

# WHAT WE WE DID IN 2021:

## Three Pillars of Central Banking



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## **MANAGING INFLATION AMID SUPPLY SHOCKS (PRICE STABILITY)**

### ***Monetary Stability***

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#### **The Monetary Board (MB) maintains monetary policy settings in 2021**

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In 2021, the MB held eight monetary policy meetings and decided to maintain the BSP key policy interest rate on its overnight reverse repurchase facility at 2.0 percent. The corresponding interest rates on the overnight lending and deposit facilities were also kept steady at 2.5 percent and 1.5 percent, respectively. The reserve requirement ratios were likewise left unchanged.

The policy decisions of the MB were based on the Bank's assessment of the dynamics and risks in the inflation environment over the policy horizon. The baseline inflation forecasts for 2021 were higher than the target range since the policy meeting on 12 August 2021. The above-target inflation outlook was mainly due to higher global crude and non-oil prices, the slower-than-expected arrival of imported pork, and higher-than-expected inflation outturns during the review period. However, the projected inflation path remains within the inflation target band of 2 to 4 percent over the policy horizon. The return to the target outlook for 2022 to 2023 reflects the continued impact of the direct measures to address domestic supply shocks in meat and fish products, the

anticipated shift to favorable supply-demand conditions in the international oil market, and the predominant negative base effects by the second half of 2022.

Moreover, inflation expectations continue to be well-anchored to the target level over the same period. However, the BSP observed that the risks to the inflation outlook continue to lean toward the upside for 2022 while remaining broadly balanced for 2023. Upside risks are linked mainly to the potential impact of continuing constraints on the supply of key food items and petitions for transport fare hikes. Strong global demand amid lingering supply-chain bottlenecks could also exert further upward pressures on international commodity prices. The effective implementation of non-monetary interventions to ensure adequate domestic food supply must be sustained in order to mitigate potential supply-side pressures on inflation.

Meanwhile, the emergence of new COVID-19 variants continue to pose downside risks to the outlook for growth and inflation. Nonetheless, the BSP observed that economic growth now appears to be on firmer ground, supported by the government's accelerated vaccination program and calibrated relaxation of quarantine protocols. In particular, credit activity has gradually recovered in recent months, reflecting improved business activity and market sentiment.

On balance, the BSP sees enough scope to keep a patient hand on the BSP's policy levers owing to a manageable inflation environment. At the same time, downside risks to the economic recovery emanate from the emergence of new COVID-19 variants as well as the potential tightening of global financial conditions. Hence, preserving ongoing monetary policy support at this juncture shall help sustain the economy's momentum over the next few quarters.

Looking ahead, the BSP affirms its support for the economy while keeping an eye on the potential risks to future inflation. The BSP stands ready to respond to potential second-round effects arising from supply-side pressures, in line with its price and financial stability objectives.

## **Monetary Operations**

In 2021, total placements in the BSP's monetary facilities stood at ₱1.9 trillion compared with ₱2.0 billion in 2020. Banks' placements in the reverse repurchase (RRP) facility, overnight deposit facility, term deposit facility (TDF), and BSP Securities accounted for 15.9 percent, 37.5 percent, 32.9 percent, and 13.6 percent, respectively, of the total amount of liquidity absorbed by the BSP.

Consistent with the normalization of market conditions following the liquidity-provision measures of the BSP and in line with the practice of assessing current financial system liquidity in the conduct of its monetary operations, the average weekly total offer volume for the TDF auctions was higher at about ₱520.6 billion in 2021 relative to the ₱247.9 billion in the previous year. The average bid-to-cover ratios for the seven-day and 14-day tenors were lower at 1.3 and 1.2 compared

with 1.6 and 1.6, respectively, in the previous year. The BSP has not issued the 28-day TDF since 14 October 2020 as the BSP started migrating funds from the said instrument to 28-day BSP Securities. Meanwhile, the average bid-to-cover ratio for the daily RRP offerings increased to around 3.9 in 2021 relative to 3.7 in 2020.

Since the maiden auction of BSP Securities on 18 September 2020 when it began offering 28-day BSP Bills, market reception has remained positive. The results of the weekly auctions of BSP Securities reflected sustained strong demand amid ample liquidity in the financial system. In 2021, total subscription amounted to around ₱6.8 trillion or about 1.4 times the ₱4.9 trillion aggregated offer amount.

Moreover, effective 10 December 2021, the BSP has allowed trust entities to participate in the secondary market for BSP Securities. The move is in line with the BSP's efforts to strengthen the effectiveness of its market-based instruments for monetary operations.

In addition, the BSP has included digital banks as eligible participants in its monetary operations effective the same date. A part of its digital banking framework, the measure aims to further improve the transmission of monetary policy.

## **Loans and Credit**

The BSP implemented a reorganization of its Department of Loans and Credit (DLC) toward strengthening its risk governance in credit and lending operations as well as enhancing process efficiency. The move sought to ensure its effective performance as the Lender of

Last Resort (LOLR)<sup>41</sup> in line with the principles for the management of credit risk of the Bank for International Settlements' Basel Committee on Banking Supervision.

Following the reorganization, the BSP instituted reforms to streamline credit operations, reinforce its credit risk management, and ensure that the Bank's credit facilities remain consistent with its monetary policy stance while upholding the LOLR principle. These reforms included:

- Revision of DLC's guidelines implementing Section 282 of the Manual of Regulations for Banks on Rediscount/Lending Rates to consider the developments in the BSP's monetary operations and ensure that the rediscount rates are aligned with the LOLR principle;
- Streamlining of the operations of the BSP's rediscounting line (RL) and rediscounting availments by permanently adopting the provisions of BSP Memorandum No. M-2020-016 dated 31 March 2020, which simplified the submission by the banks of applications and other documentary requirements;
- Alignment of Overdraft Credit Line (OCL) and RL requirements with the Supervisory Assessment Framework by removing the composite rating under the CAMELS<sup>42</sup> Rating System

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<sup>41</sup> This key principle states that depository institutions should exhaust other possible sources of funding first before going to central banks.

<sup>42</sup> Capital, asset quality, management, earnings, liquidity and sensitivity to market risk.

<sup>43</sup> These are provisional advances to the NG pursuant to Section 89 of Republic Act (RA) No. 7653, as amended by RA 11211, otherwise known as the New Central Bank Act. The second tranche, in

from the value-dating criteria for OCL and the eligibility criteria for RL, and by removing the non-performing loans ratio from the eligibility criteria to allow a holistic assessment of creditworthiness of banks applying for RL;

- Adoption of principles-based Credit Information System in the evaluation of RL applications to allow flexibility considering the changes in the BSP's supervisory assessment system and other factors that are reflective of the applicant banks' creditworthiness;
- Revision of the Off-site Credit Analysis Report to consider the rediscounting banks' credit experience with BSP and the supervisory assessment by the Financial Supervision Sector; and
- Cessation of the Clean OCL Facility to improve the BSP's credit risk management consistent with the recommendation in the Financial Sector Assessment Program dated 18 October 2019, which was prepared by the International Monetary Fund and the World Bank.

In 2021, the BSP extended loans in the aggregate amount of ₱1.1 trillion, higher by 90.5 percent than the loans extended in the previous year of ₱566.9 billion. The increase is due to provisional advances to the National Government (NG) in the aggregate amount of ₱1.1 trillion<sup>43</sup> in

the amount of ₱540.0 billion, was approved per MB Resolution (MBR) No. 1702 dated 28 December 2020 (fully paid in July 2021), while the third tranche of provisional advances to the NG for the same amount was approved per MBR No. 832 dated 1 July 2021 (fully paid in December 2021). The loan, which was implemented through the DLC, is evidenced by a non-negotiable and non-interest-bearing promissory note.

support of its efforts to provide fiscal stimulus to address the adverse impact of COVID-19.

On the other hand, total availments of rediscounting loans by banks amounted to ₱6.0 million, significantly lower than ₱26.9 billion the previous year. The primary reason cited by banks for the sharp decline is their high liquidity position amid the pandemic. Furthermore, the banks' OCL loans amounted to ₱25.0 million.

Meanwhile, the total principal collections amounted to ₱1.1 trillion in 2021, higher by 83.5 percent than ₱592.0 billion in the year prior. A large portion of the amount pertains to the NG's full payment of the ₱1.1 trillion provisional advances and previously assumed loans amounting to ₱792.0 million.<sup>44</sup> Principal collections from rediscounting and OCL loans, among others, amounted to ₱5.8 billion and ₱25.0 million, respectively.

With these collections, the BSP's total outstanding loan portfolio stood at ₱106.2 billion by end-2021, lower by 5.9 percent than the outstanding loans of ₱112.9 billion by end-2020. The loan portfolio as of end-2021 is primarily composed of loans and advances to NG amounting to ₱68.3 billion (64.4 percent of the total outstanding loans), loans to the Philippine Deposit Insurance Corporation amounting to ₱36.0 billion (33.9 percent), and emergency loans amounting to ₱1.8 billion (1.7 percent).<sup>45</sup>

<sup>44</sup> Loans originally extended by the Central Bank of the Philippines and later assumed by the NG.

<sup>45</sup> The loan portfolio also includes Special Program Loans of ₱35.0 million, rediscounting loans of ₱19.0 million, OCL loans of ₱15.0 million, and restructured end-user borrower loans of ₱4.0 million, which comprise less than 0.1 percent of the

No new past due loan (PDL) was recorded in 2021 since all current loans were collected as they fell due. Existing PDLs were also recovered through various remedial measures such as foreclosure and cash settlement schemes. In addition, recoveries amounting to ₱21.0 million were noted on PDLs that had been previously written off, as the BSP continued to exert collection and recovery efforts on delinquent loans. During the year, PDLs amounting to ₱155.0 million were also written off pursuant to Monetary Board Resolution (MBR) No. 518 dated 29 April 2021. These efforts resulted in a decrease in the total amount of PDLs from ₱5.8 billion in 2020 to ₱4.8 billion in 2021. Past due ratio also decreased to 4.5 percent in 2021 from 5.1 percent in 2020.

The BSP also closely watched the liquidity needs of the Philippine banking system as the country faced the emergence of new and more virulent variants of COVID-19, among others. In line with this, the BSP extended the implementation of a couple of temporary measures in the BSP's rediscounting facility. The first reduced the term spread on rediscounting loans, regardless of maturity, under the Peso Rediscount Facility<sup>46</sup> and Exporters' Dollar and Yen Rediscount Facility (EDYRF).<sup>47</sup> The second allowed the acceptance for rediscounting with the BSP, under its EDYRF, of United States Dollar- and Japanese Yen-denominated credit instruments related to the activities considered critical during the

total outstanding loans.

<sup>46</sup> The Monetary Board approved the reduction of the term spread on peso rediscounting loans to zero relative to the Overnight Lending Rate effective 20 March 2020.

<sup>47</sup> Implemented since 16 July 2020 through Memorandum No. M-2020-056 dated 16 July 2020.

implementation of enhanced community quarantine.<sup>48</sup>

## **Asset Management**

The BSP continued to properly administer and dispose its acquired real properties despite the challenges posed by the COVID-19 pandemic. It adopted various measures to expedite disposals and manage its receivables arising from such transactions.

Aside from the alternative payment channels introduced in the previous year, the BSP started accepting payments via Electronic Commerce Payments or ECPay (e.g., GCash, 7-Eleven, RD Pawnshop) in 2021. It likewise regularly conducted public auctions, which is the initial mode of disposal of BSP-acquired properties, through the implementation of supplemental guidelines and procedures incorporating health and safety protocols.

The total book value of acquired properties stood at ₱11.9 billion as of 31 December 2021, lower by ₱0.5 billion or 3.7 percent than ₱12.3 billion the previous year.

Through various schemes, the BSP approved the sale of 5,315 properties with a total net book value of ₱418.0 million for an aggregate purchase price of ₱862.5 million. This generated for the BSP an estimated net income of ₱418.3 million.<sup>49</sup>

The total collections of ₱781.3 million on sales contract receivables represent 97.2 percent of the total installments due. Interest income earned for the period amounted to ₱272.2 million. In addition,

<sup>48</sup> Implemented since 08 April 2020 through Memorandum No. M-2020-024 dated 08 April 2020.

the BSP earned a total miscellaneous income of ₱392.6 million, a significant portion of which was realized profit from properties sold on installment basis in the amount of ₱301.6 million.

## **International Operations**

The BSP continued to ensure that the country's foreign exchange (FX) regulatory framework remains responsive to the needs of a dynamic and expanding economy.

In the third quarter, the BSP issued Circular No. 1124 dated 10 August 2021 implementing the "12<sup>th</sup> wave of liberalization of FX regulations." The major reforms aim to promote greater ease in the use of FX resources of the banking system, support digital payments and electronic transactions, and further simplify the procedures and documentary requirements for various FX transactions.

The BSP also issued Memorandum to All Authorized Agent Banks No. M-2021-050 dated 4 September 2021 reminding banks to implement the "Know Your Customer" policy and conduct due diligence to ensure that FX transactions are compliant with all applicable laws, rules, and regulations. It also reminded banks that the list of regulated or prohibited imports and exports under the FX Manual, as amended, have been limited only to those under the BSP's purview.

Meanwhile, the BSP continued to perform its role in external debt management to keep external debt service requirements at manageable

<sup>49</sup> Net of administration cost and broker's commission amounting to ₱26.2 million.

levels and ensure external debt sustainability. Prior approval of the BSP, through the Monetary Board (MB), is required for all foreign loans to be contracted or guaranteed by the Republic of the Philippines (RP), its instrumentalities and agencies, government-owned and controlled corporations, and local government units. As of end-December 2021, the BSP approved a total of US\$13.1 billion public sector medium- to long-term foreign borrowings. These included four bond issuances amounting to US\$6.2 billion, of which US\$5.9 billion was for the National Government's (NG) general financing requirements for 2021, while the balance was for the refinancing of an existing loan of a government financial institution (GFI); nine program loans totaling US\$3.9 billion which were mostly to support COVID-19 pandemic response; and 12 project loans of the RP amounting to US\$3.1 billion to fund COVID-19 pandemic response, which included vaccine procurement, social protection and support for economic recovery; other infrastructure projects; emergency response; and maritime safety enhancement.

In view of the cessation of the London Interbank Offered Rate (LIBOR) and similar phaseout of other foreign currency-denominated LIBOR-based rates in 2022, the BSP facilitated the approval of the reference rate replacement<sup>50</sup> for various LIBOR-based loans<sup>51</sup> of the RP and a GFI.

To enhance its debt management capability, the BSP soft launched the Debt Management and Financial Analysis System 6 which offers new

analytical features and enhanced reporting capabilities for the management and analysis of external debt. The BSP also implemented refinements to its external debt statistics by recognizing perpetual capital securities, a hybrid instrument that is normally treated as an equity instrument, as part of the computation of the country's total external debt. This was done in consultation with the International Monetary Fund in accordance with the BSP's commitment to continuously align the country's statistics with international standards.

From	To
JPY LIBOR	Tokyo Overnight Average Rate
US\$ LIBOR	Secured Overnight Financing Rate
GBP LIBOR	Sterling Overnight Index Average Rate

The BSP regulates foreign loans and foreign currency borrowings (including those in the form of bonds, notes and other debt instruments) so that these can be serviced in an orderly manner and with due regard to the economy's overall debt-servicing capacity. For 2021,<sup>52</sup> the BSP registered 353 private sector foreign loan accounts amounting to US\$5.1 billion, excluding the issuance of 121 registration documents covering amendments to the loans' financial terms. These were used for general corporate purposes, relending, capital expenditures and working capital requirements, among others. The BSP also registered guarantees amounting to US\$30.0 million.

<sup>50</sup> Alternative Benchmark rates

<sup>51</sup> From the Japan International Cooperation Agency, World Bank-International Bank for Reconstruction and Development, Asian

Development Bank and Asian Infrastructure Investment Bank

<sup>52</sup> Preliminary data

The BSP also supports the country's policy to encourage foreign investments. In 2021, the BSP facilitated the registration of US\$1.8 billion foreign direct investments of non-residents, which is lower by 7.0 percent (or by US\$143.0 million) than US\$2.0 billion in the same period last year. Out of the US\$1.8 billion registered investments, US\$1.1 billion was funded mainly by cash through inward or constructive remittances while the US\$754.0 million balance pertained to other transactions such as FX payments or offsetting of FX payments made offshore by the foreign investor to another offshore entity to settle the investee firm's payables to offshore entity and investments made prior to 15 March 1973 (US\$628.0 million); stock dividends (US\$117.0 million); and debt-to-equity conversion (US\$9.0 million).

