent (P870.1 billion)\(^7\) of these transactions were e-money transactions coursed through banks. During the same period, there were 29 bank electronic money issuers (EMI), two non-bank EMIs, five other EMIs, and three EMNSPs (Figure 3). These pioneering regulatory innovations preceded the recent trend of regulatory sandboxes.

Bank composition and distribution remained relatively unchanged. In terms of operating head office and branches and other banking offices, universal and commercial banks held the largest share at 98.6 percent. Meanwhile, rural and cooperative banks had the most number of operating banks at 83.1 percent or 500 banks given that these are mostly one-branch types of bank. In terms of branches and other offices, universal and commercial banks had the largest share at 58.6 percent or 6,195 branches. Meanwhile, there were a total of 691 micro-banking offices (up from 540 as of end-2015), 448 regular other banking offices (down from 482) and 233 extension offices (up from 211). The expansion in branch network augments the reduction in the number of operating banks and provides more financial access points in the countryside. Details of bank composition and

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\(^{6}\) Circular No. 240 issued on 05 May 2000.


\(^{7}\) E-money transactions of electronic money issuers (EMIs) at 21.7 percent (P241.3 billion) and non-bank financial institutions (NBFIs) at 0.1 percent (P0.7 billion) accounted for the balance of 21.8 percent.
distribution are summarized in Appendix 4 and Figure 4. These banks are mostly located in highly urbanized and populous areas of the National Capital Region (NCR), CALABARZON and Central Luzon where it is economically viable to maintain a brick-and-mortar branch. Overseas, most bank branches or other offices are located in the Middle East and Asia Pacific regions, which is reflective of the strong presence of Filipino migrant workers in these regions (Appendix 4). Meanwhile, bank density ratio⁸ was maintained at seven (7) banks per city/municipality since 2015. Demographic penetration was at 16 banks per 10,000 Filipinos⁸.

**Sustained deposit inflow supported asset expansion**

The increased utilization of both traditional and non-traditional platforms boosted deposit generation, resulting in an expansion of P1,271.9 billion (13.8 percent) to P10,504.0 billion in 2016 from P9,232.0 billion in 2015 (Figure 5). The banking system has a stable funding base, as deposits are primarily peso-denominated¹⁰ and sourced mostly from resident individual depositors¹¹. Deposit liabilities were mostly in the form of savings deposits amounting to P5,217.1 billion representing a 49.7 percent share as of end-December 2016. This is followed by time deposits at P2,839.5 billion with a 27.0 percent share. Meanwhile, bulk of the total number of deposit accounts (56.2 percent) only have a deposit size of P5,000 and below aggregating to P17.1 billion. In terms of location, majority of deposits resides in the National Capital Region (NCR) (66.9 percent share), distantly followed by Cebu (4.4 percent share) and Cavite (2.1 percent share)¹².

The uptrend in deposit liabilities was supported by year-on-year (YoY) growths in domestic savings (up to 6.7 percent in December 2016) and income from abroad (up to 5.4 percent) (Figure 6). The uptick in deposit liabilities is in line with the positive outlook of consumers on the domestic economy, resulting from the perceived improvement in the peace and order situation, effective government policies, anticipated increase in salaries and availability of more jobs¹³.

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⁴ Composed of head offices, branches and other offices.
⁸ Derived/based on the latest population data from the Philippine Statistics Authority.
¹⁰ Amounted to P8,766.1 billion representing 82.7 percent share of total deposits as of end-December 2016.
¹¹ Amounted to P10,413.5 billion representing 99.2 percent share of total deposits as of end-December 2016. Composed mostly of individuals with deposits amounting to P5,066.3 billion (48.6 percent share of total resident deposits), non-financial private corporations with P3,656.9 billion (35.1 percent share) and the government with P1,207.1 billion deposits (11.6 percent).
¹² Data as of end-September 2016.
¹³ Source: 4th Quarter Consumer Expectation Survey Report.
This is contrary to the slowdown in business outlook for the 4th quarter of 2016 due to concerns over the direction of foreign policies and economic reforms, weakening global demand, foreign exchange losses of importers due to peso depreciation and lack of supply of raw materials.

Other sources of funding, albeit at a much lesser extent include bills payable and unsecured subordinated debt (UnSDs). Bills payable rose by 12.0 percent to P701.7 billion from P626.2 billion as of end-2015. On the other hand, the level of UnSDs dropped by P24.1 billion to P89.7 billion from P113.8 billion as of end-2015 driven by matured UnSDs.

Meanwhile, the BSP announced in September 2016 the adoption of the electronic clearing of checks by January 2017 which is expected to speed up the crediting of funds to depositors’ account from three to five banking days to only one banking day.

For the protection of the depositing public against counterfeit fraud or skimming attacks, the BSP implemented the migration to Europay, Mastercard and Visa (EMV) technology starting 1 January 2017. Parallel to this, the EMV Card Fraud Liability Shift Framework (ECFLSF) was enforced by the BSP. This is to recognize that a BSP-supervised Financial Institution (BSFI) that has adopted the EMV technology shall be protected from financial liability arising from losses on counterfeit card fraud. The liability of this type of fraud shall, however, shift to the BSFI which has not fully or has partially migrated to the EMV requirement. These reforms further strengthened the depositor’s confidence in the banking system.

Banks’ resources primarily allocated to lending activities

The sustained inflows of deposits funded the growth in the banking system’s total assets to P13,585.8 billion as of end-December 2016, 12.4 percent higher than the level as of end-December 2015. Of the banks’ total resources, 54.8 percent were deployed to finance lending activities as credit expansion continued in 2016. Meanwhile, cash and due from banks comprised the second largest share of total assets at 20.4 percent, overtaking financial assets which comprised 18.8 percent share (Figure 7). For the last five years, allocation of the banking system’s resources across asset classes barely changed with loans consistently cornering the largest share.

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14 Source: 4th Quarter Business Expectation Survey
15 Circular No. 924 dated 7 September 2016
16 Circular No. 936 dated 28 December 2016
Real estate activities and consumer finance were the main drivers of loan expansion

Total loan portfolio (TLP) posted a YoY growth of 16.6 percent to PHP 7,612.5 billion, higher than the 12.0 percent growth in December 2015 (Figure 8). By economic sector, real estate activities had the largest loan intake at 17.3 percent as well as the highest YoY increase in loan level at PHP 196.3 billion (Figure 9). The other economic activities with double-digit percent shares were wholesale and retail trade, manufacturing, and loans to individuals for consumption purposes which had TLP shares of 12.1 percent, 11.4 percent and 10.3 percent, respectively. Loan distribution to key economic sectors is highly reflective of related developments in the domestic economy.

The continued uptrend in both real estate and consumer loans prompts careful monitoring. Real estate exposures (REEs) went up by 19.5 percent to PHP 1,812.1 billion17, with the continued expansion driven largely by a rise in loans to both home buyers and property developers. Meanwhile, real estate loans (RELS) rose to PHP 1,549.0 billion18, more than twice the end-2012 level, but its YoY growth has decelerated (Figure 10). The preliminary results of the Real Estate Stress Test (REST) as of end-September 2016 under an assumed write-off rate of 25 percent default on REEs and other real estate property19 showed that the stressed capital adequacy ratio (CAR) and common equity tier 1 (CET1) ratio of the universal and commercial banking industry registered above the 10 percent and 6 percent minimum thresholds, respectively, on solo and consolidated bases.