The funds came mainly from Singapore (US\$918.0 million); the British Virgin Islands (US\$202.0 million); the Netherlands (US\$194.0 million) and Japan (US\$158.0 million). Major beneficiaries of the investments were firms engaged in financial and insurance activities (US\$1.2 billion); manufacturing (US\$316.0 million); transportation and storage (US\$112.0 million); and wholesale and retail trade; repair of motor vehicles and motorcycles (US\$111.0 million).

On the other hand, foreign investments registered with authorized agent banks<sup>53</sup> on behalf of the BSP from January to December 2021 amounted to US\$13.6 billion, reflecting a 16.6 percent increase (or by US\$1.9 billion) compared to the US\$11.7 billion level for the same period in 2020. Overall foreign portfolio investment transactions in 2021 yielded

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<sup>53</sup> It should be noted that when the investments were initially made by the non-resident investors,

net outflows of US\$574.0 million, lower by 86.5 percent (or by US\$3.7 billion) than the US\$4.2 billion net outflows in 2020.

The BSP has been actively working with various agencies in providing support to various government initiatives. The BSP has actively participated in the Export Development Council and in various export-related organizations such as the Center for International Trade Expositions and Missions, Philippine Exporters Confederation, Inc., and the Halal Export Development and Promotion Board. Engagement with these organizations provided the BSP with the opportunity to discuss and address the challenges affecting the export sector especially amid the COVID-19 pandemic.

The BSP also worked with trade regulatory agencies involved in the National Single Window Steering Committee and Technical Working Group for the planning and ongoing establishment of TradeNet, an internet-based application that allows parties involved in trade to lodge information and documents with a single-entry point to fulfill all import, export and transit-related regulatory requirements. The BSP also worked with the Philippine Trade Facilitation Committee, which coordinates the Philippine government's actions on matters pertaining to the implementation of the World Trade Organization's Trade Facilitation Agreement and other related commitments.

Further, the BSP actively participated in the Interagency Committee for Review of Foreign Loan Documents which conducts reviews or negotiations of

these were all categorized as foreign portfolio investments.

various financing agreements of the NG. It also took part in meetings of the National Economic and Development Authority-Investment Coordination Committee for the evaluation and approval of major capital development projects of various agencies, including public-private partnership projects. The BSP also took part in discussions of the Investment Promotion Units Network spearheaded by the Board of Investments to address the concerns and issues of investors through a system of coordination.

Moreover, to support the effective implementation of rules on physical cross-border transfer of currencies, the BSP donated 13 units of multi-currency bill counters with printers to the Bureau of Customs (BOC) in 2021.

To enhance stakeholder engagement, the BSP also intensified its information campaign to increase public awareness of the Bank's FX regulations and statistics through the following: public advisories (in the form of infographics) posted at the BSP website and its official social media accounts; periodic updating of the FX Regulations Sub-Section in the BSP website; conduct of briefings and information sessions on foreign investments; and press engagements to give updates on external debt, including MB-approved public sector COVID-19 related foreign borrowings, and amendments to FX rules. The BSP also participated in BOC online seminars and spoke on "Cross-Border Transfer of Philippine and Foreign Currencies," as well as on "Anti-Money Laundering and Cash Handling."

## ***Economic Research and Information Dissemination Activities***

In the wake of the pandemic, the BSP has unrelentingly strived to adapt to the new economy in the pursuit of price and financial stability as well as economic recovery. Despite the uncertainty in the global and domestic environment, the BSP continued to provide relevant, accurate, and timely information to its stakeholders. These also served as critical inputs to the formulation and implementation of policies on price and financial stability. In addition, new initiatives were pursued in 2021 to improve the Bank's research and institutional outputs and processes.

**Regular reports.** In line with the thrust of bringing the BSP closer to the Filipino people, the organization continued to publish its regular reports in 2021 to inform its stakeholders of the developments in the macroeconomy and financial system. Among the published reports were the BSP Annual Report, the yearly Report on Regional Economic Developments in the Philippines, Year-end Report on BSP Financial Inclusion Initiatives, the semestral Report on the Philippine Financial System, and the semestral Financial Stability Report. The Inflation Report elaborated the key considerations behind the monetary policy decisions during the year. A number of reports were also published on a quarterly or monthly basis to provide the public a timelier update on macroeconomic developments. These include the Inflation Report, Report on Economic and Financial Developments, Balance of Payments (BOP) Report, International Investment Position, Philippine Balance Sheet Approach Report, and Recent

Trends in the Philippine Financial System. The BSP likewise published relevant statistical reports, including the daily Key Statistical Indicators, weekly Selected Economic and Financial Indicators, monthly Selected Philippine Economic Indicators, annual Factbook on the Philippine Banking System, as well as statistical bulletins on the Reference Exchange Rate, the Residential Real Estate Price Index (RREPI), and the Financial Inclusion Dashboard.

**Press releases, livestreams and social media.** To complement the publication on monetary policy decisions, the BSP published press releases on inflation, month-ahead inflation forecasts, BOP position, gross international reserves, external debt, foreign portfolio and direct investments, remittances, domestic liquidity, BSP rediscount rates and loan availments, financial inclusion and digital finance, and requests for MB opinions on proposed domestic borrowings. Press statements on the results of the quarterly surveys on residential real estate prices, bank lending standards, and consumer and business confidence were also regularly published.

Aside from published media, the BSP continued the social media streaming of its monetary policy press conferences and briefings on the Inflation Report, developments on the Balance of Payments, and results of the Business Expectations Survey (BES), and Consumer Expectations Survey (CES) via Facebook Live. The GBED Talks, which are streamed press chats with the Governor covering selected BSP undertakings and initiatives, were regularly held.

Through the BSP website and social media accounts (i.e., Facebook, Instagram, Twitter), public advisories and learning materials in the form of infographics, short videos, and digital exhibits were also released to provide information regarding the BSP's functions, policies, initiatives and key statistics. For instance, the BSP continued to manage PisoLit, a financial education (fin-ed) page on Facebook, which provides relatable and practical financial tips and resources, scam prevention reminders, and consumer protection advisories. As an added feature in 2021, Ekolit was introduced to share simplified description of economic concepts.

**Surveys.** In order to enhance the information content of the hard data releases of the BSP, various surveys were conducted with the goal of providing a more comprehensive view of economic conditions in aid of monetary policy analysis and formulation. Among these were the quarterly Senior Loan Officers' Survey, which provided an assessment of current bank lending conditions; the Philippine Banking Sector Outlook Survey, which served as a complementary tool that gathered the sentiments and outlook of banking industry leaders; the monthly Cross Border Transactions Survey, which reported the resident-to-nonresident transactions that bypass the domestic banking system; the annual and quarterly Coordinated Direct Investment Survey, which covered the financial transactions and stock of equity and debt between resident companies and their immediate foreign counterparts; the quarterly survey on International Mobile Money Transfer Services, which monitored the information on resident Electronic Money Issuers' transactions

with non-residents; the semi-annual Coordinated Portfolio Investment Survey, which reported the residents' holdings of foreign-issued equities and long and short-term debt securities; and the quarterly BES and CES, which captured the business sentiment and general consumer outlook on future economic conditions.

In 2021, the BSP released the results of the 2018 Consumer Finance Survey, which is a nationwide survey on the financial condition of Filipino households conducted by the BSP every three years. In addition, the BSP launched the enhanced Corporate Financial Trends Survey (CFTS) via the Reports Receiving System. The CFTS is a statistical initiative designed to improve the BSP's surveillance of the Philippine corporate sector's financing trends. It is an annual survey that gathers granular financial data from non-financial corporations across various industries. Finally, an ongoing initiative is the creation of the Commercial Property Price Index, which is expected to complement the RREPI in providing information regarding real property prices. Together, these two indices are designed to provide more comprehensive information on the developments in the real estate sector of the economy.

**Research publication initiatives.** In 2021, a major initiative for strengthening the BSP's research capacity was the creation of the BSP Research Academy (BRAC). The establishment of BRAC aims to foster a positive research culture aimed at producing research that is collaborative, of high quality, and sustainable. Through this initiative, the BSP is expected to continue its practice of providing sound and evidence-based policies.

The BSP produced various research papers and articles on the macroeconomy and on the financial sector. BSP officers and staff published studies on financial market behaviors and financial risks through the *BSP Working Paper Series*, as well as concise and reader-friendly articles on the early warning system for *Currency Crisis* and review of the inflation target for 2021-2024 through the *BSP Economic Newsletter*. The BSP likewise contributed an article to the *Philippine Review of Economics* tackling the evolution of the monetary policy framework in the Philippines.

Moreover, the BSP initiated research collaboration through the signing of a Memorandum of Understanding (MOU) with four institutions: namely: (1) the Philippine Institute for Development Studies (PIDS); (2) the Philippine Center for Economic Development; (3) the Agricultural Credit Policy Council; and (4) the Philippine-American Educational Foundation. Meanwhile, two more collaborations were already included in the pipeline, specifically, with the Ateneo Center for Economic Research and Development and the University of the Philippines Los Baños. Also, several activities were geared towards the attainment of the BSP's goal of creating a positive research culture. These include the BSP International Research Fair held on 13 to 14 July 2021 with the theme "Central Banking in the Time of the Pandemic"; the Joint BSP-PIDS Research Forum held on 27 October 2021, entitled "Resilient Legs for Economic Recovery in the Post-Pandemic Era"; the three BSP-UP Professorial Chair Lectures; and the inaugural BSP-wide Research Café and Research Community in Action.



With the growing interest in central bank digital currency (CBDC), the BSP released a comprehensive report entitled “Central Bank Digital Currency for the BSP: Fundamentals and Strategies.” The exploratory study scanned the issues and implications of CBDCs and offered recommendations on the possible next steps for the BSP. Other exploratory studies pursued by the BSP include the use of big data (e.g., news articles) as an alternative data source for constructing indices that will be useful in monitoring and assessing the financial and economic environment, and in predicting crises and mitigating risks. The indices under study include (i) a real-time, high-frequency confidence and sentiment index; (ii) a Philippine Economic Policy Uncertainty (PEPU) index; (iii) a Monetary Policy Uncertainty index; and (iv) a COVID-related PEPU index.

**Information dissemination activities.**

As the BSP adapts to the new normal, the delivery of its information campaigns has shifted to virtual and online modes, which, in turn, has expanded the reach of said campaigns in terms of numbers of audiences and geographical areas covered. The information dissemination activities are anchored on the principle that Filipinos who are well-informed and well-versed in basic economic and financial concepts could make informed decisions leading to better economic and financial well-being. In 2021, 32 learning programs, which comprised of 26 online learning sessions, four virtual events on “Economic and Financial Learning Program on the Role of the BSP and other relevant Central Banking Topics,” and two learning sessions with PHINMA Education, were conducted to provide the general public a better understanding of the role of the BSP in

the economy. Learning materials in various formats were also released through different communication channels.

To improve the financial literacy and capabilities of Filipinos, the BSP continued its partnership with key agencies—such as, the Department of Education (DepEd), Commission on Higher Education (CHED), Overseas Workers Welfare Administration (OWWA), and Department of Social Welfare and Development (DSWD)—in implementing fin-ed programs for personnel and stakeholders of the said agencies. On 3 June 2021, the DepEd issued the Financial Education Policy that will intensify the integration of financial literacy lessons in select subjects in the K to 12 basic education curriculum. Meanwhile, the BSP worked with the CHED in crafting a Personal Finance 101 course module for inclusion in the curriculum for secondary education. Customized fin-ed webinars were also designed to empower Overseas Filipino Workers and beneficiaries of the government’s Pantawid Pamilyang Pilipino Program. Other collaborative capacity-building initiatives pursued in 2021 were the launch of the fin-ed game called “Fish N’ Learn” which embeds key messages on personal financial management and sustainable fishing for fisherfolks, and the development of new learning videos for civil servants as well as uniformed and civilian personnel.

The BSP also intensified its Customer Centricity Campaign in 2021 by securing high-level buy-in and support of regulators and regulated entities from the banking, insurance, capital markets, and securities sectors during BSP’s Financial Education Stakeholders Expo

held on 22 to 26 November 2021. The expo had the theme, “Financial Literacy as Critical Enabler for Personal and National Economic Resiliency,” which showcased milestones of BSP’s multi-sectoral partnership programs and various learning sessions. It also featured plenary and breakout sessions on cryptocurrencies, stock market investing, Personal Equity and Retirement Accounts, and credit cards 101. The event also included panel discussions about behavioral insights on how Filipinos make personal financial decisions and about financial literacy and entrepreneurship as tools for economic resiliency and recovery.

At a more technical level, the BSP organized an international research conference on 27 to 29 September 2021 in partnership with the Reinventing Bretton Woods Committee. Carrying the theme “Shifting Gears, Changing Lanes: Central Banking in a Post-COVID Economic World,” the conference engaged central bankers and leading experts from academia in the discussion of emerging and pressing policy issues that central banks are confronted with in light of the evolving COVID-19 pandemic. Topics that were discussed include: (1) central banking and dealing with the enduring impact of COVID-19; (2) new monetary policy era for emerging markets; (3) forecasting future crises; (4) payments innovation, financial inclusion and financial stability risks; (5) monetary sovereignty and the path towards the digitalization of money; (6) climate change risks as a redefining issue for financial stability; and (7) the post-COVID-19 global economy.

The BSP likewise hosted the closing ceremonies of the 32<sup>nd</sup> National Statistics Month on 29 October 2021. During the event, the BSP conducted a virtual public

information campaign on economic and financial statistics produced by the BSP as well as featured audio-visual presentations on the central bank’s surveys.

Lastly, the BSP conducted the first Regional Macroeconomic Conference Series, which tackled topics on recent economic developments with a focus on regional developments and the state of micro, small and medium enterprises, and BSP policy responses; and the 34<sup>th</sup> Environmental Scanning Exercise on the topic, “Sustainable Finance in the Philippines: Challenges and Implications.”

**Inter-agency and multilateral committees.** The BSP actively participated in local and international committee discussions and provided expert views on various economic policies and issues. It took part in the meetings of the Committee on Tariff and Related Matters, and attended as technical support in the public hearings on the rice and pork tariff modification petitions. As a member of the Export Development Council, the BSP provided technical views on trade projections and statistics used by the Council in crafting policies and outlook for the sector.

The BSP also continued its active participation in the Economic Development Cluster (EDC) and the Development Budget Coordination Committee (DBCC) as a resource institution. In the EDC, the BSP provided technical views and reports on key economic policies and development issues under its purview. Meanwhile, in the DBCC, the BSP engaged actively in discussions regarding economic policy and macroeconomic assumptions, serving as the basis for the preparation of the NG’s annual budget and fiscal

program. Moreover, the BSP also participated in committees and technical working groups involved in drafting the Philippine Development Plan 2017-2022 Update, and in consolidating the National Competitiveness Agenda. On the international front, the BSP is part of the working group that conceptualized the first version of the Association of Southeast Asian Nations (ASEAN) Taxonomy for Sustainable Finance, a multi-tiered framework that promotes the orderly transition and adoption of sustainable finance practices in the region.

Other inter-agency committees that the BSP joined included the National Food Authority Council and its specialized committees, Philippine Trade Facilitation Committee, National Single Window Steering Committee and Technical Working Group, Center for International Trade Expositions and Missions Board, National Economic and Development Authority-Investment Coordination Committee, Halal Export Development and Promotion Board, Interagency Committee for Review of Foreign Loan Documents, National Wages Productivity Commission, Regional Tripartite Wages and Productivity Board, Philippine Development Plan Planning Committee, and Philippine Statistics Authority. It also took part in international working groups such as the Executives' Meeting of East Asia-Pacific Central Banks Monetary and Financial Stability Committee, Bank for International Settlements Expert Group, South-East Asian Central Banks Experts Groups on

Capital Flows, ASEAN Community Statistical System Committee, and ASEAN Working Group on International Investment Statistics.

**Trainings, workshops and technical assistance projects.** The BSP continued to engage in capacity-building exercises within the organization and with external counterparties. One of the research support activities of the BSP, through the BRAC, was the in-house lecture and workshop series on relevant research topics, and presentations of research works by BSP staff to the members of the BRAC's Research Experts Panel.<sup>54</sup> These activities aimed to strengthen the research capability of the BSP staff through research guidance and mentoring.

Capacity building through technical assistance partnerships with multilateral agencies continued as well in 2021. The BSP conducted a consultation-workshop with the Global Projection Model Network (GPMN)<sup>55</sup> to review and improve the structure of the Policy Analysis Model for the Philippines, which is one of the macroeconomic forecasting models used by the BSP for monetary policy analysis and policy simulations. Moreover, the BSP has started the scoping activities with the Japan International Cooperation Agency for a technical assistance program aimed at enhancing the BSP's macroeconomic and forecasting models, and conduct of market intelligence activities.

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<sup>54</sup> Members of the Research Experts Panel include Dr. John Nye, Professor, Economic History, New Institutional Economics, George Mason University; Dr. Roberto Mariano, Professor Emeritus of Economics, University of Pennsylvania; and Dr. Ramon Moreno, former Head of Economics for Latin America and the Caribbean, Bank for International Settlements.

<sup>55</sup> The GPMN is a non-profit research institute that provides global macroeconomic forecasts and risk scenarios. The institute organizes workshops, provides training and technical assistance related to the suite of models used by the team, and develops macroeconomic models and software solutions that support the forecasting environment.



The BSP also actively collaborated with other central banks and foreign financial authorities to exchange information and best practices on central banking issues and other areas of mutual interest. For instance, the BSP established formal collaborations, via an MOU, with the Monetary Authority of Singapore and Central Bank of Mauritius for information exchange and capacity building in areas such as financial technology, financial market, digital currencies, and Islamic banking.

**Program and process initiatives.** The BSP implemented innovation measures and collaborative activities to continuously improve the conduct of its functions in fulfillment of its mission and advocacies. Through its Knowledge Research Network (KRN), the BSP continued to bring public awareness and greater understanding of monetary policy, strategy, and decisions. Activities included the conduct of e-learning sessions, release of the *KRN Update Newsletter*, and distribution of updated editions of 28 titles of BSP publications for physical display in selected KRN partner institutions.

Innovations within the BSP include various automation initiatives, such as a data validation tool and automated dashboard, to ensure that the data and information released to the public are accurate, timely, and relevant. These innovative tools also enable the BSP staff to manage and analyze the various data generated and monitored within the bank more efficiently, in support of the BSP management's decision-making and formulation of policies and programs in line with the BSP mandate. In keeping with the developments on the use of big data in central banking, the BSP established the Data

Management and Analytics Unit (DMAU). The unit will look into studies related to data analytics and the use of structured and unstructured data from traditional and non-traditional sources to create indicators as inputs to monetary and financial policies. The DMAU will also serve as the BSP's center for data analytics and data dissemination activities, including various automation initiatives. The BSP also began the development of its Market Intelligence and Data Analytics Staff (MIDAS) unit which will focus on conducting research studies on subjects and issues related to digitalization and fintech. The MIDAS unit will also explore the use of big data and other new forms or types of data as inputs to the conduct of monetary and financial policy formulation and implementation.

The BSP developed the Big Data Project in 2020 in partnership with the University of the Philippines. The project included the crafting of the BSP's Big Data Governance Framework and Big Data Roadmap, which began to be implemented in 2021. The roadmap outlines the BSP's big data resource development activities that aim to harness the benefits of using big data to serve the public better through (1) real-time market surveillance, (2) filling information gaps to better monitor and assess economic and financial conditions, (3) better analysis and assessment of BSP's policy actions, regulations and communications, and (4) early detection of systemic risks, among others. Strategic activities under the Big Data Project include the conduct of Big Data Training Series aimed at improving the data science and analytics skills of the BSP personnel; firming up data sharing agreements with various sources to expand data coverage, and

procurement of big data and analytics tools to support the various analytics initiatives in the BSP.

## **International Reserves Management and Domestic Operations**

In what has been an unprecedented 2021 challenged by the COVID-19 outbreak, the BSP implemented prudent management of the gross international reserves (GIR). Amid the low-yield yet volatile market environment, the BSP executed strategies to enhance returns and diversify risks, while at the same time maintaining liquidity and capital preservation as key objectives. Despite the difficulties, it was able to generate significant income during the year.

The year was also marked by ample liquidity in the domestic market due to the funds released from various COVID-19 response programs, the BSP's purchases of government securities in the secondary market, and foreign exchange (FX) operations.

### **Management of domestic liquidity.**

System liquidity continued to be ample with outstanding placements in the BSP's monetary tools amounting to ₱1.9 trillion as of end-2021. The BSP injected around ₱370.0 billion through the BSP's government securities (GS) and FX purchases as well as ₱540.0 billion through the provisional advances to the National Government. The BSP bought a total of ₱212.0 billion worth of GS from the secondary market in 2021, around 4.1 percent of total GS market trades and lower than the ₱980.0 billion from the previous year. The decline in total GS purchases may be attributed to ample system liquidity and the normalization of market conditions.

The BSP also kept its Term Deposit Facility and Securities Facility offerings relatively low to support banks' liquidity requirements. Total availments in the Overnight Lending Facility, most of which were for BSP testing, amounted to ₱1.9 billion in 2021, higher than the ₱740.0 million the year before.

### **Maintenance of peso stability.**

In line with the BSP's aim of preserving the stability and convertibility of the national currency, it continued to monitor the USD/PHP market and maintained its presence to manage the volatility of the exchange rate. The BSP registered net US dollar purchases for the year as it took advantage of dollar buying opportunities amid accommodative monetary policy stance by the Fed (in the first half of the year) and the BSP, easing of mobility restrictions in the National Capital Region later in the year, and optimism on the vaccine rollout.

Nonetheless, the peso depreciated by 5.8 percent to ₱51.0/\$1 on 31 December 2021 from ₱48.0/\$1 on 31 December 2020. Its value ranged from ₱47.6/\$1 to ₱51.0/\$1 throughout the year. The peso was weighed by a stronger US dollar, pessimistic local business confidence, reimposition of quarantine measures due to the surge in COVID-19 cases, and downgrades of the country's growth and credit outlook by various analysts.

### **Management of international reserves.**

The BSP implemented investment strategies to enhance returns from international assets while observing the objectives and risk limits set and approved by the Monetary Board.



These included additional investment in a green bond fund managed by the Bank for International Settlements and an increase in existing mandates with external fund managers.

The BSP also modified its strategic exposure to gold assets in the GIR, following the shift to active management of the Gold Reserves Portfolio in 2020.

## Box Article 2

### Incorporating Sustainability Principles in Reserve Management

A central bank's framework for managing foreign reserves has traditionally focused on meeting a triad of objectives: liquidity, safety, and return. But recently, central banks have been incorporating sustainability objectives into their policy frameworks as well as reserve management guidelines.

While sustainability is a noble idea, adding a new objective for central banks requires considerable analysis of the cost, not just the benefits. The exercise is fraught with challenges. These include determining the sustainable principles to adopt and ensuring that there is an adequate and stable supply of sustainability products in the market. After all, central banks can only invest in securities issued by sovereigns, sub-sovereigns, and supranational entities. In addition, reserve managers should consider the possible trade-offs between traditional reserve management objectives and sustainability objectives.

Researches and surveys by official institutions have examined this trend and determined how sustainability considerations might fit within central banks' reserve management frameworks.

For instance, the Bank for International Settlements (BIS) published a series of working papers that discuss the relationship between reserve management and sustainability objectives. The BIS papers revealed that "while central banks are playing an increasingly active role in promoting green finance, comparatively little attention is paid to how they might integrate sustainability into their policy frameworks.

Sustainability might be integrated into the reserve management process either explicitly by articulating sustainability as a defined purpose for holding reserves, or implicitly as a supporting aspect of existing policy purposes."<sup>56</sup> Moreover, the BIS finds that sustainable investments can be included in reserve portfolios without foregoing safety and return, although their accessibility and liquidity currently pose some constraints.<sup>57</sup>

In addition, a Central Banking Publications survey<sup>58</sup> showed that central banks are increasingly incorporating Socially Responsible Investing (SRI) into reserve management in 2021. For those considering implementing SRI, the major obstacle is the concern over the impact on returns. For those not actively considering SRI, they face challenges on how to integrate such principles within the central bank's mandate. They are also concerned over its effect on liquidity and returns, and the lack of a clear definition of SRI.

<sup>56</sup> Fender, I., McMorrow, M., Sahakyan, V., & Zulaica, O. (2019). Green bonds: the reserve management perspective. BIS Quarterly Review. Retrieved from: [https://www.bis.org/publ/qtrpdf/r\\_qt1909f.htm](https://www.bis.org/publ/qtrpdf/r_qt1909f.htm)

<sup>57</sup> Fender, I., McMorrow, M., Sahakyan, V., & Zulaica, O. (2020). Reserve management and sustainability: the case for green bonds? (BIS Working Paper No. 849). Retrieved from: <https://www.bis.org/publ/work849.htm>

<sup>58</sup> The Central Banking Publications conducts its Reserve Management Trends survey annually. The respondents for this survey are reserve managers from central banks across different regions. In the 2021 survey, 78 central banks participated.

<sup>59</sup> World Bank (2021). Central Bank Reserve Management Practices: Insights into Public Asset Management. Retrieved from: <https://openknowledge.worldbank.org/handle/10986/36442>

Other approaches for incorporating sustainability principles by central banks include negative screening, and the incorporation of a criteria on environmental, social and governance factors. Central banks have operationalized the focus on impact investing by investing in green bonds.

Green bonds are fixed-income securities whose proceeds are exclusively applied to projects that promote climate or other environmental sustainability purposes.<sup>60</sup> Green bonds offer institutional investors access to sustainable investments in the fixed-income market.

### **BSP's Journey in Investing in Green Bonds**

The BSP has worked toward incorporating sustainability principles into its reserve management framework.

The BSP was one of the early investors in the BIS' green bond fund (BISIP G1), placing an initial US\$150.0 million in the said fund in October 2019. Since then, the BSP's investments in the fund have grown, reaching US\$550.0 million as of end-2021. The BSP believes that green bonds provide higher returns and diversification benefits to its FX reserves as well as advances its sustainability initiative.

In February 2022, the BSP is set to invest in a similar fund, Asian Green Bond Fund (BISIP G3), that the BIS will be launching in early 2022 following an announcement on 21 October 2021.

Apart from the BIS initiatives, the BSP, through its membership in the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP), has also taken part in discussions on promoting green bonds in the region. On 14 July 2021, the EMEAP agreed to support investments in green bonds through the Asian Bond Fund (ABF). Such an initiative is aimed at helping catalyze a further deepening of local currency-denominated green bond markets in the region. The inclusion of green bonds in the index of the ABF will take effect on 31 March 2022.

## International Economic Cooperation

The BSP actively participated in collaboration activities organized by various regional and international forums.<sup>61</sup> The discussions in 2021 focused on economic developments amid the pandemic, monetary and fiscal policy responses, and the way forward for the new economy. The BSP also organized or took part in several critical bilateral dialogues with foreign authorities,<sup>62</sup> facilitating the sharing of information and best practices. In addition, it also discussed possible collaboration with bilateral partners in areas such as digital financial services and innovations, retail payments, central bank digital currencies, cross-border data, Islamic banking, and bilateral trade and investment.

**Contribution in advancing regional initiatives.** The BSP is part of the working group that conceptualized the framework and principles of the first version of the ASEAN Taxonomy for Sustainable Finance which was launched in November 2021 at the sidelines of the 26<sup>th</sup> United Nations Climate Change Conference. The ASEAN Taxonomy aims to support businesses in the region that promote sustainable agenda and/or adopt sustainable practices. The BSP also made significant contributions in the completion of two initiatives under the

ASEAN finance process, namely: (1) the Policy Note on ASEAN's recent experiences in Capital Account Safeguard Measures which provides insights on the pre-emptive policy measures implemented by ASEAN Central Banks in 2019 and 2020 especially during the height of the COVID-19 pandemic; and (2) the ASEAN Sustainable Banking Principles, which aim to guide future policies and commitments among ASEAN central banks to promote sustainable banking in the region. Under the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP) forum, the BSP led the facilitation and completion of several studies on banking regulations and sustainable finance,<sup>63</sup> and contributed to the landscape review of cross-border retail payments in EMEAP member jurisdictions. Information obtained from these research projects provided a basis for EMEAP in developing more concrete measures for the region.

**Participation in global and regional financial safety nets.** The BSP continued to be active in various financial arrangements toward safeguarding the stability of the international monetary system. The BSP supported the initiative of the International Monetary Fund to boost global liquidity via the general allocation of Special Drawing Rights (SDR)<sup>64</sup> equivalent to US\$650.0 billion.

<sup>60</sup> MSCI (2021, September 7). Bloomberg MSCI Green Bond Indices. Retrieved from: <https://www.msci.com/documents/1296102/26180598/BBG+MSCI+Green+Bond+Indices+Primer.pdf>

<sup>61</sup> These include Bank for International Settlements, Executives' Meeting of East Asia-Pacific Central Banks, ASEAN, ASEAN+3, Asia-Pacific Economic Cooperation, and Official Monetary and Financial Institutions Forum.

<sup>62</sup> These include dialogues with the US Treasury, US ASEAN Business Council, Monetary Authority of Singapore, Bank of Thailand, and Otoritas Jasa Keuangan.

<sup>63</sup> These include a study on (a) the Emergency Liquidity Assistance Frameworks across EMEAP members; (b) the impact of the International Financial Reporting Standards 9 on Financing to Small and Medium Enterprises; and (c) the adoption of Basel III Liquidity Standards.

<sup>64</sup> The SDR is an international reserve asset created by the IMF in 1969 to supplement its member countries' official reserves. The value of the SDR is based on a basket of five currencies—the US dollar, the euro, the Chinese renminbi, the Japanese yen, and the British pound sterling.

The Philippines' share in the SDR allocation is approximately SDR2.0 billion (US\$2.8 billion), which increased the country's gross international reserves (GIR) and strengthened the country's resilience against external shocks. In addition, the BSP enhanced its relationship with the IMF with the doubling of the amount of commitment for lending under the New Arrangements to Borrow from SDR340.0 million (US\$477.0 million)<sup>65</sup> to SDR680.0 million (US\$954.0 million) effective 1 January 2021 until the end of 2025. The Bank also maintained its bilateral borrowing arrangement with the Fund by committed resources for lending of up to US\$431.0 million.

Closer to the region, the BSP took part in the enhancements of the Chiang Mai Initiative Multilateralization (CMIM), the reserve-pooling arrangement under the ASEAN+3 Finance and Central Bank Process. Notable enhancements include the increase of the IMF de-linked portion<sup>66</sup> from 30.0 percent to 40.0 percent of each member's maximum arrangement amount, making the quick disbursing CMIM facility's access larger to members in need without ties to an IMF-Supported Program, and the use of local currencies in the members' contribution to CMIM arrangements. The BSP also facilitated the swift renewal of the Bilateral Swap Arrangement with Japan which took effect on 1 January 2022.

Aside from providing standby resources for financing arrangements, the BSP also supported initiatives that aided the poorest and most vulnerable countries

affected by natural and health disasters. Through the IMF, and on behalf of the Republic of the Philippines, the BSP contributed US\$4.0 million to the Fund's Catastrophe Containment and Relief Trust<sup>67</sup> to be disbursed in four equal annual installments, which began in 2021. The BSP's active participation in sustaining these financial safety nets is a testament of the country's strong external position while at the same time expanding the BSP's policy toolkit in the event of external shocks or balance of payments problems.

**Negotiation and conclusion of international agreements.** The BSP signed memorandums of understanding (MOUs) with the Monetary Authority of Singapore and Central Bank of Mauritius involving information exchange and capacity building in the areas of financial technology (FinTech), financial market, digital currencies, Islamic banking, and other areas under the parties' jurisdiction.

The BSP also joined the Department of Finance, as lead agency, and the Securities and Exchange Commission and Insurance Commission, as co-conforming agencies, in the negotiation and signing of the MOU with the British Embassy Manila. The MOU formalizes the United Kingdom's support for the country's initiatives in FinTech development, sustainable finance, capital market development, and accounting standards.