On the other hand, consumer loans (CLs) expanded YoY by 19.9 percent to PHP 1,271.6 billion (Figure 11 and Table 1). Residential real estate loans made up the largest share of CLs at 40.9 percent, followed by motor vehicle loans (30.5 percent), credit card receivables (15.5 percent), salary-based general-purpose consumption loans (11.0 percent) and other consumer loans (2.1 percent). In particular, motor vehicle loans were increasing at a high rate of approximately 30 percent YoY since end-2015, outpacing the growth rate of residential RELs. According to the Chamber of Automotive Manufacturers of the Philippines, Inc. (CAMPI), sales for the automotive industry for the year 2016 grew by 24.6 percent and surpassed the industry’s target due to successful introductions of new models complemented by various events and promotions20. Automobile sales were generally driven by upbeat consumer outlook, flexible financing options and decline in prices of domestic petroleum products.

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17 As defined under Memorandum No. M-2012-046 dated 21 September 2012, REEs comprise loans as well as investments in debt and equity securities where the proceeds of the latter shall be used to finance real estate activities (consolidated basis).
18 Composed of 65.8 percent commercial RELs and 34.2 percent residential RELs.
19 This refers to land and buildings recorded in Real and Other Properties Acquired (ROPAs) and Non-Current Assets Held for Sale (NCAHS) accounts.
20 http://www.campiauto.org/2016-is-another-grand-year-for-automotive-industry-with-24-6-growth/.
Banks continued to set aside funds for MSMEs and agri-agra borrowers, with rural and cooperative banks’ compliance ratios far above the minimum

The banking system provided a total of ₱478.9 billion credit to micro, small and medium enterprises (MSMEs) in compliance with Republic Act (R.A.) No. 6977, as amended by R.A. Nos. 8289 and 9501. This resulted in the system’s overall compliance ratio of 9.0 percent, slightly lower than the required 10 percent (i.e., 8.0 percent for MSEs and 2.0 percent for MEs). (Table 2)

The banking system’s total credit allocation to MEs of ₱275.9 billion resulted in a compliance ratio of 5.2 percent which was above the required 2.0 percent. On the other hand, the banking system’s funds allocated to MSEs totaling ₱202.9 billion led to a compliance ratio of only 3.8 percent. It was noted that the rural and cooperative bank industry’s MSE compliance ratio of 22.9 percent far exceeded the 8.0 percent statutory floor.

Meanwhile, banks allocated a total of ₱435.8 billion of loanable funds for agriculture and agrarian reform credit under R.A. No. 10000 (the Agri-Agra Reform Credit Act of 2009), higher than the ₱432.7 billion level as of end-2015. However, the banking system’s 13.0 percent compliance ratio for other agricultural credit was slightly below the required 15.0 percent. Moreover, its compliance ratio for agrarian reform credit was only 1.0 percent, falling short of the required 10.0 percent for agrarian reform credit. (Table 3)

The rural and cooperative bank industry’s agrarian reform and other agricultural credit compliance ratios of 17.0 percent and 29.5 percent were far above the required ratios of 10.0 percent and 15.0 percent, respectively. As such, in spite of its minimal share in the banking system’s loan portfolio, said industry was able to cater to the needs of agri-agra as well as MSME borrowers.

The BSP has continued to pursue initiatives to usher the flow of funds to the MSME and agricultural sectors. In particular, BSP guidelines on sound credit risk management practices\(^1\) gave banks more leeway to lend to customers, including MSMEs, who are creditworthy but may not necessarily have collateral which can unduly restrict access to credit. This regulation also exempts start-up enterprises from submitting documents usually required from regular borrowers (e.g. income tax return and audited financial statement) in the first three years of their banking relationship. Moreover, alternative financing opportunities are available for the MSME

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### Table 1

Universal, Commercial and Thrift Banks
Components of Consumer Loans
(As of End-Period Indicated, Levels in Billion Pesos, Ratios in Percent)

<table>
<thead>
<tr>
<th></th>
<th>Dec 2016</th>
<th>Dec 2015</th>
<th>Year-on-Year Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Consumer Loans</strong></td>
<td>1,271.6</td>
<td>1,060.9</td>
<td>19.9%</td>
</tr>
<tr>
<td>Residential Real Estate Loans</td>
<td>519.9</td>
<td>444.0</td>
<td>17.1%</td>
</tr>
<tr>
<td>Motor Vehicle Loans</td>
<td>388.4</td>
<td>303.9</td>
<td>27.8%</td>
</tr>
<tr>
<td>Auto Loans</td>
<td>376.4</td>
<td>293.4</td>
<td>28.3%</td>
</tr>
<tr>
<td>Motorcycle Loans</td>
<td>11.9</td>
<td>10.4</td>
<td>14.2%</td>
</tr>
<tr>
<td>Credit Card Receivables</td>
<td>197.7</td>
<td>179.3</td>
<td>10.3%</td>
</tr>
<tr>
<td>Salary-Based General-Purpose</td>
<td>139.5</td>
<td>104.3</td>
<td>33.7%</td>
</tr>
<tr>
<td>Consumption Loans</td>
<td>26.2</td>
<td>29.4</td>
<td>-10.9%</td>
</tr>
<tr>
<td>Other Consumer Loans</td>
<td>2.4</td>
<td>1.9</td>
<td>20.2%</td>
</tr>
</tbody>
</table>

### Table 2

Philippine Banking System
Compliance with the Mandatory Credit Allocation to MSMEs\(^2\)
(As of End-December 2016)\(^3\)
(Levels in Billion Pesos, Ratios in Percent)

<table>
<thead>
<tr>
<th></th>
<th>All Banks</th>
<th>U/KBs</th>
<th>TBs</th>
<th>RCBs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Loan Portfolio Net of Exclusions</td>
<td>5,292.5</td>
<td>4,521.7</td>
<td>670.7</td>
<td>100.0</td>
</tr>
</tbody>
</table>

**Minimum Amount Required to be Allocated for:**
- Micro and Small Enterprises (MSEs): Credit (8%)
  - Minimum Required: 423.4
- Medium Enterprises (MEs): Credit (2%)
  - Minimum Required: 105.9
- Total: 529.3

**Percentage of Compliance for MSEs:**
- Total compliance: 202.9
- Percentage of Compliance for MSEs: 3.8%
- Percentage of Compliance for MEs: 4.9%
- Total: 5.2%

**Percentage of Compliance for MSMEs:**
- Total compliance: 478.9
- Percentage of Compliance for MSMEs: 9.0%

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1. Required under R.A. No. 10000 (the Agri-Agra Reform Credit Act of 2009)
2. Preliminary. Subsidiary data as of end-September 2016
3. As of end-December 2016
sector with the Credit Surety Fund (CSF) Program. This was institutionalized through the passage of CSF Cooperative Act of 2015 (R.A. No. 10744) on 6 February 2016. The CSF assists unbankable MSMEs gain access to formal sources of credit by allowing MSMEs which are members of cooperatives to borrow from banks using the CSF surety cover as security for the loan in lieu of conventional collateral; thus easing difficulties in obtaining loans due to lack of acceptable collateral, credit knowledge and credit track record.

The BSP likewise adopted the agricultural value chain financing (AVCF) framework to facilitate financing to agricultural sector. The AVCF encourages linkages among various players in an agricultural value chain, thereby reducing the credit risk of participating farmers and facilitating their access to credit.

**Loan quality was maintained despite continued loan growth**

With the continued growth in the banking system’s loan portfolio, it was observed that the level of non-performing loans (NPLs) also increased to P144.8 billion from P136.8 billion as of end-2015. Nonetheless, the loan quality of the banking system remained satisfactory as the NPL ratio stood at 1.9 percent at end-2016 compared to 2.1 percent at end-2015. The non-performing REL ratio was likewise kept low at 1.9 percent. The quality of total CLs also improved to 3.9 percent from 4.5 percent at end-2015.

Non-performing assets (NPAs) declined to P255.1 billion due to the downward trend in ROPA. The NPA ratio improved to 1.8 percent from 2.0 percent at end-2015. Lastly, the banking system is steadily increasing its buffer for credit losses as evidenced by better NPL coverage ratio of 119.4 percent (from 118.0 percent) and NPA coverage ratio of 80.4 percent (from 77.1 percent). Comparative asset quality indicators by category of banks is summarized in Table 4.

**Rebalancing investment portfolio mitigated the impact of rising interest rates**

Banks’ gross financial assets went up by 3.9 percent YoY to P2,590.7 billion. These were largely composed of held-to-maturity (HTM) financial assets (P1,254.0 billion) and available-for-sale (AFS) securities (P1,038.0 billion) with shares of 48.4 percent and 40.1 percent, respectively. Financial assets held-for-trading (HFT) and unquoted debt securities classified as loans (UDSCL) stood at P168.3 billion (6.5 percent) and P106.4 billion (4.1 percent), respectively. It was observed that banks are shifting their portfolio from trading to non-trading securities. In particular, securities booked under HTM have been on an uptrend since end-2013 (Figure 12). This investment strategy intends to shield the banking system’s balance sheet from mark-to-market (MTM) losses as a result of interest rate fluctuations.

Portfolio investments of universal, commercial and thrift banks were mostly peso-denominated aggregating to P1,360.9 billion (52.8 percent share) while the dollar-denominated investments reached P1,217.4 billion (47.2 percent share). In terms of counterparty, banks invested in securities issued by the Philippine National Government which accounted for a sizeable share of 65.7 percent (P1,694.2 billion). This was followed by resident corporations at 11.1 percent (P286.6 billion) and non-resident central government/banks at 8.2 percent (P210.3 billion).

Amid market volatilities, banks are building up liquidity in the form of cash and due from banks which rose by 11.9 percent to P2,765.2 billion. The growth was largely driven by the increase in banks’ funds placed in the BSP’s liquidity facilities. In

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**Table 4**

<table>
<thead>
<tr>
<th>Philippine Banking System</th>
<th>Comparative NPL, NPA &amp; Coverage Ratios</th>
<th>As of December 2016</th>
<th>(In Percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Gross NPL Ratio</td>
<td>NPA Ratio</td>
<td>Coverage Ratios</td>
</tr>
<tr>
<td>All Banks</td>
<td>1.9%</td>
<td>1.8%</td>
<td>119.4%</td>
</tr>
<tr>
<td>Universal and Commercial Banks</td>
<td>1.4%</td>
<td>1.4%</td>
<td>144.7%</td>
</tr>
<tr>
<td>Thrift Banks</td>
<td>4.7%</td>
<td>5.3%</td>
<td>73.0%</td>
</tr>
<tr>
<td>Rural and Cooperative Banks</td>
<td>11.2%</td>
<td>11.0%</td>
<td>73.0%</td>
</tr>
</tbody>
</table>

* Preliminary. Data for rural and cooperative banks as of end-September 2016

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23 Circular No. 908 dated 14 March 2016
24 Other than loans and equity investment in subsidiaries, associates and joint ventures.
25 Booked under foreign regular, FCDU/EFCDU and foreign offices.
26 Other counterparties include non-resident banks at 6.9 percent (P176.5 billion), non-resident corporations at 3.1 percent (P80.0 billion), Philippine government-owned and controlled corporations at 2.8 percent (P73.0 billion) and resident banks at 1.1 percent (P28.6 billion). Minimal shares were posted by non-resident public sector entities, resident individuals, the BSP, Philippine local government units and multilateral agencies totaling 1.1 percent (P29.1 billion).
and liabilities propelled the growth in non-interest income. This combined uptrend tempered the P2.4 billion drop in gains from sale/derecognition of non-financial assets, specifically in ROPA\textsuperscript{28}. Meanwhile, fees and commission has sustained its build up, increasing by as much as P4.8 billion (6.9 percent) to P74.7 billion from P69.9 billion at end-2015\textsuperscript{29}.

Further investments in technology allowed banks to improve their operational efficiencies as cost-to-income (CTI) ratio stood at 63.6 percent from 64.5 percent in 2015. Accordingly, sustained profitability provided better returns to shareholders as return to equity (ROE) rose to 10.5 percent in 2016.

**Banking system capitalization registered at comfortable level**

The sustained profitability of the system supported the build-up of banks’ capitalization. In particular, the P109.3 billion spike in retained earnings and undivided profit fueled the uptrend in total capital accounts to P1,547.6 billion from P1,402.8 billion as of end-2015. Capital raising activities totaling P50.7 billion by several universal and commercial banks that occurred during the year also contributed to the rise in total capital. Meanwhile, reflecting the volatile market conditions, other comprehensive income is still at a loss at P34.4 billion from P18.5 billion at end-2015.

**CAR of U/KBs stabilized following several quarters of erratic movement**

The Philippine banking system registered a risk-based capital adequacy ratio (CAR) of 15.6 percent as of end-September 2016. With respect to the Basel III framework, U/KBs’ CAR stabilized to 15.4 percent on solo basis and 16.1 percent on consolidated basis, following several quarters of erratic movement in the CAR, resulting from volatile financial markets, aggressive lending strategies and initial stabilization impact of Basel III implementation (Figure 14). The minimal change in the CAR for this quarter ensued as the growth in total qualifying capital (TQC) from higher profits was nearly matched

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\textsuperscript{26} Year-on-Year (Y-o-Y) growth of P36.5 billion or 10.6 percent.

\textsuperscript{27} Increased by 48.2 percent to P25.2 billion from P17.0 billion at end-2015.

\textsuperscript{28} To P8.0 billion from P10.6 billion at end-2015

\textsuperscript{29} Stemming from the P5.3 billion hike in other fees and commissions
by the expansion in risk-weighted assets (RWA) from new corporate loans for the period.

TQC of U/KBs slightly went up by 2.3 percent to P1,337.8 billion at end-September 2016 from P1,308.3 billion last end-June 2016 on consolidated basis 10 (Figure 15). A notable driver to the increase in TQC was the hike in retained earnings and undivided profits. Meanwhile, Common Equity Tier 1 (CET1) capital, the most loss absorbing form of capital, comprised almost all of TQC as the CET1 ratio stood at 14.2 percent on consolidated basis 11. Several banks have continued efforts to expand their CET1 capital through capital infusion, further supporting the industry from unexpected losses in times of market stress.

As of end-September 2016, RWA of U/KBs grew quarter-on-quarter to P8,285.2 billion from P8,115.6 billion 12 (Figure 16). This expansion was mainly due to the rise in the loan portfolio, most of which are 100 percent risk-weighted and attributed to new corporate loans in the third quarter of 2016. On the other hand, market RWA slid this quarter due to the sale of securities and lower outstanding non-deliverable forwards (NDF) transactions. Meanwhile, on consolidated basis, credit RWA accounted for a substantial 87.8 percent of total RWA at P7,278.3 billion, followed by operational RWA with a 9.5 percent share or P783.1 billion and market RWA with a 2.7 percent share or P223.9 billion.

Overall, the banking system remained well-capitalized. There is high-quality of capital instruments in the system composed primarily of common equity and retained earnings. However, the CAR of the industry may decelerate moving forward on account of the growth in RWA from the sustained increase in the industry’s loan portfolio. This warrants close monitoring as this may signal a faster-paced growth in banks’ risk-taking activities vis-à-vis their capital build-up exercise.