In April 2021, the BSP signed and issued the Certificates of Concurrence (COCs)

<sup>65</sup> Based on the exchange rate of SDR0.7/US\$1.0 as of 18 February 2022, according to the IMF website

<sup>66</sup> IMF De-linked Portion is the amount each member may request from the CMIM when there is no matching IMF-supported program.

<sup>67</sup> The trust allows the IMF to provide grants for debt relief for the poorest and most vulnerable countries hit by catastrophic natural disasters or public health disasters.



for the ratification of the Regional Comprehensive Economic Partnership (RCEP)<sup>68</sup> and ASEAN Trade in Services Agreement (ATISA)<sup>69</sup>. The BSP is also actively involved in the negotiation of enhancing the ASEAN-Australia-New Zealand Free Trade Area (AANZFTA), particularly on areas relating to banking and other financial services. The implementation of RCEP, ATISA, and an enhanced AANZFTA is expected to further expand the markets of Philippine banks and other financial institutions. The agreements also aim to increase access to financial services while reducing costs, promoting innovation, and creating a more stable and predictable environment in the sector.

In October 2021, the BSP signed and issued a COC on the Ratification of the United Nations Convention on the Use of Electronic Communications in International Contracts. The convention provides a uniform set of rules that will be observed multilaterally to promote e-commerce through cross-border mutual recognition of digital signatures, electronic communication, and contracts.

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<sup>68</sup> The RCEP is an ASEAN-led free trade agreement (FTA) between the 10 ASEAN member states (i.e., Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and

Vietnam) and its five FTA partners (i.e., Australia, China, Japan, New Zealand, and South Korea).

<sup>69</sup> The ATISA affirms ASEAN's commitment to free and open trade and regional economic integration.

### Box Article 3

## BSP Implements New Reforms to Ease Foreign Exchange Usage and Electronic Transactions

The BSP issued Circular No. 1124 dated 10 August 2021 as part of its commitment to maintain a foreign exchange (FX) regulatory framework that is responsive to the needs of a dynamic and expanding Philippine economy. The issuance marks the 12<sup>th</sup> wave of FX reforms, following measures implemented in 2017 and 2019 that primarily eased rules on foreign borrowings and foreign investments, respectively.

The following are the major reform areas under Circular No. 1124:

- a. Electronic submission of documents and use of electronic or digital signatures. As the COVID-19 pandemic highlighted the need for regulations to be more flexible, the BSP decided to permanently<sup>70</sup> adopt the electronic submission of documents and use of electronic or digital signatures to facilitate clients' submission of documentary requirements and the BSP's processing of applications, as well as to support e-commerce transactions.
- b. Digital payments and electronic transactions. The BSP allowed the FX sale by banks without prior BSP approval for various FX transactions involving e-commerce market participants to support electronic transactions and digital payments. This ensures that FX rules are attuned with market developments and responsive to the needs of the economy as e-commerce transactions rise.
- c. Trade and non-trade current account transactions. The reforms will further facilitate trade and non-trade current account transactions as stakeholders are provided with greater flexibility in submitting alternative documents to support FX sale by banks for settlement of FX obligations. These FX reforms are also supportive of both public and private sector development projects as prior BSP approval is no longer required for FX sales by banks to cover FX obligations under Engineering, Procurement and Construction contracts or similar contracts and agreements, and those under certain netting arrangements. Furthermore, cognizant of the possible need for monetary support of dependents of Philippine residents, the BSP also allowed the FX sales by banks for living allowance and medical expenses of dependents living abroad.
- d. Peso deposit accounts of non-residents. The BSP further expanded the list of eligible sources of funding for peso deposit accounts of non-residents to include, among others, peso receipts relating to trade transactions and private sector foreign borrowings that are duly approved by, registered with, or reported to the BSP. The expansion in eligible fund sources will further encourage peso transactions of residents with non-residents. For instance, allowing deposits of onshore peso receipts of non-residents from trade transactions will facilitate electronic transactions under local currency settlement frameworks.

<sup>70</sup> In response to the declaration of community quarantine by the Office of the President, the BSP temporarily allowed electronic submission of documents to the

BSP and banks as well as use of electronic or digital signatures as part of the BSP's operational relief measures under Circular No. 1080 dated 27 March 2020.



e. Foreign borrowings, foreign investments, and FX derivatives transactions. To facilitate access to FX of the banking system and enhance data capture on external debt, the BSP allowed registration of certain private sector foreign borrowings such as those obtained without the requisite BSP approval and intended to refinance unregistered or unreported foreign loans or foreign currency borrowings. The BSP also allowed the FX sale by banks for refund of taxes and erroneously withheld taxes related to BSP-registered foreign investments. In addition, the BSP lifted the prior Monetary Board approval requirement for all FX derivatives transactions to be entered into by non-bank government entities to provide them with flexibility in managing their funds.

Overall, these reforms are expected to facilitate FX transactions which, along with other key market reforms, will help support the country's continued economic recovery.

With the continuing liberalization of FX rules, the BSP expects banks to maintain the implementation of safe and sound practices in their operations. The BSP shall continue to review and enhance the country's regulatory framework to facilitate FX transactions by improving access to foreign currencies of the banking system and further streamlining the procedures and documentary requirements.

## **PROMOTING A SOUND, STABLE AND RESILIENT FINANCIAL SYSTEM (FINANCIAL STABILITY)**

The BSP continued to promote the safety, soundness, and resilience of the financial system in 2021 through reform initiatives, policy disciplines, and adherence to prudential regulations and international standards. The BSP leveraged advances in technology to strengthen surveillance activities and sharpen supervisory tools. Similarly, it facilitated the increased participation of more BSP-supervised financial institutions (BSFIs) in the financial system, promoted responsible innovation and the sustainability agenda, and supported deepening of the domestic capital market.

### **Financial Supervision**

#### **Promoting the sustained safety, soundness and resilience of the financial system**

Continued reforms and policy initiatives that strengthened banks' corporate governance and risk management since the 1997 Asian Financial Crisis—including enhancements of the BSP supervisory framework—shielded the Philippine financial system from the ill effects of the COVID-19 pandemic. Thanks to past reforms, banks faced the unprecedented crisis from a position of strength.

The BSP ensured that BSFIs were operating in a safe and sound manner through supervision, multi-stakeholder collaboration, consumer protection, and regulations.

This included the implementation of the Supervisory Assessment Framework, which facilitates a more robust and forward-looking evaluation of the risk profile and quality of governance of the BSFIs. The BSP has been pro-active in engaging with BSFIs and employed the use of digital platforms in the conduct of examinations. Moreover, thematic reviews were conducted for emerging risk areas or areas of significant concern across the industry such as mobile or internet banking and money laundering/terrorist financing. This blended approach was complemented by enhanced surveillance activities, including ad hoc stress testing exercises.

#### **Multi-stakeholder collaboration**

This included provision of technical support and inputs to legislative measures relevant to the financial system, with special focus on creating a more sustainable micro, small and medium enterprises and agricultural financing ecosystem, as well as providing assistance to critically affected sectors of the crisis. This also included continued stakeholder engagement with foreign counterpart regulators through the Executives' Meeting of East Asia-Pacific Central Banks Working Group on Banking Supervision (EMEAP WGBS), as chairman until 2022; and with supervised financial institutions through the Bank Supervision Policy Committee.

Moreover, the BSP strengthened collaboration of financial sector regulators under the Financial Sector Forum with the signing of the Memorandum of Agreement (MOA) on Cooperative Oversight Framework and the MOA on the Implementation of a

Centralized System for Accreditation/Selection of External Auditors in the Financial Sector, as well as the creation of technical working group on sustainable finance to harmonize cross-sectoral regulations and standards on sustainable finance encompassing governance, risk management, disclosures and taxonomy.

The BSP also promoted research initiatives and publications such as the papers on stress testing and microfinance as well as the Industry Cybersecurity Playbook.

### Consumer protection

The BSP continued outreach activities and capacity-building programs through virtual platforms amid the pandemic restrictions to ensure that consumers are properly informed particularly on the optimal use of digital financial channels and protection against cyber fraud and scams. It also intensified surveillance focusing on COVID-19-themed cyberthreats and issued various advisories to address emerging cyberthreats.

### Regulation

The BSP issued responsive regulations, including time-bound relief measures to support BSFIs and their borrowers (households and businesses) amid the COVID-19 crisis.

The BSP issued 21 circulars, 93 circular letters and 56 memoranda to all banks and non-bank supervised entities. Below are some of the key circulars and memoranda issued in 2021.

- Amendments to corporate governance guidelines for BSP-supervised financial institutions. The amendments comprise the second phase of the enhancements to BSP's enhanced corporate governance guidelines. The amendments governing interlocking directorships or officerships, or both, follow a principles-based approach in assessing the soundness of interlocking positions, ensuring that the concerned individuals effectively carry out their responsibilities in the BSFI and are not in conflicting positions.
- Guidelines on reputational risk management. The issuance sets out the supervisory expectations on banks to effectively manage reputation risk. Banks should take a holistic approach in managing reputation risk in relation to other risk areas. Moreover, banks should properly identify and assess sources of potential threats that could damage their reputation.
- Environmental and Social Risk Management Framework. This governs the integration of environmental and social (E&S) risks in the enterprise-wide risk management frameworks of banks. This second phase of environment, social and governance related issuance provides granular expectations on the management of E&S risks in relation to credit and operational risks.
- Amendments to the regulations on investment management activities. The regulation reduces the minimum amount for opening an investment management account from ₱1.0 million to any lower amount, subject to a floor of ₱100,000. This provides expanded

investment opportunities to retail investors who may have found the previous high entry requirement prohibitive.

- Amendments to operational risk management and internal control measures. The guidelines aim to strengthen Know-Your-Employee (KYE) policies and practices and tighten controls related to confirmation of deposit accounts, as part of the overall operational risk management system of BSFIs. The issuance highlights the importance of continuing assessment of employees' fitness and propriety to perform the responsibilities required of the position. BSFIs are expected to leverage on existing controls, available reports, and other relevant information to facilitate the assessment. The revised policy also identified certain behaviors that serve as red flags warranting further scrutiny as part of personnel's performance evaluation.
- Amendments to the relevant regulations on Foreign Currency Deposit System - Phase 2. This is part of the BSP's phased reform agenda for foreign currency deposit units (FCDUs). The amendments provide banks the opportunity to perform efficient and flexible liquidity cash management of foreign currency-denominated funds by streamlining the rules on lending to the regular banking unit by FCDUs. The issuance also expands the coverage of entities allowed to engage in FCDUs to include Islamic and digital banks and streamlines the licensing requirements for banks applying for such authority.
- Amendments to derivatives regulations of banks, quasi-banks and trust corporations. The revised regulations removed tenor limits on instruments classified as generally authorized derivatives activities (GADA) and add non-deliverable foreign exchange (FX) forwards and FX swaps to the list of GADA under dealer capacity for universal and commercial banks. This issuance supports the growth of and expedite the availability of new products in the domestic derivatives market.
- Amendments to regulations on the open foreign exchange position of banks. The issuance revised the net open FX position limit (FX NOP) of a bank to the lower of 25.0 percent of qualifying capital or US\$150.0 million, from the previous limit of 20.0 percent of unimpaired capital or US\$50.0 million, whichever is lower. The increase in both the absolute and capital-dependent NOP limits recognizes the growing demand for FX arising from the growth in the volume of underlying trade transactions and investments.
- Guidelines on the management of liquidity risk by Islamic banks and Islamic banking units. The policy aims to support the implementation of Republic Act No. 11439 or An Act Providing for the Regulation and Organization of Islamic Banks. It is primarily aligned with the BSP's existing liquidity risk management framework for conventional banks, with additional provision to cover the specificities of Islamic banking operations. It aims to create an enabling environment that will allow Islamic banks to operate alongside the conventional banks under the

- same regulatory approach, taking into consideration the unique features of Islamic financial activities and transactions.
- Guidelines for Virtual Asset Service Providers (VASPs). The amended framework effectively categorizes existing virtual currency exchanges as VASPs. It has expanded the activities of VASPs subject to the licensing regime of the BSP from initially covering those involved in facilitating the exchange of fiat and virtual assets (VAs). In particular, the following activities shall likewise be subject to the BSP's licensing requirements, regulatory expectations for money service businesses (MSBs), as well as anti-money laundering, countering the financing of terrorism, and proliferation financing obligations: (1) exchange between one or more forms of VAs; (2) transfer of VAs; and (3) safekeeping and/or administration of VAs or instruments enabling control over VAs.
  - Open Finance Framework. The Open Finance Framework promotes consent-driven data portability, interoperability, and collaborative partnerships among entities who adhere to the same standards of data security and privacy. Filipinos will be able to make informed financial choices by having a consolidated view of their personal data and their financial transactions that they can use to access more affordable services that fit their needs. Consumers will have the power to grant access to their financial data that will shape a customer-centric product development objective.
  - Amendments to the rules and regulations on the mandatory credit allocation for agriculture and agrarian reform credit. The amendments facilitate the provision of available financing to the agri-agra sector by providing banks with expanded financing avenues, streamlining banks' process of investing in agri-agra eligible securities, and promoting innovative financing solutions that fall within the ambit of Republic Act No. 10000.
  - Report on the Risk Assessment of Cash, Cross-Border and Cross-Sector Transactions. The report represents the first phase of the SRA that focused on the assessment of risks attendant to cash, cross-border and cross-sector transactions. The assessment seeks to understand, analyze, and assess the money laundering, terrorist financing, and proliferation financing risks arising from cash transactions of banks and other BSFIs, the flow of suspected criminal proceeds through cross-border transactions, and the risks across certain sectors.
  - Guidance Papers on Managing Terrorist Financing (TF) and Proliferation Financing (PF) Risks and Implementation of Targeted Financial Sanctions (TFS). The guidance papers highlight the good practices, relevant typologies, and red-flag indicators related to terrorism, TF and PF, and implementation of TFS. They likewise identify areas for improvement to strengthen measures to detect, prevent, and mitigate risks arising from the aforementioned activities.

- Implementation of Republic Act No. 11523, otherwise known as the Financial Institutions Strategic Transfer (FIST) Act. The FIST Act aims to assist the financial system perform its role of efficiently mobilizing savings and investments for the country's economic recovery as well as its sustained growth and development from the losses brought about by the COVID-19 pandemic. The BSP issued the implementing guidelines of the FIST Act and its Implementing Rules and Regulations to the different types of BSFIs. It also provided for a reporting template.
- Regulatory relief on the non-imposition of sanctions for breach in single borrower's limit by foreign bank branches established prior to Republic Act No. 10641. The Monetary Board, in its Resolution No. 1708 dated 28 December 2020, approved the grant of regulatory relief to foreign bank branches established prior to Republic Act No. 10641 as part of the initiatives of the BSP to support the country's economic recovery, subject to certain conditions.
- Regulatory relief on the capital treatment of provisioning requirements under the Philippine Financial Reporting Standard (PFRS) 9. As approved by the Monetary Board, covered BSFIs will be allowed to add-back increase in Stage 1 and Stage 2 provisioning requirements booked under allowance for credit losses from end-December 2019 to CET1 capital over a period of two (2) years starting 1 January 2022 reporting period, subject to a declining add-back factor of 100.0 percent (from 1 January to 31 December 2022) and 50.0 percent (from 1 January to 31 December 2023).
- Regulatory treatment of restructured loans on the measurement of expected credit losses (ECL). As approved by the MB, BSFIs that have established that the borrowers' financial difficulty is temporary shall classify the restructured loan accounts under Stage 2 for purposes of determining ECL: *Provided*, That the restructured loan accounts are not more than 90 days past due on principal and or interest payments. Restructured loans that are classified under Stage 2 shall be considered as credit-impaired (Stage 3) if there is evidence that full repayment of the loan under the modified terms is unlikely without foreclosure of collateral.
- Enhancements to the BSP operational relief measures. The Monetary Board, in its Resolution No. 530 dated 29 April 2021, approved the following enhancements to the BSP operational relief measures, in light of the ongoing COVID-19 situation: (1) deferment in the submission of the 2020 annual audited financial statements (AFS) of BSFIs; (2) relaxation of the notification requirements on changes in banking days and hours as well as temporary closure of bank branches/branch-lite units (BLUs) and BSFI offices/service units; (3) relief measure on customer identification; (4) waiver of fees related to the grant of license or authority to provide Types A and B Advanced Electronic Payments and Financial Services; and (5) waiver of BSP approval on requests for extension of the deadline to open approved bank branches/BLUs.

- Use of Philippine Identification System (PhilSys) ID for customer identification and verification. This was issued in response to the call of the Philippine Statistics Authority (PSA) urging the public acceptance of the Philippine Identification (PhilID) cards as valid proof of identity in government and private transactions. The guidelines reminded all BSFIs that the PhilID card is considered an official document to establish and verify the identity of a customer and should be accepted as official and sufficient proof of identity without the need to present any other IDs.
- Acceptance and authentication of Philippine Identification Card under the Philippine Identification System. This was issued in line with the PSA press release and advisories. The BSP reminded BSFIs that the PhilID card, in physical or mobile format, issued under the PhilSys pursuant to Republic Act No. 11055 or the PhilSys Act, shall be accepted, subject to proper authentication, as a sufficient proof of identity. The memorandum further clarified that while the online authentication and the cryptographic verification methods are still being developed and not yet available, relying parties, such as BSFIs, can administer or implement the physical/visual verification of the physical or security features of the PhilID, which are superior to a handwritten signature, and the same qualifies as an "offline authentication" and is already in compliance with the procedures of Republic Act No. 11055.
- Reminder to BSFIs to refrain from discriminatory practices toward persons with disability (PWD). The issuance is to remind BSFIs against discriminatory practices toward PWDs.
- Advisory on modus operandi (MO) of organized crime groups (OCG) through auto loans. The advisory warns BSFIs against emerging MOs of OCGs or "carnapping syndicates." The warnings emphasized that carnapping syndicates acquire high-end motor vehicles (MV) through auto loans under fictitious identities. The mortgaged MVs are subsequently sold to the public using fake conduction stickers and plate numbers.
- Advisory on banking and Other related functions considered as essential services and its employees among authorized persons outside of residences. The issuance aims to ensure the continuous availability of financial services to the public. All BSFIs are enjoined to adopt appropriate work arrangements consistent with the community quarantine imposed by the national government. The BSFIs and its employees are also reminded to continuously observe minimum public health standards and protocols issued by the Department of Health and Inter-Agency Task Force.

**Leveraging advances in technology to strengthen surveillance activities, sharpen supervisory tools, and promote efficiency**

Advances in supervisory technology provide the BSP, as a supervisor, with an opportunity to improve the quality and

timeliness of risk identification and monitoring.

The BSP is also an institutional partner of the RegTech for Regulators Accelerator (R2A), which develops cutting-edge digital tools or regulatory technology (RegTech) solutions to improve the speed, quality, and comprehensiveness of information for risk-based supervision and evidence-based policymaking. Among its activities along these lines are the following:

- Process improvements geared toward enhancement of receipt and generation of data from BSFIs, dashboard for risk profiling of BSFIs, and data pull of information for ease of reporting;
- Online customer satisfaction survey, an online feedback mechanism using Microsoft Forms and Microsoft Power Automate applications;
- Launch of Fit-and-Proper System access, a web-based search engine tool that provides information on individuals, which are necessary inputs to supervisory processes, such as confirmation of directors and officers of BSFIs;
- Launch of Visualization Tool for Analytics, a Microsoft Power BI-based platform. The goal is to promote "augmented supervision" through the development and use applications and analytic tools to improve the collection, management, and delivery of data for supervisory purposes and achieve a faster turnaround time from data to insight;
- Completion of the Integrated Pawnshop and Money Services

Business Registration System, which automates the registration process of Pawnshops and MSBs; and

- Introduction of electronic submission of reports, together with rationalization of submission of prudential reporting requirements.

### **Increased participation in the financial ecosystem of more BSP-supervised financial institutions and promotion of responsible innovation**

The BSP's Three-Year Digital Payments Transformation Roadmap sets out initiatives and strategies for achieving an efficient, safe, and inclusive payments ecosystem. The roadmap has a couple of objectives. First, it aims to strengthen customers' preference for digital payments by converting 50.0 percent of the total volume of retail payments into digital form. Second, it seeks to expand the proportion of financially included adult Filipinos to 70.0 percent.

The issuance of the digital banking and open finance frameworks is geared toward the achievement of such objectives. Following the release of the Digital Banking Framework in December 2020, the BSP chartered six digital banks (comprised of two converting banks and four new players) in 2021.

Other initiatives were the following:

- Issuance of Guidelines for VASPs;
- Issuance of clarificatory guidelines on Philippine Identification System (PhilSys) ID acceptance and authentication, including the relaxation of Know-Your-Customer requirements, particularly the presentation of valid IDs by retail

clients in opening Basic Deposit Accounts and by identified recipients of social amelioration programs supporting the pillars on digital finance;

- Issuance of inter-agency reference guidelines on Customer Identification and Verification as well as Consumer Protection under the auspices of the Financial Sector Forum; and
- Promotion of Islamic banking and finance in collaboration with the Philippine Economic Zone Authority and Accounting and Auditing Organization for Islamic Financial Institutions.

### **Advancement of the sustainability agenda**

Consistent with the Sustainable Central Banking Program (2019), the BSP issued sustainability-related regulations for banks. Following the release in April 2020 of the overarching principles on the integration of sustainability policies and practices in the banks' corporate governance, risk management system, strategic direction, and operations, related activities were conducted in 2021, including:

- Communication of the BSP's commitment for the achievement of global climate goals and contribution to the 26<sup>th</sup> United Nations Climate Change Conference of Parties;
- Launch of the Philippine Sustainable Finance Roadmap and Guiding Principles in October 2021;
- Issuance of the Environmental and Social Risk Management Framework;

- Active participation in global and regional conversations on sustainable finance, such as memberships in the Sustainable Banking and Finance Network, Network for Greening the Financial System, East Asia-Pacific Central Banks (EMEAP-WGBS and MFSC), ASEAN SLC Task Force on Sustainable Finance, Working Group 1 of the ASEAN Taxonomy Board, and Inter-agency Technical Working Group on Sustainable Finance or the Green Force;
- Conduct of vulnerability assessment on the potential impacts of climate change and other environmental risks on BSP offices and branches, and gap analysis on the integration of sustainability principles in the key operations and functions of the BSP; and
- Collaboration with multilateral development partners and industry associations on the conduct of various capacity-building activities on sustainable finance.

### **Deepening of the domestic capital market**

The BSP amended regulations relevant to domestic capital markets, including amendments to investment management account, derivatives, securities custodian and registry operations, and open foreign exchange positions of banks. These enhancements are expected to pave the way for new entrants and retail investors, product expansion, price discovery, robust risk management and governance systems, consumer protection, ample liquidity, and transfer of appropriate technology, among others.



Amid enabling regulations, digital Personal Equity and Retirement Account contributions, which serve as a source of long-term savings for capital market deepening, grew last year.

## Box Article 4

### **Innovating Bank Examination During the Pandemic**

As mandated under Republic Act (RA) No. 7653, otherwise known as the New Central Bank Act, as amended by RA 11211, examinations are performed to determine whether BSP-Supervised Financial Institutions (BSFI) are conducting their businesses in a safe and sound manner. For the longest time, examinations were done on-site or at the BSFIs' premises. However, travel limitations, and health and safety concerns in the wake of the COVID-19 pandemic posed considerable challenges in conducting on-site examinations.

As the pandemic lingers on, many organizations have changed and adopted new approaches to carrying out their mandates. Thus, the Bangko Sentral ng Pilipinas (BSP) leveraged the use of information technology (IT) platforms to exchange information and documents, and communicate with BSFIs instead of face-to-face engagements.

Alternative modes of examination have been adopted in other jurisdictions even prior to the pandemic. As early as 2007, the Federal Deposit Insurance Corporation, an independent agency supervising and examining financial institutions in the US, introduced the electronic examination (Jones & Meyer, 2007) or e-Exam, in which electronic data are exchanged through a secured delivery method. Industry response to e-Exams has been positive. Examination conducted on-site requires adequate work spaces for the examination team which is not the case for virtual examination. Moreover, providing documents to the examiners electronically, rather than through the traditional hard copy, saves considerable time and effort from banks, especially those already maintaining digital copies of bank documents.

The BSP adopted an alternative mode of examination called "blended examination" which generally mimics on-site examination procedures using online platforms. Discussions with bank management, document reviews, and walk-throughs of processes and systems are being done virtually, with scope to conduct on-site visits of banks, when necessary.

Blended examinations provided huge benefits. The BSP was able to continue fulfilling its mandate without compromising the health and wellness of BSP examiners. This examination approach complemented the introduction of the Supervisory Assessment Framework, a robust, dynamic and forward-looking assessment framework, which enabled the BSP to effectively carry out its supervisory functions both off-site and on-site.

However, a blended examination is not without its challenges and limitations. Three key issues were identified namely: insufficient BSFI manpower, deficient IT infrastructure, and lack of on-site observation inputs.

In view of the government-imposed restrictions during the pandemic, BSFIs adopted alternative work arrangement, limiting personnel who are reporting physically to their offices and delaying the submission of some examination requirements. The shift has affected the availability, accessibility, and ease of viewing of documents, which may be attributed to insufficient resources to adopt blended examination. Moreover, financial institutions that largely rely on manual operations tend to suffer from poor internet connection or inadequate equipment.



Finally, the BSP cannot conduct the usual observations on the practices, controls, and dynamics within the bank, which should feed into the assessment of the quality of corporate governance.

The BSP responded to these challenges by strengthening its surveillance tools, enabling it to analyze financial institutions depending on their profile, i.e., type of institution, business model, and market. These tools include the supervisory dashboards with inputs coming from the prudential reports and event-driven reports submitted by financial institutions, information from aggregated consumer complaints, baseline surveys, and stakeholder engagements.

The BSP also conducts trend analysis and stress tests. The latter provides information on the extent to which the financial institution's capital can absorb potential losses. The BSP supervision teams schedule more frequent meetings with the board of directors and officers of financial institutions that are exposed to higher-than-normal risk. These financial institutions are required to submit more detailed reports and documents to show their monitoring systems and governance processes. Meanwhile, trends or risks noted across banks with a similar profile are discussed with industry associations.

Moving forward, the BSP will continue to leverage advances in technologies and combine traditional and new approaches to further improve its supervision processes in line with its mandate to promote the sustained safety, soundness, and resilience of the financial system.

## Box Article 5

### Promoting Islamic Banking in the Philippines and the Road Ahead

Amid the COVID-19 pandemic, 2021 was a remarkable year with the Bangko Sentral ng Pilipinas' (BSP) unceasing initiatives to promote Islamic banking in the country while intensifying collaboration with other regulatory agencies to jointly build the foundation for the domestic Islamic finance industry.

The BSP recognizes that a whole-of-government approach is critical to advance the initiatives on Islamic banking and finance. Linkages with key stakeholders need to be created to establish an expanded Islamic banking ecosystem. This is the strategy in implementing the key provisions of the Islamic Banking Law (Republic Act No. 11439) and the Organic Law for the Bangsamoro Autonomous Region in Muslim Mindanao (Republic Act No. 11054).

To institutionalize the Bank's commitment to spearhead relevant initiatives of the Islamic banking law, the BSP created the Islamic Banking Supervision Group (IBSG) on 18 June 2021. IBSG is the focal group for the BSP's strategic initiatives and prudential policy reforms to implement the Islamic Banking Law and other pertinent provisions of laws that aim to strengthen Islamic banking.

Geared toward expanding the multiple linkages of stakeholders in the promotion of Islamic banking and finance in the country, the BSP reconstituted the Interagency Working Group (WG) on Islamic Banking and Finance on 25 August 2021 under Office Order No. 1064. This rekindled the whole-of-government approach in the establishment of a strong and sustainable Islamic finance ecosystem that can thrive alongside the conventional system.

The WG is primarily tasked to develop the comprehensive regulatory framework for the sector, including the necessary instruments and infrastructures for its expansion and long-term sustainability by linking the initiatives of the relevant agencies in the areas of Islamic capital market, government sovereign *Sukuk* issuance, *Takaful* or Islamic Insurance, tax neutrality, accounting and auditing standards, *Shari'ah*-compliant deposit insurance mechanism, and the nationwide capacity-building programs.

Also, the group is now comprised of high-level and senior officers from the BSP, Securities and Exchange Commission, Bureau of Treasury (BTr), Insurance Commission (IC), Philippine Deposit Insurance Commission (PDIC), Bureau of Internal Revenue (BIR), Department of Trade and Industry, Financial Reporting Standards Council, and the National Commission on Muslim Filipinos (NCMF). This high-level membership in the WG on Islamic Banking and Finance will ensure firm commitment to move forward the various initiatives and implementation plans of the working group.

In 2021, the BSP issued Circular Nos. 1069, or Guidelines on the Establishment of IBs and IBUs, and 1070 to implement the provisions of RA 11439; Circular No. 1116 on the Guidelines on the Management of Liquidity Risk by Islamic Banks (IBs) and Islamic Banking Units (IBUs) on 25 May 2021 to emphasize, among others, that *Shari'ah* compliance is critical even in liquidity risk management of IB/IBUs. The issuance reiterates the approach of the BSP to maintain an open and flexible approach in shaping the regulatory framework for Islamic banking.

The BSP is currently working on the guidelines on the reporting framework of Islamic banking transactions and arrangements. This prudential reform is closely coordinated with

the BIR, which is drafting the detailed guidelines for implementing tax neutrality. The BSP will issue more regulations aimed at providing an enabling regulatory environment where Islamic banks can operate alongside the conventional banking system.

The WG's collaboration recently succeeded in pushing for another milestone prudential reforms on *Takaful*. The dialogues conducted between BSP and the IC's focal group on Islamic insurance facilitated the issuance by the commission of its Baseline Regulatory Framework for *Takaful* Undertakings on 27 January 2022.

The WG is also actively engaging with the BTr and the Department of Justice for the potential first sovereign *Sukuk* issuance of the Philippines.

Recognizing the importance of collaboration in promoting Islamic banking and finance, the BSP entered into a Memorandum of Understanding (MOU) with the Philippine Economic Zone Authority on 19 October 2021. The parties agreed to jointly cooperate and collaborate in the promotion of Islamic banking and finance through, among others, the establishment of Green Ecozones, Halal Hubs, and provision of relevant capacity building programs and access to *Shari'ah*-compliant products and services in halal ecozones. This partnership is expected to bring far-reaching benefits, including the search for potential new Islamic banking players.

Following the MOU signing, a roadshow was held in December 2021 in Dubai in coordination with the Board of Investments. The Philippine delegates met representatives from the Dubai Islamic Bank Group and other organizations to discuss the licensing framework for Islamic banks in the Philippines.

The BSP ended 2021 with the successful signing of another MOU with the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) on 1 December 2021, providing for cooperation in the areas of capacity building and technical assistance as well as possible adoption of relevant AAOIFI-issued standards by the domestic Islamic banking and finance industry, among others. This complements the BSP's membership in another key standard-setting body on Islamic finance: the Islamic Financial Services Board.

In 2022, the BSP aims to reach another milestone by establishing an important element of Islamic banking. In cooperation with the Bangsamoro Government, the Department of Finance and the NCMF, the BSP is leading initiatives to establish a *Shari'ah* Supervisory Board in the Bangsamoro Autonomous Region of Muslim Mindanao. The move signals to the market the key role of *Shari'ah* compliance in Islamic banking. It is also noteworthy that the forthcoming passage of an amendatory law will empower the PDIC to set up insurance coverage for depositors of Islamic banks and formulate rules and regulations for the extension of financial assistance, taking into consideration the peculiar characteristics of Islamic banking. The WG will take a crucial role in advancing initiatives in this area. To ensure that Islamic banks will have supportive monetary policy and infrastructure in the BSP, there will be calibrated policy reforms for the integration of *Shari'ah*-compliant instruments in the BSP's monetary operations framework and the development of financial facilities for Islamic banks.

The BSP is carefully shaping the building blocks of an expanded Islamic banking system by collaborating with all the stakeholders and agencies tasked to develop the complementary components of an Islamic finance industry in the country. There are still bigger plans needing firm commitment and bold measures, and more work for all the stakeholders, making the promotion of Islamic banking and finance even more exciting and promising.