Nonetheless, there are other Basel III reforms in place to provide support to the risk-based capital adequacy framework, as follows: (1) a 6.0 percent capital conservation buffer; (2) a loss absorbency at the point of non-viability (PONV) requirement 23 for Additional Tier 1 and Tier 2 capital; and (3) a Domestic Systemically Important Banks (DSIBs) framework 34.

As a backstop measure, the BSP will also implement the Basel III leverage ratio 35, a non-risk based measure designed to restrict the build-up of excessive leverage in the banking sector and avoid deleveraging processes that can destabilize the broader financial system and the economy 36. Compliance with the prescribed leverage ratio is being monitored as early as end-2014. The preliminary Basel III leverage ratio reported by industry, ranging from 7.42 percent to 8.43 percent, on solo basis, and 8.18 percent to 9.08 percent, on consolidated basis, were consistently above the BSP regulatory threshold of 5.0 percent and the international minimum of 3.0 percent.

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10 TQC on solo basis stood at P1,141.3 billion as of end-September 2016.
11 CET1 ratio on solo basis stood at 13.4 percent as of end-September 2016.
12 RWA on solo basis stood at P7,411.4 billion as of end-September 2016.
13 Circular No. 768 dated 21 September 2012. Loss Absorbency ensures that debt instruments which qualify as capital under Basel III will be subjected to losses before any public sector funds are injected and taxpayers are expected to said losses. Effectively, these debt instruments are pari passu with equity as far as treatment of losses from operations is concerned.
14 Circular No. 856 dated 29 October 2014.
15 Circular No. 881 dated 09 June 2015. The monitoring period of the Basel III Leverage Ratio was extended until 31 December 2017 on account of the revisions to the Basel III Leverage Ratio framework by the Basel Committee on Banking Supervision (Circular No. 943 dated 26 January 2017).
16 BCBS press release of 12 January 2014 on BCBS (2014a), Basel III leverage ratio framework and disclosure requirements (http://www.bis.org/publ/bcbs270.htm).
Off-Balance Sheet Activities Expanded

Trust department and commitment transactions fueled the 4.7 percent year-on-year growth in contingent accounts

The banking system’s contingent accounts which accounted for 49.1 percent of on-balance sheet assets, went up by 4.7 percent to P6,665.2 billion as of end-2016 (Table 5). Trust department accounts and commitment transactions fueled the 4.7 percent year-on-year growth in off-balance sheet assets of banks.

The trend of the off-balance sheet activities of banks leveled off as of end-December 2016 (Figure 17). For the period, the notable P197.9 billion decline in derivative instruments was partly offset by the expansion in commitment transactions and bank guarantees amounting to P156.4 billion and P30.0 billion, respectively.

Off-balance sheet accounts of banks were comprised of: trust department accounts (42.7 percent), derivatives instruments (35.7 percent), commitments (15.2 percent), bank guarantees (4.1 percent) and trade related accounts (2.3 percent). The movement in the trust department accounts will be discussed in a separate section of this Report.

Notional value of derivatives eased due to the drop in foreign exchange contracts

Total notional value of derivatives transactions37 stood at P2,380.5 billion, down by 7.7 percent or P197.9 billion from P2,578.5 billion as of end-2015 (Figure 18). This easing was due to the 17.9 percent (P288.9 billion) drop in foreign exchange contracts, primarily from a downtrend in forward foreign exchange contracts. Over time, foreign exchange contracts account for majority of derivative transactions. However, its trend is noticeably erratic, relative to the low but relatively flat interest rate contracts. Meantime, the breakdown of derivative transactions in December 2016 is as follows: foreign exchange contracts at P1,329.0 billion with 55.8 percent share (from P1,617.9 billion with 62.7 percent share as of end-2015), interest rate contracts at P1,037.2 billion with 43.6 percent share (from P956.1 billion with 37.1 percent share) and credit derivatives at P14.3 billion with 0.6 percent share (from P4.5 billion and 0.2 percent share).

---

37 Notional Amounts of Derivatives Held For Trading (Stand-Alone and Embedded).
The depreciation of the peso against the dollar significantly affected foreign exchange contracts for the year (Figure 19). Although still accounting for majority of foreign exchange contracts (70.1 percent share), forward foreign exchange contracts dropped by P292.0 billion to P931.4 billion. The same trend is also evident in the P24.5 billion slide in currency swaps to P304.8 billion (22.9 percent share).

The uptrend in both credit card lines and other commitments propelled the increase in total commitments

Total commitments widened by 18.3 percent to P1,011.3 billion from P854.9 billion as of end-2015, propelled by the uptrend in credit card lines by 20.5 percent or P91.7 billion to P539.9 billion and other commitments by 15.5 percent or P63.2 billion to P469.9 billion (Figure 20). The hike in credit card lines is aligned with the growing demand for credit card as seen in the rising credit card receivables reported during the period.

Growth in bank guarantees buoyed by performance stand-by LCs

Bank guarantees climbed by 12.2 percent to P275.2 billion from P245.2 billion as of end-2015 (Figure 21). This increment was mainly due to the P30.5 billion or 14.0 percent rise in stand-by letters of credit (LCs), particularly performance stand-by LCs in December 2016. In terms of composition, bank guarantees were primarily made up of stand-by LCs (89.9 percent share) with the remaining share arising from outstanding guarantees (10.1 percent share).

Similar to the growth in levels of performance stand-by LCs, other trade-related contingent accounts posted an 18.8 percent increase to P155.1 billion as of end-December 2016. Foreign commercial LCs continued to account for majority of the trade-related accounts (Figure 22).

---

38 All transaction types of forward foreign exchange contracts fell in December 2016, specifically outright forwards by P159.1 billion to P268.2 billion, forward legs of swaps by P132.6 billion to P622.9 billion and non-deliverable forwards by P0.3 billion to P40.4 billion.
39 Accounting for 22.9 percent of foreign exchange contracts; the remaining 7.0 share is held by over the counter and exchange traded foreign exchange options contract at P92.8 billion.
40 Normally refer to banks’ underwritten accounts sold, committed credit lines for commercial papers issued, credit card lines and other types of off-balance sheet commitments.
41 Credit card lines are unused portions of all commitments to extend credit both to individuals for household, family and other personal expenditures as well as to commercial and industrial enterprises through credit cards.
42 Credit card receivables grew by 10.3 percent to P197.7 billion as of end-2016 from P179.3 billion as of end-2015.
Trust Operations

Overview

The expansion of the unit investment trust fund (UITF) portfolio with the 23.0 percent growth in 2016 bolstered the trust industry’s dynamism. This resulted in the industry’s resilient performance in 2016 which recorded a double-digit growth in resources to P2,961.0 billion, 10.8 percent higher than in 2015. The trust industry’s resources represented 21.8 percent of the total assets of the Philippine banking system.

Changing Landscape of the Trust Industry

Total number of financial institutions (FIs) with active trust operations declined to 37 from 40. In an effort to clean up FIs with dormant trust license, three industry players have surrendered their trust license in 2016. The complete transfer of the trust department accounts of Planters Development Bank was made in 2016 following the corporate merger with the China Bank Savings, Inc. which was approved on 17 December 2015.

With the effectivity of Circular No. 884 dated 22 July 2015 providing the guidelines for the establishment and operations of trust corporation, two institutional players spun-off their trust departments to establish trust corporations. This shows preference of some industry players to establish separate trust entities with their own capital and management structure. These trust corporations are required to have a minimum capitalization of P100 million at inception, to which they are provided a five-year transition period to increase their capital to P300 million. They will also have their own management structure and strategic plan. These entities will not be subject to the credit-related controls applicable to bank operations such as the single borrowers’ limit and limits on loan accommodations to directors, officers, stockholders and their related interests. The creation of trust corporation is a prudent policy direction which would allow for more business focus with its separate entity and management structure.

Seventeen universal banks accounted for a large share of the total trust assets at 83.3 percent (P2,466.6 billion). A distant second were the eight (8) commercial banks with 11.4 percent (P337.2 billion), followed by five (5) NBFI (4 investment house and 1 trust corporation), which held 4.0 percent (P118.0 billion), and lastly, seven (7) thrift banks (TBs) holding 1.3 percent (P39.3 billion) (Figure 23).

Figure 23
Trust Assets by Financial Institution
As of End-Period Indicated

<table>
<thead>
<tr>
<th>Name of Financial Institution (FI)</th>
<th>Effective Date of Surrender/Revocation of License</th>
<th>Type FI</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banco De Oro Savings Bank, Inc.</td>
<td>16-May-2016</td>
<td>TB</td>
</tr>
<tr>
<td>JPMorgan Chase Bank N.A. Makati Branch</td>
<td>19-May-2016</td>
<td>KB</td>
</tr>
<tr>
<td>First Metro Investment Corporation</td>
<td>12-Jan-2017</td>
<td>IH</td>
</tr>
</tbody>
</table>

Other FIs which have surrendered their trust license which is currently under valuation by the BSP include BPI Family Savings Bank, BPI Capital Corporation, Optimum Development Bank and Security Bank Savings Corporation.

Circular Letter No. CL-2016-010 dated 10 February 2016

The following banks made spin-off of their trust department to create separate trust corporations:

<table>
<thead>
<tr>
<th>Name of Bank</th>
<th>BSP Certificate of Authority</th>
<th>Name of Trust Corporation</th>
<th>Date of Operation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maybank ATP Kim Eng Capital Partners, Inc.</td>
<td>30-Sep-2016</td>
<td>ATMAM Trust Corporation</td>
<td>23-Nov-2016</td>
</tr>
<tr>
<td>Bank of the Philippine Islands</td>
<td>29-Dec-2016</td>
<td>BPI Asset Management and Trust Corporation</td>
<td>5-Feb-2017</td>
</tr>
</tbody>
</table>
UITFs as main driver of growth

Trust accountabilities continued its uptrend since 2013 registering a 10.8 percent year-on-year growth to reach the P2,961.0 billion as of end-December 2016 (Figure 24). The expansion in total accountabilities was mainly driven by the 10.0 percent year-on-year increase (or P156.2 billion) in trust accounts to achieve the P1,715.3 billion level. The year-on-year growth of P83.8 billion (10.5 percent) and P51.5 billion (16.6 percent) in agency accounts and other fiduciary services, respectively, supported further the increase in trust accountabilities.

The growth in trust accounts was driven mainly by the UITFs which posted a double-digit growth of 23.0 percent, or by P158.6 billion, to reach P847.7 billion (Figure 25). This reflects the industry’s innovation in providing features and structures of UITFs that suit investors’ appetite. There are various types of UITF that are now available in the market which include, among others, feeder funds, multi-class UITFs and UITF with unit-paying feature allows for a non-guaranteed stream of income to its participants. Expansion of UITFs came mostly from the U/KBs which grew by 23.8 percent (P160.9 billion) to P836.1 billion compared in 2015. This portfolio represents 29.8 percent of total trust accounts of U/KBs.

Resilient asset growth despite constrained access to BSP deposit facilities

Despite the restriction of access to BSP deposit facilities, the total assets of the trust industry reached P2,961.0 billion, or 10.8 percent higher than in 2015. Expanding trust assets reflect the industry’s flexibility in finding alternative investment outlets (Figure 26).

Since 2014, trust accounts and UITFs were allowed access to the BSP facilities’ until the issuance of Memorandum No. M-2016-016. This regulation discontinued the access of all trust entities to the BSP deposit facilities with expectation that they wind down their outstanding placements in the ODF and TDF by 30 June 2017. The regulation reinforces that the BSP deposit facilities serve as a monetary policy instruments for managing domestic liquidity and are not intended to become investment outlet by banks and trust entities.

Figure 26
Composition of Trust Assets
As of End-Period Indicated

Since 2014, trust accounts and UITFs were allowed access to the BSP facilities’ until the issuance of Memorandum No. M-2016-016. This regulation discontinued the access of all trust entities to the BSP deposit facilities with expectation that they wind down their outstanding placements in the ODF and TDF by 30 June 2017. The regulation reinforces that the BSP deposit facilities serve as a monetary policy instruments for managing domestic liquidity and are not intended to become investment outlet by banks and trust entities.

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46 This refers to the Special Deposit Account (SDA) which was replaced by the Term Deposit Facility (TDF) and the Overnight Deposit Facility (ODF) under the Interest Rate Corridor (IRC) System as provided under Circular No. 913 dated 2 June 2016.
The deposits in banks posted substantial increase by 36.2 percent (P193.7 billion) which more than countered the decline in cash and due from BSP by 25.3 percent (P97.1 billion). Deposits in banks of P729.3 billion at the end of 2016 is the highest recorded level since end-December 2012 (Figure 27).

In terms of assets, there also remains to be a high concentration on equities. Investments in equity securities grew by P76.0 billion (10.7 percent) to P789.5 billion in 2016, indicating less risk aversion and greater preference for higher yield amid the relatively stable macroeconomic environment and generally low interest rate environment.

By type of financial institution, the asset mix reflected the varying approaches and risk appetite of U/KBs, TBs and NBFIs (Figure 28). It is notable that bulk of their resources are in financial assets with growing deposits in banks.

The industry NPL ratio climbed to 1.2 percent while the gross loans declined to P69.6 billion as of end-December 2016. However, this poses manageable risk to the industry given that the loan portfolio represents only 2.3 percent of total resources.

**The industry recorded a slight reduction in net income**

Net income from trust slid to P5.4 billion, 5.3 percent (P0.3 billion) less than in year 2015 as expenses grew by 6.0 percent (P0.2 billion) during the same period. In particular, other administrative expenses went up to P0.6 billion (17.7 percent) from last year. Meanwhile, fees and commissions slightly went down by 0.1 percent due to a reduction in the fees being collected in the effort to regain interest in trust accounts. Higher indirect expenses (16.4 percent), other expenses (13.3 percent), and compensation (3.0 percent) likewise pulled down income.

The industry trust income is equivalent to 3.5 percent of the total net income of the Philippine banking system for the period under review.
Foreign Currency Deposit Unit (FCDU) System

Overview

The resources of the Foreign Currency Deposit Unit (FCDU) of banks have been steadily increasing for the past five (5) years. In 2016, FCDU assets expanded by 9.4 percent year-on-year to $48.2 billion. FCDU funding remained stable with strong depositors’ base which are mostly residents. Net profits significantly improved at $1.1 billion, posting a 39.9 percent year-on-year growth.

As of end-December 2016, there were 79 banks with FCDU authority. A total of 39 universal and commercial banks (U/KBs) have an expanded FCDU (EFCDU) authority, while the remaining three U/KBs, 25 thrift banks (TBs) and 12 rural and cooperative banks (R/CBs) have FCDU authorities. Under the Manual of Regulations on Foreign Exchange Transactions (FX Manual), banks with FCDU authority can perform the allowable transactions in any acceptable foreign currency.

Funding remained stable with strong deposit mix

The FCDU system sourced majority of its funds from deposit liabilities, which accounted for 74.4 percent of total FCDU assets (Figure 29). FCDU deposits increased by 10.6 percent to $35.9 billion from $32.4 billion as of end-2015. FCDU deposits accounted for 16.5 percent of the total deposit liabilities generated by the banking system. The bulk of deposits came from residents at 97.6 percent share ($35.0 billion) while the remaining 2.4 percent share ($0.9 billion) were sourced from non-resident depositors (Figure 30).