## Box Article 6

### **Mergers, Consolidations and Acquisitions Project Enhances Ease of Doing Business**

The BSP and other concerned government agencies have embarked on a project that will enhance transactions related to mergers, consolidations and acquisitions in the banking sector.

Under the Mergers, Consolidations and Acquisitions (MCA) Project, the BSP, Philippine Deposit Insurance Corporation, Philippine Competition Commission, Securities and Exchange Commission, and Cooperative Development Authority adopt simplified and coordinated requirements and procedures related to MCAs, consistent with the goal of enhancing the ease of doing business in the country.

In a virtual ceremony held on 5 November 2021, the five agencies signed a memorandum of agreement (MOA) on the procedures for applications for MCAs of banks. The MOA contains provisions on the following areas:

1. Issuance of guidelines that will streamline the procedure, reduce aggregate processing time, and facilitate prompt action or resolution on MCA application of banks;
2. Establishment of a working arrangement among the agencies in the processing of banks' applications for MCAs; and
3. Enhancement of complementary roles of each agency in promoting and maintaining the stability of the Philippine banking system.

An MCA application used to be separately and sequentially processed by the agencies involved—each with different requirements and timelines. The same process is considered “interconnected” as the deliverable of one agency is an input to the other. As a result, a delay in one agency creates a domino effect on the entire process. In response, the MCA Project strives to harmonize the requirements of the different agencies and adopts simultaneous processing of applications.

The entire MCA application process takes 55 business days. For its part, the BSP reviews the viability of the business plan relative to the MCA transaction and compliance with banking laws, BSP rules, and regulations. The BSP processes MCA applications in 40 business days. Part of the objective of the MCA Project is to promote reliance on the expertise of the agencies in the implementation of their respective mandates and governing laws. Hence, the BSP will be working closely with other agencies during the evaluation of an MCA application. Alongside the reduction in processing time, the BSP will also implement operational enhancements to meet the required processing timeline.



The said interagency MOA supports the BSP's efforts to encourage banks to pursue MCAs to build up size and strength. Furthermore, the execution of the MOA is aligned with the BSP's advocacy for bank mergers and consolidations. It promotes stronger banking institutions founded on good governance and effective risk management systems. It is also expected to strengthen and reduce fragmentation in the banking system. The streamlined procedure, reduced processing time, and prompt action or resolution of applications will encourage banks to pursue MCAs. With higher capital and resources as well as better economies of scale, banks will widen their reach and gain more access to investments and clients.

The agencies will issue implementing guidelines through a joint circular to provide details of the processes described in the agreement. The MOA also states that the agencies may later adopt other additional guidelines and procedures, consistent with the terms of the MOA. These include the establishment of a data portal for the electronic submission of documents that may be accessed by authorized personnel of each agency.

## Box Article 7

### **Managing the Effects of the Philippines' Inclusion in the Financial Action Task Force List of Jurisdictions Under Increased Monitoring or Grey List**

The Philippines made a high-level political commitment to work with the Financial Action Task Force (FATF) and Asia Pacific Group (APG) on Money Laundering to strengthen the effectiveness of the country's anti-money laundering/counter-terrorist financing (AML/CFT) regime. Anchored on a "whole-of-country" approach, the Philippines has taken proactive steps to address by January 2023 the identified strategic deficiencies in its regime to counter money laundering, terrorist financing (TF), and proliferation financing (PF).

Critical components of the "whole-of-country" approach include ensuring that strategic steps are being taken to address the identified areas and to manage and mitigate the effects of the inclusion of the Philippines in the FATF list of jurisdictions under increased monitoring or grey list. These are coordinated and overseen by the National AML/CFT Coordinating Committee (NACC) headed by the Executive Secretary. Created under Executive Order No. 68, series of 2018, the NACC is tasked to harmonize AML/CFT efforts of relevant government agencies to ensure that they are consistent with the National AML/CFT Strategy 2018-2022. The BSP chairs the Supervision of Financial Institutions Sub-Committee, one of the five subcommittees of the NACC.

The NACC, in its Resolution No. 3 dated 26 November 2021, issued the advisory on the application of the risk-based approach on Filipinos after the inclusion of the Philippines in the FATF Grey List. It emphasized, among others, that Filipinos should not be considered as high-risk based solely on the said FATF statement and therefore should not be subjected to enhanced due diligence or any form of countermeasures by reason only of jurisdictional or country risks arising from the grey list. The BSP also formed a dedicated team that tracks and collates the actions and countermeasures taken by other jurisdictions as well as catalogs incidents related to de-risking and correspondent banking, among others. The information gathered will be used in implementing appropriate policy responses and other necessary interventions.

The BSP is implementing measures to address the three action-plan items relating to implementing the new registration requirements for money or value transfer services, applying sanctions on unregistered and illegal money remittance operators, and enhancing the effectiveness of the targeted financial sanctions framework (TFS) for both TF and PF.

The BSP remains committed to implement strategies to closely identify and monitor the impact of the FATF's grey-listing of the Philippines to inform policy actions and engagement activities with key stakeholders. It will ensure that the remaining action plan items for BSP and BSFIs will be adequately addressed, in line with the country's strong commitment to address all identified strategic deficiencies to exit from the grey list.

## Systemic Risk Management

The BSP delivered on milestones critical to the financial stability agenda. These included technical initiatives such as the Systemic Risk Crisis Management (SRCM) Framework, and the enhancement of various firm-level network models that are at the core of the initial phase of the first-ever Macroprudential Stress Tests in the country.

Collaborations within and between agencies were likewise strengthened. Rephrasing the context of systemic risk to a broader audience was prioritized, and capacity-building activities were pursued.

**Executive Order No. 144.** A key highlight for the country's financial stability agenda, EO 144, institutionalized the Financial Stability Coordination Council (FSCC) as the interagency body responsible for enhancing financial stability by mitigating systemic risks through timely macroprudential policy interventions. The issuance of EO 144 reflected the government's resolve to strengthen the ability to collectively address systemic risks, and to improve current and future societal welfare.

**Regional Consultative Group for Asia (RCGA) of the Financial Stability Board.** Governor Diokno is on an unprecedented second term as RCGA co-chair. In this capacity, he continues to provide thought leadership with his contributions to the discussions on the impact of global and regional macroeconomic developments in Asia.

**Approval of the SRCM.** This defines the arrangements among the FSCC agencies on how to coordinate in good times so that they become well organized when under conditions of stress. The framework identifies key actions required to classify, assess, manage, and communicate systemic risks that escalate into a crisis. This is an important preemptive initiative to ensure crisis preparedness at the system level and reflects both the BSP's and the council's commitment to managing systemic risks.

**Macroprudential Stress Test.** Another milestone is the conduct of the country's first-ever Macroprudential Stress Test. The completed initial phase assessed the resilience of non-financial corporations (NFCs) to severe yet plausible income shocks using a whole-of-market approach. Central to the analysis is the risk amplification mechanism through business relationships across firms, which estimated the potential second-round effects of decreased supply and demand arising from stressed revenues. The focus on the corporate sector reflected the FSCC's continued vigilance over NFC solvency vulnerabilities and their potential impact on the financial system.

**Network centrality measures added to Strategic Objective 3 in the BSP Strategy Map.** Systemic-risk thinking within the BSP was enhanced by the inclusion of network centrality measures as part of the third strategic objective in the BSP Strategy Map. Specifically, periodic updates on the movements in

the eigenvector centrality scores of the bank-conglomerate network provided empirically-grounded assessments of network connectivity and density.

### **Advisory Committee Deliberations.**

Discussions were conducted at the Advisory Committee (AC) technical staff level highlighting current economic and market conditions. Subsequently, the AC technical staff provided recommendations on monetary stance at the AC level with due consideration to financial stability concerns.

### **Inclusion of new studies and surveillance tools in the periodic Systemic Risk Review.**

The Systemic Risk Review provided to the Financial Stability Policy Committee (FSPC), the BSP's oversight body for financial stability matters, and the interagency FSCC included new studies, enhanced methods, and analytics that improve systemic risk analysis and the identification of its channels of contagion.

- The Credit Risk Dashboard extended the BSP's analysis beyond the banking sector. The estimated vulnerability index incorporates debt-servicing, liquidity, and profitability factors covering local private and publicly listed companies to assess financial distress.
- Intertemporal NFC liquidity and credit conditions were also analyzed using the Vercelli (2009) model, an extension of the Minsky financial instability hypothesis. The examination of the existence and persistence of local zombie firms—companies artificially sustained by

credit—provided complementary information on the state of the non-financial corporate sector.

- Various network analyses were conducted to identify domestic and global contagion and concentration risks. The visualizations traced transmission channels while the estimated centrality measures identified systemically important firms and sectors. The enhancement of intra- and inter-conglomerate maps supplied a “real-world” view of channels through which financial fragilities of “large” institutions may be transmitted.
- Systemic risk analysis was carried out using Power BI, an analytical tool that helped in the visualization of solvency issues among NFCs. This likewise exemplified the BSP's commitment to digital transformation.
- Climate change and its implications for the energy sector were among the new risk areas monitored. Going beyond the physical risks, the potential impact of transition risks on financial markets and the real economy was highlighted in FSPC and FSCC discussions. The analysis of the energy industry included the relationship between gross domestic product (GDP) and energy, the Philippine power supply outlook, and the changing dynamics of the oil industry.
- Analysis of the risks to macroeconomic conditions was widened to include the Philippines' GDP growth recovery trajectories. Simulations were conducted to identify the timeline by which the country returns to pre-



pandemic levels and when it will recover nominal economic losses due to the pandemic. Beyond the aggregate, monitoring also included a more granular analysis of the drop in household incomes across demographics and the uneven nature of the recovery.

**Issuance of the first semester Financial Stability Report (FSR) and Statement on the State of Financial Stability.**

In the FSR, the BSP reviewed the broad effects of COVID-19 and focused on three industries that are central to the new economy. The BSP also recommended specific action items. Separately, the BSP used the Flesch-Kinkaid readability index and found that the country's FSR compares well with other such reports. Meanwhile, the Statement on the State of Financial Stability, a first-ever public release, provided a comprehensive yet succinct assessment of 11 risk areas.

**Capacity building.** Capacity building opportunities were provided to both the BSP and the Interagency FSCC personnel. This covered workshops and the crafting of appropriate macroprudential policy interventions. These included The Asia School of Business Training Program on Bond Valuation and Yield Curve Construction, the International Monetary Fund Singapore Regional Training Institute's Financial Market Analysis training and conduct of various internal capacity building initiatives.

## Box Article 8

### **Executive Order 144: Strengthening Domestic Financial Stability Initiatives**

The global financial system was brought to the proverbial cliff by the Global Financial Crisis (GFC) of 2008. It was not just the magnitude of the dislocations that was the centerpiece of policy discussion but the sheer surprise that such a crisis could unfold to end the period of the Great Moderation. Thus, the authorities invested a lot of effort in understanding why the buildup and emergence of such a crisis was not evident, while doing much of the firefighting to stabilize the global economy.

Much of the learning insights were summarized under the policy pursuit of financial stability and its focus on managing systemic risks. This defined the post-GFC reform agenda. The issuance of global standards or best practices thereafter was meant to “achieve financial stability” as defined by the experience from the GFC. In fact, as the COVID-19 pandemic induced a global recession in 2020, authorities have been keen to evaluate whether the post-GFC reforms have withstood the test of the “next crisis.”

For the BSP, there was much to learn from the GFC. The country did not experience any direct fallout from the collapse of Lehman Brothers and the necessity to bail out the American International Group. But understanding why the crisis happened and preemptively preventing (rather than responding *ex post facto*) a similar disruption in the local context were important policy considerations. Thus, in the 2009 strategic planning exercise of the BSP, this specific notion of financial stability<sup>1</sup> was discussed, and a high-level internal committee was soon put in place to monitor and act upon any emerging systemic risk within the purview of the BSP as the monetary authority.

#### **Creating the Financial Stability Coordination Council and the Executive Order**

There was a realization that system-level disruptions could come from other elements of the financial system. This led to the convening of the interagency Financial Stability Coordination Council (FSCC) in 2011. As a voluntary aggrupation, the council's work has always been collaborative. However, in one of its regular meetings in late 2020, executive committee members themselves suggested that the council be “formalized”.

Thus, the BSP Governor, as FSCC chairman, wrote the President in December 2020 requesting consideration of an executive order that would “institutionalize” the FSCC. The President favorably responded and signed Executive Order (EO) No. 144 on 3 July 2021.

#### **The Key Elements of the Executive Order**

The EO recognizes “the importance of financial stability to the overall health of the country’s financial system and strengthen[s] the ability of the Government to collectively address systemic risks, which may arise in different segments of the financial market.” This is the key premise for the order, highlighting the crosscutting nature of systemic risks.

Recognizing that systemic risk, by its nature, is crosscutting, the EO allows the FSCC to collaborate with foreign authorities who work on financial stability issues. Domestic collaboration is likewise called upon when it comes to data and research.

The organizational structure of the FSCC is retained by the EO. The BSP Governor shall be the chairperson of the council and the BSP shall serve as the technical secretariat.

### **The EO and the BSP Charter**

The issuance of the EO fully supports the amended charter of the BSP. Under Republic Act (RA) No. 11211, financial stability is one of the four mandates assigned to the BSP. There is, in fact, full complementarity between RA 11211 and EO 144. The former calls for working with identified government institutions, which, at the minimum, are the member agencies of the FSCC. The latter, on the other hand, provides a vehicle for handling the crosscutting nature of the risks.

While the BSP charter speaks of “administrative autonomy,” this should not be interpreted to mean that the BSP will be isolated from other government agencies in performing financial stability functions. The EO simply established the legal framework for what will still be a collaborative effort under the leadership of the BSP Governor.

Operationally, the EO does not, in any form or shape, set aside the fact that banks remain the dominant players in our financial system. Nonetheless, it recognizes that systemic risks can arise from any component of the system. Given all these, the order provides a solid basis for acting collaboratively toward enhancing the welfare of the Filipino people.

## Box Article 9

### **Safeguarding Financial Stability: The Systemic Risk Crisis Management Framework**

The Global Financial Crisis of 2008 as well as the recent recession caused by the COVID-19 pandemic both show the disruptive nature of crises. While authorities may not have had a ready playbook for each crisis, working in an organized manner helps diffuse the panic and confusion of both market players and the public. With crises happening every so often, authorities have the responsibility to be organized when one occurs. In this context, the BSP and the Interagency Financial Stability Coordination Council (FSCC) have taken a preemptive step to prepare for the next occurrence of a systemic shock by making the system more resilient even when there is no crisis. This is embodied in the Systemic Risk Crisis Management (SRCM) Framework.

The SRCM Framework defines the FSCC's organized approach to handling systemic risk crises but it is different in two respects. First, it looks specifically at systemic crises, as this is about system impairment that affects the economy and not just the rehabilitation and recovery of specific institutions. The definition of "systemic risks" is taken from the joint work of the IMF-BIS-FSB (2009): "[T]he disruption to the flow of financial services that (1) is caused by an impairment of all or parts of the financial system; and (2) has the potential to have serious negative consequences for the real economy." Second, the SRCM Framework, despite its name, is not only about responding to a crisis. Instead, it is an overarching framework for market oversight that is implemented in normal times so that authorities would be better prepared during periods of stress.

#### **Coverage and Key Protocols**

Given the crosscutting nature of systemic risks, the SRCM Framework is a collaborative undertaking among financial authorities. It defines the arrangements among them, which includes formalizing the declaration of systemic risk crisis, initiating crisis protocol arrangements among the authorities, implementing policy interventions, communicating with the various stakeholders, and learning lessons after systemic risk crisis. The framework provides for updating the authorities' knowledge of risk behaviors and sharpening their policy toolkit thereafter.

The SRCM Framework provides guidance on three parts of crisis management: pre-crisis, crisis mode, and post-crisis arrangements. The framework starts with the importance of defining a systemic risk crisis—this is an important organizational tool that triggers immediate action from relevant financial regulators. The crisis management team is immediately designated among the principals of the FSCC member-agencies, and the framework provides quick order to the crisis response. A defined escalation process within the first 48 hours of a systemic risk crisis is emphasized in the SRCM Framework, while still recognizing that some details may change on a case-to-case basis, depending on the nature of the crisis at hand.