It was noted that the depositors’ profile is a mix of resident individuals with $15.5 billion deposits and private corporations with $16.7 billion deposits, adding stability to the FCDU funding. FCDU deposits also serve as additional buffer against external shocks, secondary to the country’s gross international reserves.

Other significant sources of funds were: bills payable at $7.4 billion with 15.3 percent share, followed by bonds payable at $2.0 billion with 4.2 percent share, and net due to head office at $1.1 billion with 2.3 percent share.

FCDU loans directed on financial intermediation activities

On the back of higher deposits, FCDU resources expanded by 9.4 percent to $48.2 billion (Figure 31). Total FCDU assets accounted for 17.7 percent of total system-wide assets. By banking group, U/KBs held the largest FCDU asset share at 97.3 percent, followed by TBs at 2.7 percent while R/CBs had negligible share due to their limited FCDU operations.

The assets of the FCDU system was largely comprised of financial assets of $22.3 billion (46.2 percent), loans (net) of $18.3 billion (38.0 percent), as well as cash and due from banks of $6.9 billion (14.4 percent).

The growth in assets was largely driven by lending to banks and other entities engaged in financial and insurance activities. Total FCDU loans (gross) including interbank loans receivables increased year-on-year by 15.4 percent from $16.0 billion to $18.5 billion as of end-2016.

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47 Prepared in compliance with Foreign Currency Deposit Act (Republic Act No. 6426).

48 Section 72, Authorized Transactions, FX Manual
Interbank loans grew by 36.8 percent to reach $4.5 billion which were mainly in the form of term loans at $4.1 billion (91.2 percent).

By economic activity (Figure 32), the main drivers of growth were the increased lendings to (i) financial and insurance activities ($775.6 million), (ii) electricity, gas and water supply ($171.5 million), and (iii) transportation and storage ($152.7 million). Manufacturing and wholesale/retail trade as well as public utilities have the largest loan intake at 22.7 percent and 20.8 percent, respectively. The depreciation of the peso will have an impact on these borrowers particularly if they have no organic source of US dollars.

Most of the outstanding FCDU loans were classified as medium and long-term (more than five years) loans at 62.8 percent while short-term loans represented 37.2 percent.

**FCDU investments maintained at same level while rebalancing non-trading portfolio**

The investment portfolio of the FCDU system generally remained at the $22.3 billion level which accounted for 43.4 percent of the total system-wide financial assets portfolio. Securities intended for trading (Held-For-Trading) has been declining since 2014. There was also a rebalancing of non-trading portfolio as available for sale (AFS) securities declined by $2.7 billion (26.5 percent) while held-to-maturity (HTM) securities increased by $2.8 billion (29.1 percent) (Figure 33). The growth in HTM securities intends to safeguard the system against mark-to-market losses in anticipation of the US fed rate hike.

The bulk of FCDU investments of banks were debt securities issued by the (i) National Government amounting to $9.6 billion, (ii) non-residents including multilateral agencies at $9.1 billion, and (iii) non-bank corporations at $2.3 billion (Figure 34). Banks with FCDU authority continued to hold foreign currency denominated sovereign debt securities or ROPs and non-resident-issued securities as shown in the respective increases in these portfolio at 4.2 percent and 3.1 percent, respectively.
Liquidity remained ample

Taken all together, the liquidity position of banks’ FCDU is sufficient during the review period. Liquid assets-to-deposits ratio and loans-to-deposits ratio stood at 81.4 percent and 51.5 percent, respectively.

As of end-September 2016\(^{50}\), banks with E/FCDU authority generally complied with the required 100 percent asset cover for their foreign exchange liabilities. The average and median asset cover ratios stood at 101.5 percent and 101.0 percent, respectively. Generally, the same set of banks were also compliant with the 30 percent liquid assets cover requirement.

In view of the adoption of the Liquidity Coverage Ratio starting 1 January 2018, the 30 percent liquid assets cover shall be lifted for U/KBs\(^{51}\).

FCDUs reported a significant increase in profits

Net profits for the year ended 31 December 2016 registered at $1.1 billion which is 39.9 percent higher than the 2015 recorded income (Figure 35). The $302.0 million growth in the bottom-line figure was largely driven by the gains realized from the sale of trading ($118.1 million) and non-trading financial assets ($336.2 million). Contributing further to said net earnings was the $8.9 million increase in net interest income.

As a result, return on assets (ROA) improved to 2.3 percent from 1.8 percent in 2015. Net interest margin (NIM), however, slightly eased to 1.6 percent from 1.7 percent in 2015.

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50 56 out 60 banks with reported E/FCDU transactions for the third quarter.

51 BSP Circular 946 dated 17 February 2017, Amendments to Liquidity Floor and FCDU Regulations.
Foreign Bank Branches and Subsidiaries

Overview

The Philippines continued to be a sweet investment spot for foreign banks in the Asian region primarily due to its strong economic fundamentals and growth potential. Foreign bank branches (FBBs) and subsidiaries fared better in 2016 despite the presence of global headwinds. Aggregate resources expanded by 6.8 percent compared to 4.5 percent contraction in end-2015. These were mainly backed up by new deposits generated and fresh funds injected by existing and new foreign players. Foreign banks displayed significant increase in net profits as it spiked to P11.2 billion in end-2016 from P5.9 billion in end-2015. Banking risks are manageable as shown by asset quality, liquidity and solvency indicators.

Most FBBs and subsidiaries originated from Asia

As of end-December 2016, there were 25 foreign banks which were authorized to operate in the Philippines (Figure 36).

There were two new foreign bank entrants in the Philippines pursuant to Republic Act (R.A.) No. 10641 namely: First Commercial Bank (FCB), which established a branch, and Woori Bank, which entered into a partnership with Vicsal Development Corporation to invest in WealthBank, a Development Bank. Further, United Overseas Bank Limited, which is already operating in the Philippines under R.A. No. 7721, opted to convert its mode of entry to a branch with commercial banking license from a subsidiary mode with thrift banking license.

Majority of FBBs and subsidiaries originated from the Asia-Pacific region, most of which are from Taiwan and Korea (Figure 37). The number is seen to further increase due to the potential entry of Qualified ASEAN Banks under the ASEAN Banking Integration Framework (ABIF). It may be recalled that in March 2016, the BSP and Bank Negara Malaysia signed the Heads of Agreements which contain the guidelines pertaining to the entry of QABs between the two countries.52 Outside this regional integration initiative, there are more foreign banks that signified interest to establish presence in the Philippines due to its sound macroeconomic fundamentals and stable growth prospects.

Figure 36
Foreign Bank Branches and Subsidiaries
Composition
As of End-December 2016

<table>
<thead>
<tr>
<th>By Bank Category</th>
<th>Branch</th>
<th>Subsidiary</th>
</tr>
</thead>
<tbody>
<tr>
<td>Universal Bank</td>
<td>6</td>
<td>-</td>
</tr>
<tr>
<td>Commercial Bank</td>
<td>14</td>
<td>2</td>
</tr>
<tr>
<td>Thrift Bank</td>
<td>-</td>
<td>3</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>20</td>
<td>5</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>By Mode of Entry</th>
<th>Branch</th>
<th>Subsidiary</th>
</tr>
</thead>
<tbody>
<tr>
<td>R.A. 337</td>
<td>4</td>
<td>-</td>
</tr>
<tr>
<td>R.A. 7721</td>
<td>10</td>
<td>3 1/2</td>
</tr>
<tr>
<td>R.A. 10641</td>
<td>6 1/2</td>
<td>2 1/2</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>20</td>
<td>5</td>
</tr>
</tbody>
</table>

1. The United Overseas Bank Philippines (UOBP) converted its mode of entry from a subsidiary to a branch of United Overseas Bank Limited. UOBP ceased operations as a thrift bank on 03 January 2016.
3. This includes WealthBank, A Development Bank, wherein 51 percent of its voting stock was acquired by Woori Bank.