Despite the clear aim of crisis preparedness, the SRCM Framework also provides guidance on market arrangements during normal time. Preemptive surveillance and monitoring tools, such as regular implementation of macroprudential stress tests and crisis simulation exercises, are emphasized as crucial undertakings not only in preparing for crises, but more importantly in

mitigating them. Both macroprudential stress test and crisis simulation exercises are whole-of-market simulations that are meant to detect vulnerabilities and focus on the interlinkages within the market network that ultimately define the health of the system. It is important that these normal-time arrangements are in place in preparation for a quick transition to crisis mode, once needed.

On the other hand, the framework also provides guidance on transitions to post-crisis protocols. It discusses the importance of a steady winding down and of taking stock of lessons learned to inform future policymaking.

### **Two Specific Systemic Risk Issues**

Emerging risks in cybersecurity and climate change transition, which are now seen to have systemic impact, are also covered by the SRCM. For instance, the growing number of cyberattacks do not only directly affect financial customers, but also have a broader systemic impact on the credibility, reliability, and integrity of financial service providers, such as the banking system. On the other hand, while the physical impact of climate change is clear from the vast scientific literature, climate conditions affect the value (if not existence) of physical assets and thus, credit and revaluation risks. Even climate change mitigation measures, such as the transition from fossil fuels to renewable energy sources, would create dislocations and disruptions in capital markets that can have systemic effects. There needs to be closer monitoring of these emerging systemic risk issues by financial stability regulators. While the issues originate outside the financial system, they will ultimately spill over to it and to the broader real economy.

### **Putting a Premium on Communication**

Effective communication for systemic risk management is a challenge in normal times, even more so in times of crisis. Silence will feed into uncertainty, while imprudent pronouncements can induce more panic or damage the credibility of authorities. And given the highly nuanced nature of systemic risk management and macroprudential policy, it is imperative that they are effectively discussed among stakeholders in normal times. Then, the matter is not something new that is only discussed when crises arrive. With this, the SRCM Framework offers a strategy for streamlined and effective communication across sectors—regulators, market players, and the public. This is an important factor that is evident across the phases of SRCM. This communication model described in the framework is not just communication under conditions of stress, but communication as a normal recourse of authorities. There is value in increasing the risk sensitivity of stakeholders without inducing panic.

Communication then becomes a "last mile" that supports all internal coordination and policy action, stabilizing against fear. Indeed, well-informed people make well-informed decisions. The aim is to raise enough sensitivity to risk so that people are better equipped to parse through the noise and make better-informed choices.

#### **Reference:**

Financial Stability Board, International Monetary Fund and the Bank for International Settlements. (2009). Guidance to Assess the Systemic Importance of Financial Institutions, Markets and Instruments: Initial Considerations: Report to the G-20 Finance Ministers and Central Bank Governors. October.

## **FOSTERING SAFE, EFFICIENT, AND INCLUSIVE PAYMENT AND SETTLEMENT SYSTEM**

The emergence of innovative contactless payment technology is revolutionizing the retail payments market and is expected to temper cash usage over time. The promotion of payments digitalization while maintaining the safety and efficiency of the national payment system has been at the forefront of the BSP's policy agenda as the country transitions towards a cash-lite society. These reforms support the digital transformation of the national payment system, which proved to be crucial in broadening financial inclusion. At the same time, they also enabled households, businesses, and the government to conduct financial transactions amid the social mobility restrictions and health protocols against the COVID-19 pandemic.

The journey towards a cash-lite society will be governed by the BSP's enabling policy environment that supports broadening the payment choices available to Filipinos. A healthy mix of safe and dependable digital payment options, alongside adequate availability of good quality physical currency, will be maintained. Despite the sustained progress in payments digitalization, the BSP shall ensure the smooth functioning of the cash cycle in the economy in order for cash to continue to be a reliable payment option, albeit at a reduced scale.

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<sup>71</sup> The PESONet is a batch electronic fund transfer system launched in November 2017. Meanwhile, InstaPay is an instant payment system launched in

## **Strengthening the Payment System through Purposive Reforms**

As the economy gradually reopens, the BSP seeks to further promote broader payments digitalization and onboard more Filipinos into the formal financial system. It will also uphold the protection of consumers' rights and interests in the New Economy arrangements.

**COVID-19 pandemic emerged as an essential catalyst for greater digital payments adoption.** The BSP's pre-pandemic initiatives to lay the groundwork for interoperable payment systems proved critical in expanding digital payments adoption during the COVID-19 health crisis. The National Retail Payment System (NRPS), launched in 2015, provides the policy and regulatory framework for the establishment of a safe, efficient, and reliable payment system for the Philippines. The NRPS laid down the regulatory foundations crucial in accelerating the transition to a cash-lite economy by capitalizing on the benefits of digital payments to support the country's economic competitiveness and inclusive growth. The NRPS paved the way for the creation of two automated clearing houses, the Philippine Electronic Fund Transfer System and Operations Network (PESONet) and InstaPay,<sup>71</sup> which allow interoperable fund transfers among accounts from different participating bank and non-bank financial institutions.

April 2018 that facilitates immediate fund transfers on a 24/7 basis.

**There has been a sustained rise in the adoption of digital payments in the Philippines since the start of the pandemic.** The latest e-payments measurement report disclosed that as of end-2020, the share of monthly digital payments volume reached 20.1 percent, which is equivalent to 910 million monthly digital payments,<sup>72</sup> slightly exceeding the BSP's target of "20 percent in 2020" that was set when the NRPS Framework was launched in 2015. It also represents a remarkable progress from 2018 and 2013 when digital payments made up only 10.0 percent and one percent of the total retail payments volume, respectively.

**The combined PESONet and InstaPay transactions rose by 44 percent in volume and 46 percent in value as of end-December 2021 compared with 2020.**<sup>73</sup> InstaPay volume and value of transactions already surpassed ATM withdrawals<sup>74</sup> for the period January-December 2021, while PESONet may approach check volume over time if it will maintain its steady increase. In the same period, the number of PESONet participants increased to 94 while InstaPay reached 62 payment service providers. The growth and diverse participation of banks, including thrift banks and rural banks, as well as non-bank e-money issuers indicate the widening reach of interoperable digital payment services across different regions and income classes in the country.

<sup>72</sup> This volume of monthly digital payments has increased by 38 percent from 660 million monthly digital payments in 2019.

<sup>73</sup> It rose from 36.2 million transactions to 52.1 million transactions, and by 46 percent in value from ₱543.1 billion to ₱792.9 billion from 2020 to 2021.

**Familiarization with and wider use of digital payments made through PESONet and InstaPay gave impetus to other digital payment streams such as the EGov Pay and QR Ph facilities.**

Using the PESONet rail, EGov Pay is an electronic payment facility that allows individuals and businesses to digitally pay taxes, licenses, permits, and other obligations to the government. By end-December 2021, 445 government agencies have already been onboarded in the EGov Pay facility, compared with only two when it was launched in 2019. Usage is also on the rise, with average monthly growth rates of nine percent in volume and 12.0 percent in value of transactions in 2021.

Meanwhile, the InstaPay rail facilitates quick response (QR) code-aided payments using the National QR Code Standard (QR Ph). The BSP required the adoption of QR Ph by payment service providers, pursuant to Circular No. 1055. QR Ph was first launched in November 2019 for person-to-person (P2P) payments that can be used as a viable alternative to coins as it facilitates low-value, high-volume transactions. Riding on the momentum of QR Ph P2P, the BSP and Philippine Payments Management, Inc. rolled out the QR Ph Person-to-Merchant (P2M) facility in October 2021. The system broadens the use case of the QR Ph to enable interoperable digital payments between merchants and their customers even if they maintain accounts with different payment service providers. This innovation fosters greater payments

<sup>74</sup> ATM withdrawals only cover "off-us" transactions, where customers use their card or account on an ATM that is owned or operated by a BSP-supervised financial institution other than where the account is maintained.

digitalization of merchant transactions, which account for over 70.0 percent of total retail payments volume in the country.

**The BSP amplified its efforts to build awareness and confidence in the use of digital payment services through active participation in various stakeholder events.**

These served as potent venues for communicating payment system policy directions, introducing new digital payment streams, acquainting the general public with the benefits of digital payments as well as encouraging the practice of sound cybersecurity measures. During the BSP's 28<sup>th</sup> anniversary, a live webinar was conducted to cascade among all BSP employees throughout the country the vital progress the central bank has been making along these lines. The event underscored the organization's gains in implementing the National Payment Systems Act and enhancing payment system oversight while pursuing the digital transformation of the country through innovative payment services such as the use of QR Ph. These numerous engagements, adding up to almost 170 for 2021, include interviews, lectures, and presentations in various events organized by media outlets, industry associations, central banks, embassies, youth organizations, academe, research institutes, private companies, national and foreign government agencies, as well as international organizations. The topics discussed include payments-related policy issuances, the BSP's payment system oversight approach, cross-border payments, central bank digital currencies (CBDCs) and developments regarding

the initiatives enrolled in the BSP's Digital Payments Transformation Roadmap. These engagements helped promote public confidence in using digital payment channels and cultivate trust in the national payment system, thereby contributing to the BSP's other important policy agenda of reinforcing financial inclusion and sustaining financial stability.

**The BSP's progress in the digitalization of the national retail payment system provided the impetus for turning policy efforts towards improving the cross-border payment system.**

The BSP supports the ASEAN financial integration that aims to foster greater interconnectivity of the national payment system with the fast payment systems of other member economies, particularly those that have significant remittance, tourism, and trade transactions with the Philippines.<sup>75</sup>

The BSP shall prioritize establishing bilateral linkages with these countries in a scalable manner that can facilitate transitioning to multilateral arrangements.

**In November 2021, the Monetary Board noted the potential Central Bank Digital Currency (CBDC) use cases in the Philippines.**

The BSP's initial assessment of the state of the national payment system and the recent progress towards broader payments digitalization showed that a wholesale CBDC may help address frictions that affect the efficiency and safety of wholesale payments involving cross-border fund transfers, equity securities transactions settlement and intraday liquidity facilities. The BSP shall proceed with the planning and conduct of pilot tests to explore the

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<sup>75</sup> See box article on Enhancing the Philippines' Cross-Border Payments in the ASEAN.

operational feasibility of these CBDC use cases in the country from 2022 onwards.

**Amid the progress in payments digitalization and the rollout of more digital payments initiatives, the BSP continues to be a proactive payment system overseer that balances innovation while upholding payment system safety and efficiency.**

The BSP issued policies that aim to fortify the national payment system against systemic threats by adopting a risk-based oversight approach, requiring the implementation of internationally recognized standards for designated payment systems, and laying down a robust governance framework that promotes sound stewardship among payment system participants.

- a. **Designation of PhilPass<sup>Plus</sup> as a Systemically Important Payment System (SIPS) (Circular Letter No. CL-2021-065, 13 August 2021).** A SIPS is a payment system that poses or has the potential to pose systemic risk that could threaten the stability of the national payment system. The issuance announced the designation of the Philippine Peso Real-Time Gross Settlement (PhpP-RTGS) Payment System as a SIPS. As such, PhpP-RTGS participants shall ensure the safety, efficiency, and reliability of the payment system by adhering to the relevant regulations prescribed by the BSP for SIPS such as the adoption of Principles for Financial Market Infrastructures (PFMI). The BSP shall continue to evaluate and identify payment systems that shall be designated as SIPS and Prominently Important Payment Systems (PIPS) for proportionate oversight strategies that are

commensurate to their business activities, systemic importance, and risk profiles. Designated payment systems (DPS) such as SIPS and PIPS shall be subject to closer BSP oversight and to relatively more comprehensive risk management standards and governance arrangements, compared with their non-designated counterparts.

- b. **Adoption of the PFMI (Circular No. 1126, 14 September 2021).** The PFMI is a set of globally-recognized standards on governance and risk management that are applicable to financial market infrastructures including critical payment systems. The BSP requires the adoption of PFMI as well as other internationally-accepted standards and practices for DPS in order for its participants to facilitate comprehensive risk management. Such initiatives will strengthen resilience against potential financial crises and participant defaults.
- c. **Governance Policy for Operators of Payment System (OPS) (Circular No. 1127, 17 September 2021).** Given their critical role in the smooth circulation of funds in the economy in a safe and efficient manner, the guidelines lay down regulatory expectations on the governance arrangements and standards for all OPS. Likewise, it also sets the criteria for qualification as well as the grounds for disqualifications of individuals elected or appointed as directors or officers of an OPS. These guidelines are intended to ensure that the public policy objectives of maintaining payment system safety, efficiency, inclusivity, and

competitiveness are consistently being pursued by payment system participants amid broader payments digitalization and emergence of payment innovations. Specifically, the guidelines espouse the following principles:

- Adherence of OPS to more stringent requirements for those with concurrent authorities (e.g., OPS entities that have banking or electronic money issuer licenses);
- Application of stricter governance standards for Operators of DPS, whose size, complexity, and scope of operations pose or have the potential to pose systemic risk and hence, requires closer oversight to protect public interest; and
- Requirement for the board of an OPS to implement procedures for addressing potential conflicts of interest and prohibition of concurrent directorships, such as across a clearing switch operator (CSO), its critical service providers, and the payment system management body that governs the automated clearing house for which such CSO renders clearing services.

### **Ensuring Undisrupted Cash Operations**

The BSP's currency management strategy is guided by the mandate of ensuring sufficient supply of safe and reliable currency in the most cost-effective and efficient way. In 2021, the

BSP ensured timely and uninterrupted provision of banknotes and coins to support critical economic transactions. It worked for strategic scheduling and adoption of more efficient modes of currency shipments, provided ample buffer stock for unanticipated surge in currency demand or potential delay in currency delivery to the regions, and serviced the withdrawals of banks with new and fit banknotes and coins.

#### **After posting 21.4 percent growth at the height of the pandemic in 2020, currency in circulation (CIC)**

**decelerated in 2021** by 6.7 percent in value and 2.8 percent in volume, equivalent to ₱2,175.9 billion and 41.8 billion pieces. The moderation in CIC growth can be traced to renewed economic activity and availability of alternative digital payment modes, which both tempered the precautionary demand for cash.

#### **Consistent with the deceleration in CIC growth, overall banknote withdrawals from the BSP declined in 2021.**

On a y-o-y basis, banknote withdrawals decreased by 28.2 percent in value and 27.9 percent in volume. Coin withdrawals, however, rebounded in 2021, increasing by 117.2 percent and 9.5 percent in terms of value and volume, respectively. The confluence of recovering but still below pre-pandemic economic activity, increased digital transactions, broader utilization of the Cash Service Alliance (CSA) facility, and implementation of the restructured service fees affected the withdrawal patterns of banks from the BSP. With ample supply and tempered withdrawals, the BSP fully delivered the currency requirements of the economy in 2021.

**The transactions facilitated through the Cash Service Alliance (CSA) gained ground.**<sup>76</sup> The CSA initiative, launched in October 2020, enables the proactive role of banks in the recirculation of fit currency. The CSA maximizes the utilization of fit Philippine currency through better alliances among banks, resulting in lower operating cost.

The CSA in the Greater Manila Area went into full gear in 2021. As of end-December 2021, 28 out of the 29 Authorized Agent Banks participated in the CSA. On 1 June 2021, the CSA was launched in six other BSP Regional Offices and Branches (ROBs) with the highest volume of fit note deposits (i.e., Cebu, Davao, Tuguegarao, Tacloban, Cagayan de Oro, and General Santos). It was subsequently rolled out in the remaining ROBs on 1 July 2021.

**As of end-December 2021, total CSA transactions amounted to ₱302,491.7 million or 376.7 million pieces.** The CSA facility primarily serviced the demand for higher denominated banknotes with 1000-Piso and 500-Piso exchanges accounting for 99.2 percent of the value and 92.0 percent of the total volume of CSA transactions in 2021.

**Cash-in-Transit (CIT) services were used in several regional offices and branches.** Currencies in various denominations were delivered using CIT services to BSP branches in San Fernando, Cabanatuan, Dagupan, La

Union and Lucena. The value of CIT-serviced deliveries totaled ₱34.3 billion, equivalent to 41.1 percent of the total amount of currencies delivered to the said BSP branches.