Figure 37
Foreign Bank Branches and Subsidiaries
Country of Origin
As of End-December 2016

52 The Bangko Sentral ng Pilipinas (BSP) concluded the ABIF negotiations with Bank Negara Malaysia with the signing of the Declaration of Conclusions of Negotiations. The BSP and the Bank of Thailand also signed a Letter of Intent to begin bilateral discussions in line with the ABIF. These were done at a ceremony on 6 April 2017 at Mactan Island, Cebu.
Following is the list of foreign banks approved by the BSP to operate in the country since the implementation of R.A. No. 10641 in 2014:

Figure 38
Foreign Bank Branches and Subsidiaries
Newly Approved Foreign Banks in the Philippines
Under R.A. No. 10641
As of End-December 2016

<table>
<thead>
<tr>
<th>Name of Bank</th>
<th>Country</th>
<th>Type of Bank</th>
<th>Mode of Operation</th>
<th>First Day of Operation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Sumitomo Mitsui Banking Corporation</td>
<td>Japan</td>
<td>KB</td>
<td>Branch</td>
<td>3-Sep-15</td>
</tr>
<tr>
<td>2. Cathay United Bank Co., Ltd.</td>
<td>Taiwan</td>
<td>KB</td>
<td>Branch</td>
<td>2-Oct-15</td>
</tr>
<tr>
<td>4. Industrial Bank of Korea</td>
<td>Korea</td>
<td>KB</td>
<td>Branch</td>
<td>6-Nov-15</td>
</tr>
<tr>
<td>5. United Overseas Bank</td>
<td>Singapore</td>
<td>KB</td>
<td>Branch</td>
<td>4-Jan-16</td>
</tr>
<tr>
<td>6. Yuanta Commercial Bank Co. Ltd.</td>
<td>Taiwan</td>
<td>TB</td>
<td>Acquisition of a TB</td>
<td>(existing)</td>
</tr>
<tr>
<td>7. Woori Bank</td>
<td>Korea</td>
<td>TB</td>
<td>Acquisition of a TB</td>
<td>(existing)</td>
</tr>
<tr>
<td>8. First Commercial Bank</td>
<td>Taiwan</td>
<td>KB</td>
<td>Branch</td>
<td>16-Dec-16</td>
</tr>
<tr>
<td>9. Nha Nian Commercial Bank</td>
<td>Taiwan</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*The list was approved by the Monetary Board on 1 September 2014. The bank is currently completing its pre-operating requirements.*

**Funding principally came from deposits**

Deposit liabilities remained the principal source of funding by foreign banks. This accounted for 62.7 percent of total resources (up from 60.4 percent in 2015), followed by capital funds at 14.9 percent (up from 14.3 percent in 2015). Meanwhile, the percentage share to total assets of “Net due to HO/Branches/Agencies Abroad” and other liabilities declined to 11.6 percent and 7.9 percent, respectively (Figure 39).

Level of deposits rose by 10.8 percent (P64.6 billion) from P597.1 billion as of end-December 2015. This can be attributed to the 17.8 percent growth in savings deposits (P299.1 billion from P253.8 billion in 2015) followed by time deposits with year-on-year increase of 7.9 percent (P131.5 billion from P121.9 billion in 2015). By type of depositors, private corporations held the lion’s share at 66.9 percent followed by individuals at 23.1 percent.

While there was a reduction in the “Net Due To HO/Branches/Agencies Abroad” account, this serves as an additional source of funds of FBBs from their respective head offices or other branches abroad which came in the form of borrowings or deposit placements.

**Assets expanded but aggregate share to system-wide resources declined**

The total resources expanded by 6.8 percent to P1,055.1 billion as of end-December 2016 (from P987.8 billion as of end-2015). Despite this expansion, the aggregate share of foreign banks in the total assets of the Philippine banking system slid to 7.8 percent as of end-2016 from last year’s 8.2 percent. There is still room to accommodate greater number of foreign banks since their share remained well below the 40 percent ceiling set under Section 3 of R.A. No. 7721, as amended by R.A. No. 10641. While said Law fully liberalizes the entry of foreign banks in the Philippines, it provides safety nets such that, at least 60 percent of the banking system’s total resources shall be controlled by domestic banks which are majority-owned by Filipinos.

The assets of foreign banks were largely directed on loans and liquid assets comprised of cash, due from banks and reverse repurchase (RRP) transactions.

Credit expansion (i.e., total loan portfolio, excluding interbank loans and RRP) recorded at 6.0 percent to P366.6 billion from P345.8 billion in 2015 (Figure 40). Foreign banks continued to support the financing needs of local companies and their home country clients operating in the Philippines. Core lending activities channeled to productive sectors accounted for 69.6 percent of foreign banks’ total loan portfolio as of end-2016.

**Figure 39**
Foreign Bank Branches and Foreign Bank Subsidiaries
Major Sources of Funding
As of End-Period Indicated

<table>
<thead>
<tr>
<th>In PhP Billions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1,200.0</td>
</tr>
<tr>
<td>1,000.0</td>
</tr>
<tr>
<td>800.0</td>
</tr>
<tr>
<td>600.0</td>
</tr>
<tr>
<td>400.0</td>
</tr>
<tr>
<td>200.0</td>
</tr>
<tr>
<td>0.0</td>
</tr>
</tbody>
</table>

400
300
200
100
0

2015
2016

**Figure 40**
Foreign Bank Branches and Foreign Bank Subsidiaries
Loan Portfolio Structure by Industry Sector
As of End-Period Indicated

<table>
<thead>
<tr>
<th>Industry Sector</th>
<th>Dec 2015</th>
<th>Dec 2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td>24.7%</td>
<td>26.3%</td>
</tr>
<tr>
<td>Loans to Individuals for Consumption Purposes</td>
<td>25.3%</td>
<td>24.9%</td>
</tr>
<tr>
<td>Wholesale &amp; Retail Trade</td>
<td>9.1%</td>
<td>9.9%</td>
</tr>
<tr>
<td>Real Estate Activities</td>
<td>9.7%</td>
<td>8.5%</td>
</tr>
<tr>
<td>Financial and Insurance Services</td>
<td>6.4%</td>
<td>6.7%</td>
</tr>
<tr>
<td>Electricity, Gas, Steam and Air-Conditioning Supply</td>
<td>4.1%</td>
<td>3.3%</td>
</tr>
<tr>
<td>Other Service Activities</td>
<td>2.7%</td>
<td>2.9%</td>
</tr>
<tr>
<td>Agriculture, Forestry and Fishing</td>
<td>2.3%</td>
<td>2.2%</td>
</tr>
<tr>
<td>Transport and Storage</td>
<td>1.6%</td>
<td>1.9%</td>
</tr>
<tr>
<td>Others</td>
<td>14.1%</td>
<td>14.1%</td>
</tr>
</tbody>
</table>

*Excludes Interbank Loans and Reverse Repurchase Transactions*
The manufacturing sector has the highest loan intake cornering 26.3 percent at P96.4 billion from P85.5 billion. Lending to the manufacturing industry is very important due to its higher employment, income and output multipliers relative to other sectors. It also promotes stronger inter-industry and inter-sectional linkages, firm productivity, technological development and innovation which play a significant role in the growth of the economy.

In 2015, foreign banks’ loans were generally more focused on individuals for consumption purposes. But this was overtaken by the manufacturing sector in terms of loan intake in 2016. Consumer lending posted a 4.4 percent year-on-year growth mostly on account of the 23.6 percent (P4.7 billion) hike in motor vehicle loans to P24.6 billion. The continued strong market demand, attractive financing options, and new car variants introduced in the market translated into an upsurge in auto loans. Credit card receivables which held the largest share of foreign banks’ consumer loans at 50.7 percent decreased by 4.2 percent to P53.7 billion. On the other hand, salary-based general purpose consumer loans posted the highest increase of 84.8 percent to P7.2 billion but only occupied a minimal share of 6.8 percent as of end-2016 (Figure 41).

Foreign banks’ lending to individual consumers represented only 8.3 percent of the total P1,271.6 billion consumer loans extended by U/KBs and TBs as of end-December 2016 (Figure 42). Foreign banks’ share may increase as new entrants endeavor to penetrate the consumer market in partnership with domestic banks.

**Assets quality and liquidity stayed at satisfactory levels**

Loan quality is satisfactory as shown by lower non-performing loan (NPL) ratio at 1.2 percent compared to 1.5 percent in end-2015. The foreign banks kept the NPL and non-performing asset (NPA) coverage ratios above 100 percent at 156.7 percent and 133.8 percent, respectively. Distressed assets ratio also improved to 1.5 percent from 1.8 percent in end-2015.

FBBs and foreign bank subsidiaries were observed to be holding more liquid assets. There is the notable increase in the reported balances in cash and deposits with the BSP and other banks by 11.3 percent (P29.3 billion) and on loans and receivables arising from RRP’s with BSP and other banks by 63.1 percent (P68.9 billion).

The increase in the US Federal Reserve interest rates has negative impact on fixed income investments of banks. To protect themselves against volatilities in the fixed income market, foreign banks have reduced their holdings of financial assets. Reduction in bond holdings contributed to the P62.7 billion decline in foreign bank’s investment portfolio from P210.6 billion to P147.9 billion as of end-2016. By investment category, foreign banks’ trading portfolio significantly dropped by P39.8 billion from P90.1 billion in 2015. Also, available-for-sale and held-to-maturity securities decreased by 17.5 percent (P19.1 billion) and 47.8 percent (P4.6 billion), respectively.
Taken all together, foreign banks continue to have ample liquidity. The ratio of cash and due from banks relative to deposits remained relatively unchanged at 43.8 percent. Meanwhile, liquid assets-to-deposits ratio declined to 66.0 percent from 78.7 percent in 2015 due to lower level of financial assets. Said ratio is, however, higher compared to the banking system’s 50.7 percent.

**Foreign banks showed adequate capitalization**

Capital level of FBBs and subsidiaries grew by 11.0 percent to P156.8 billion from P141.2 billion in 2015 due to the combined effect of the P8.1 billion increase in earnings accumulated through the years as well as the P7.2 billion capital infused by both existing and new FBBs (Figure 43).

<table>
<thead>
<tr>
<th></th>
<th>End-December (in billion pesos)</th>
<th>Y-o-Y Growth Rate (in percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>141.2</td>
<td>11.0</td>
</tr>
<tr>
<td>2016</td>
<td>156.8</td>
<td></td>
</tr>
<tr>
<td>FBBs and Subs.</td>
<td>118.9</td>
<td>12.8</td>
</tr>
<tr>
<td>FBs</td>
<td>22.3</td>
<td>1.8</td>
</tr>
<tr>
<td>Subs.</td>
<td>22.7</td>
<td></td>
</tr>
</tbody>
</table>

Meanwhile, the Basel III capital adequacy ratio of FBBs at 23.1 percent and subsidiaries at 17.7 percent, on solo basis (Figure 44), were above the BSP and BIS’ thresholds of 10 percent and 8 percent, respectively, as of end-September 2016. Similarly, the respective common equity tier 1 (CET1) capital ratios, the highest quality among instruments eligible as capital, of FBBs and subsidiaries at 22.4 percent and 15.7 percent were higher than the U/KB industry CET1 capital ratio of 13.4 percent.

The total risk weighted assets (RWA) of foreign banks recorded at P645.4 billion, with percentage share as follows: credit RWA at 78.3 percent, operational RWA at 14.7 percent and market RWA at 7.0 percent.

**Higher operating income fueled foreign banks’ net profits displaying better ratios**

The net income of the industry significantly grew to P11.2 billion from P5.9 billion in 2015 (Figure 45). This was mainly driven by the substantial increase in profits from non-recurring activities recorded by four existing foreign banks.

Foreign banks generated a total operating income of P55.8 billion on account of the net interest income from loans receivables of P34.1 billion as well as non-interest income from fees and commission (P11.1 billion) and other income (P4.3 billion). This includes the fees earned from financial advisory and underwriting activities. In particular, foreign banks are instrumental in the issuance of debt/capital instruments of domestic banks, corporations and the National Government aggregating to US$4.7 billion. The P1.9 billion profits earned from foreign exchange transactions was, however, pulled down by the P1.8 billion unrealized losses from marking-to-market of derivative contracts entered into by banks.

The cost-to-income ratio of the foreign banks group improved to 67.0 percent from 70.9 percent in 2015. The foreign banks, particularly FBBs, performed better during the period under review as displayed by better return on assets (ROA) and return on equity (ROE) ratios of 1.3 percent and 8.7 percent, respectively (Figure 46).
From the P1,547.8 billion level as of end-December 2015, foreign banks’ off-balance sheet transactions\textsuperscript{53} decreased by P53.1 billion. This was mainly due to the P121.0 billion substantial decline in outstanding derivatives as of end-2016. The peso depreciation has affected foreign banks’ derivatives transactions through the reduction in foreign exchange contracts by P105.0 billion from P557.7 billion as of end-2015 and interest rate contracts by P16.0 billion from P424.7 billion a year ago.

Consistent with the growth in trade-related activities of the banking system, foreign banks facilitated trade transactions amounting to US$15.7 billion between the Philippines and other countries such as China, Japan, Thailand and United States of America.

Overall, foreign banks remained committed in their efforts to support the policy objectives\textsuperscript{54} of R.A. No. 7721, contributing to the growth of the Philippine economy.

Foreign banks sponsored or participated in various economic and trade activities where business potentials of the country were showcased and disseminated to attract more foreign investments and strengthen ties with other countries. Non-deal roadshows and forums\textsuperscript{55} were, likewise, conducted in United States and United Kingdom to bridge potential partnership between foreign and local corporations as well as to encourage investments in fixed income/securities issued by the Republic of the Philippines. These efforts contribute to the further enhancement of the country’s competitiveness in the global market.

Lastly, foreign banks continued to invest substantially in human capital in the country through the conduct of web-based trainings and seminars on the latest developments/trends in banking and finance. Through these efforts they contribute to producing and retaining competitive employees.

\textsuperscript{53} Comprised of trade-related accounts, bank guarantees, commitments, trust department accounts and derivative instruments.

\textsuperscript{54} To attract foreign investments and serve as channels for the flow of funds and investments into the economy to promote industrialization; to provide a wider variety of financial services to Philippine enterprises, households and individuals; and to contribute to the increase of employment in the country.

\textsuperscript{55} This includes the conduct of Economic Journalist Association of the Philippines – Chief Financial Officer (CFO) Forum, an annual bilateral discussion between media and pertinent CFO of the country; Commodities Asia Roadshow Forum, a commodity forum organized by financial markets team.