**The legwork on the transfer of the BSP's currency production and distribution facility to New Clark City<sup>77</sup> has begun.** The transfer is intended to boost currency production capacity and strengthen business continuity plans in case of disruptions due to natural calamities. This is also in support of the government's initiative to decongest Metro Manila traffic

**The BSP produced the requested land titles, commemorative currency, and other important documents in 2021.** The BSP delivered 4.8 million pieces of judicial title forms or 106.6 percent of the total order from the Land Registration Authority. For the Philippine Identification (PhilID) card project, the BSP produced a total of 27.3 million pre-personalized cards and 8.8 million personalized PhilID cards for the Philippine Statistics Authority.<sup>78</sup>

**The BSP also studied the feasibility of using polymer substrate for Philippine banknotes.** Based on research, the shift to polymer substrate is expected to make Philippine banknotes more durable, hygienic and more secure. It is also seen to rationalize long-term production costs and reduce environmental impact due to its

<sup>76</sup> Memorandum No. M-2021-048 required all banks to post in the CSA system all fit notes and coins intended to be deposited to or withdrawn from the GMRO or other ROBs on the next banking day.

<sup>77</sup> Pursuant to the Monetary Board Resolution No. 1215 dated 9 August 2019,

<sup>78</sup> The BSP also produced and delivered presidential medals, state decorations,

commemorative coins and medals, BSP lapel pins, and financial inclusion pins. These items include the 125-piso commemorative non-circulating legal tender coin in celebration of the 125th death anniversary of Dr. Jose P. Rizal and the commemorative medals for the 450th anniversary of the City of Manila. The BSP also diversified its line of products to include production of silver lapel pins.

recyclable property. The BSP will embark on a limited circulation test of a polymer version of the 1000-Piso note to assess whether the benefits claimed by other central banks hold true under Philippine conditions.<sup>79</sup>

### **Reinforcing the preservation of currency integrity**

**Notwithstanding intermittent community quarantines, the conduct of forensic and material composition analysis of mutilated and doubtful currencies was completed, in full compliance with the required turnaround time under the Anti-Red Tape Act.** For 2021, a total of 138,873 pieces of severely damaged Philippine banknotes and coins (₱17.9 million) were examined, 50.0 percent of which were found to be with redemption value. Meanwhile, 6,065 pieces of coins and 39,500 pieces of banknotes examined were assessed to be counterfeits.

**To ensure that only fit legal tender coins will recirculate, the BSP facilitated, through GMRO, the destruction of counterfeit, unfit, mutilated, and demonetized (CUMD) coins through the high-capacity Coin Defacement Machine (CDM) leased to BSP.** A total of 435.2 metric tons were defaced, 57.0 percent of which (249.5 metric tons) were successfully sold via public auction. For the succeeding defacement of CUMD coins, BSP GMRO procured a low-capacity CDM.

<sup>79</sup> See box article on Exploring the Viability of Polymer Banknotes in the Philippines.

<sup>80</sup> These include the National Capital Region (55.0 percent), Region IV-CALABARZON (14.3 percent), Region VII-Central Visayas (8.6 percent), and Region III-Central Luzon (5.6 percent). These four regions accounted for 83.5 percent of the volume of

**With renewed economic activities following the vaccination program and more relaxed community quarantine guidelines, the number of documented counterfeit banknotes rose by 7.0 percent from a year-ago.** Majority of the documented counterfeits were retrieved from centers of economic activity.<sup>80</sup> In terms of parts per million (PPM),<sup>81</sup> the volumes of counterfeit banknotes and coins in circulation in 2021 were at 7.9 PPM and 0.2 PPM, respectively. There has also been a notable improvement in the capacity of banks' cash handlers in counterfeit detection. The number of correctly classified counterfeit banknotes that were surrendered to the BSP for examination increased by 14.8 percent while the number of undetected counterfeit banknotes in banks' deposits with the BSP decreased by 21.3 percent.

**The BSP sustained its information campaigns on Clean Note and Coin Policy and counterfeit detection through its "Know Your Money (KYM)" webinars.** A total of 18 KYM webinars with 47,401 participants, media interviews, and prompt replies to currency-related queries from the public were facilitated.

**The BSP also conducted 11 successful law enforcement operations.** These resulted in the arrest of 19 individuals, the filing of 15 criminal charges, and the seizure and confiscation of 813 pieces of counterfeit New Generation Currency banknotes, 144 counterfeit US dollars, other foreign currencies, firearms and ammunitions, and other counterfeiting-

documented counterfeit banknotes in 2021.

<sup>81</sup> Parts per million format is the number of counterfeit banknotes per one million genuine banknotes in circulation, computed as the ratio of total volume of counterfeit banknotes to total volume of banknotes in circulation and multiplying the result by 1,000,000.



related items. By the end of 2021, the BSP was able to secure a 100-percent conviction rate, with the conclusion of the three counterfeiting cases and conviction of the accused in criminal cases for counterfeiting or possession, or both, of counterfeit currencies.

**To better support policies on currency management, a number of policy studies were undertaken.** These included (1) balance sheet approach to forecasting currency in circulation; (2) benchmarking study on the incorporation of Braille functionality in Philippine banknotes; (3) preliminary analysis of the impact of digitalization on bank withdrawals; (4) study on the impact of the shift to polymer substrate on the abaca industry; (5) environmental considerations for the adoption of polymer notes; (6) rationalization of denominational structure; and (7) streamlining of BuS policy for operational efficiency and flexibility. It also actively coordinated with the Department of Trade and Industry on the promotion of voluntary price rounding.

As the country forges toward rebuilding the economy, the BSP shall continue its work of paving inclusive pathways to smoothly transition the national payment system from cash-heavy to cash-lite. The overarching aim, of course, is to bring digital financial services within reach of all Filipinos. In support of these goals, the BSP shall foster an enabling policy environment that promotes a healthy balance between currency production on one hand and payments digitalization on the other.

The BSP shall continue to implement essential governance and risk management standards and conduct vigilant oversight of the national

payment system to inculcate discipline among payment system participants. It will also carry out active collaborative stakeholder engagements to foster the public's trust and confidence in the national payment system.

## Box Article 10

### Enhancing the Philippines' Cross-Border Payments in ASEAN

The rise in the interdependence of the different economies in the world—marked by the larger and faster flow of goods, services, and information between countries—further highlighted the importance of cross-border payments. An efficient payment arrangement can positively impact not only international remittances but also the expansion of the digital economy and global trade. As the international transfer of funds continues to be beset by long-standing challenges, the private sector addressed the customers' demands for better services through business and technological innovations. With central banks and governments leading the development of domestic fast payment systems around the world, it seems that a logical next step is to add the capability to send money to another country in real time, preferably with just a few taps on mobile devices.

Thus, many countries have begun to turn their attention to enhancing cross-border payments. The G20, a multilateral platform connecting the world's major developed and emerging economies, made cross-border payments a priority during the Saudi Arabian Presidency in 2020. Similarly, the Association of Southeast Asian Nations (ASEAN) envisions efficient and effective interoperability among payment systems in the region pursuant to the vision under the ASEAN Payments Policy Framework. The framework supported the bilateral connectivity of many of the ASEAN member states' fast payment systems.

There are many reasons for the Philippines to pursue a similar endeavor as it is the fourth largest remittance receiving country in the world in 2021, after India, China and Mexico. With digital payments gaining traction in the Philippines, as shown by the achievement of the "20 percent by 2020" payments digitalization target, the time is ripe to extend the benefits of domestic payment reforms to Filipinos beyond our shores.

In 2021, the BSP started to tackle the challenges of cross-border payments. As identified in the G20 roadmap for cross-border payments, these include high costs, low speed, limited access and insufficient transparency. The target beneficiaries are overseas Filipino workers, businesses in the tourism, export, import, and e-commerce industries as well as firms receiving financial support from their global institutional investors and affiliates abroad.

The BSP laid out three strategic undertakings to achieve its objective. The first is identifying potential payment use cases and the digital payment rails that can best serve them. It then decided to prioritize the creation of bilateral linkages between fast payment systems that allow electronic fund transfers by simply providing one's mobile phone number or email address through the use of common QR Code standards or proxy-based services in lieu of an account number. Fully aware of international efforts to create a multilateral platform, such as the Bank for International Settlement Innovation Hub's Project Nexus, the BSP is designing the envisioned two-party linkages to be flexible enough to transition to a multi-party arrangement.

This includes building a domestic and regional payments ecosystem to ensure a safer and more efficient environment for online consumers and merchants. Similarly, the BSP continues to work with the payments industry through the Philippine Payments Management, Inc. to steadily improve the payment systems in the country.

Lastly, the BSP engages with other countries to form spheres of cooperation in enhancing the safety and efficiency of cross-border payments. With the Philippines' strong economic ties with ASEAN member states (see Figure 1), the BSP focused its efforts within this region. In the second half of 2021, the BSP started to engage with various ASEAN central banks, namely, Bank Indonesia, Bank Negara Malaysia (BNM), Bank of Thailand, and Monetary Authority of Singapore (MAS), to explore opportunities for collaboration and information sharing on cross-border payment initiatives. The first fruit of these dialogues is the signing of the enhanced BSP-MAS FinTech Cooperation Agreement in November 2021, which kicks off the development of the linkage of Philippines' InstaPay with Singapore's PayNow. Another outcome is the expression of a clear intention by the BSP and BNM towards linking InstaPay with Malaysia's DuitNow.

With these initiatives, Filipinos are beginning to enjoy more opportunities to participate in economic globalization, starting with a seamless international payment experience wherever they are in the world.

**Figure 1: Key ASEAN-5 Statistics**



Sources:

Bangko Sentral ng Pilipinas (2022). Overseas Filipinos' Cash Remittances 2010 to 2021.  
<https://www.bsp.gov.ph/Statistics/External/ofw2.aspx>

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Philippine Statistics Authority (2022). Foreign Trade-Export and Imports  
<https://psa.gov.ph/statistics/foreign-trade/fts-release-id/165746>

## Box Article 11

### Exploring the Viability of Polymer Substrate on Philippine Banknotes

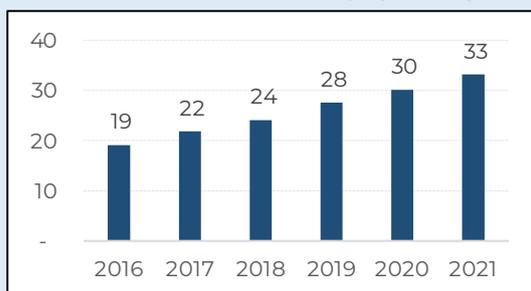
The BSP, vested with the sole power and authority to issue Philippine currency, must ensure the availability of reliable and safe currency supply to meet the requirements of the economy in the most effective and cost-efficient manner.<sup>82</sup><sup>83</sup> To better respond to the evolving needs of Filipinos and keep pace with new technology, the BSP continuously improves the country's banknotes and coins.

The current banknotes, comprising the New Generation Currency Series, were issued more than a decade ago in 2010. In line with the BSP's mandate and global good practice, it explored the adoption of polymer banknotes.

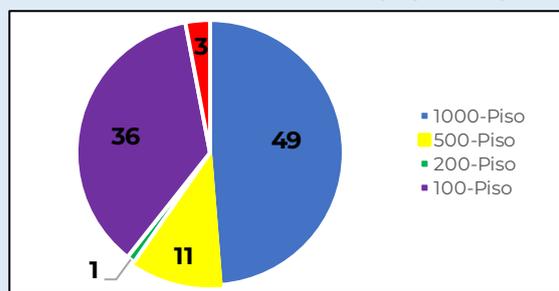
The advantages of polymer substrate are widely documented. Polymer banknotes are significantly cleaner and less susceptible to viral and bacterial transmission due to their smooth and non-absorptive surfaces. Their resilience against extreme temperatures and resistance against water and dirt make them highly durable. They have been found to last 2.5 to four times longer than paper money, more than offsetting the initial increase in production cost. Thus, polymer notes are more cost-effective than paper notes, leading to lower note issue expenses. Based on the experience of other central banks, banknote issue expenses could be reduced by 40.0 percent to 60.0 percent. In addition, polymer banknotes have a smaller carbon footprint and lower water and energy usage. Its recyclability enables polymer banknotes to have more than one life cycle. Thus, the materials can be kept within the economy indefinitely and used productively, creating further value.

While the COVID-19 pandemic heightened the preference for and use of digital modes of payments and settlement, the demand for the highest denominated 1000-Piso banknotes rose, buoyed by precautionary motive for holding cash (Figure 1) even as demand for lower denominated currencies went down. The share of 1000-Piso to total volume of currency in circulation (CIC) reached 33.0 percent as of end-December 2021. The 1000-Piso banknote is also most susceptible to counterfeiting, accounting for almost half of the volume of the documented counterfeit banknotes in 2021 (Figure 2).

**Figure 1. 2016-2021 Share of 1000-Piso in Total Volume of CIC (in percent)**



**Figure 2. 2021 Denominational Share of Counterfeit Banknotes (in percent)**



<sup>82</sup> Section 50 of the said law states: "The *Bangko Sentral* shall have the sole power and authority to issue currency, within the territory of the Philippines. No other person or entity, public or private, may put into circulation notes, coins or any other object or document which, in the opinion of the Monetary Board, might circulate as currency, nor reproduce or imitate the facsimiles of

*Bangko Sentral* notes without prior authority from the *Bangko Sentral*."

<sup>83</sup> The BSP Security Plant Complex, which has been in continuous operation since 1978 by virtue of Presidential decree No. 484 is mandated to produce banknotes and coins to meet the annual currency requirements of the economy.

The design and specification of the 1000-Piso polymer banknotes are summarized in Table 1.

<b>Table 1. Design and specification of the 1000-Piso polymer banknotes</b>	
<b>Items</b>	<b>Details</b>
Design	<ul style="list-style-type: none"> <li>• Obverse: Philippine Eagle ("<i>Pithecophaga jefferyi</i>") and Sampaguita ("<i>Jasminum sambac</i>")</li> <li>• Reverse: Tubbataha Reefs Natural Park South Sea Pearl ("<i>Pinctada maxima</i>") and Sampaguita</li> </ul>
Technical Specifications	<ul style="list-style-type: none"> <li>• Vertically aligned denomination value panel at the front upper left corner of the note using optically variable magnetic ink with rolling bar pattern</li> <li>• Small clear window located at the front left portion of the note with embossed Sampaguita image</li> <li>• Five highly embossed dots as tactile feature for the visually challenged located at the front upper left portion of the note</li> <li>• Stripe shadow image as simulated thread</li> <li>• Optically variable device foil stripe on clear vertical window bearing the seal of the Republic of the Philippines and the logo of the Bangko Sentral ng Pilipinas</li> <li>• Philippine Eagle portrait</li> <li>• Fluorescent image of South Sea Pearl in visible ink at the back of the note</li> <li>• Fluorescent serial numbers at the lower left portion of the note</li> <li>• Fluorescent image in invisible ink at the front note</li> </ul>

The BSP has also considered the impact of polymer substrate on the abaca industry, given that the existing substrate has abaca content. The possible impact on the abaca industry, in terms of foregone revenues from export receipts and direct employment, was assessed to be minimal. Nonetheless, the BSP has taken a proactive stance in exploring other avenues for possible use of abaca products such as the procurement of abaca for BSP collaterals and the inclusion of abaca content in land titles and passports.

By 2022, the BSP will initially issue 10 million pieces of 1000-Piso polymer banknotes. A memorandum of agreement is being drafted to spell out the guidelines of the said issuance. The deal will cover matters such as polymer familiarization by client banks' personnel and calibration of existing cash processing machines, vending machines, automated teller machines, bills acceptors, and other similar devices for compatibility with polymer banknotes. The BSP is currently preparing for banknote's limited circulation test (to circulate in parallel with current notes) to assess whether the benefits claimed by other central banks hold true under Philippine conditions. The test will help us determine the effects of polymerization on hygiene and public health, environmental sustainability, as well as the lifespan, durability, and counterfeiting rates of our money. It will also allow us to collect stakeholder feedback and observe changes in currency handling behavior. The BSP will start the issuance of the 1000-Piso polymer banknotes to the public in 2023.

In view of the aforementioned reasons, the 1000-Piso denomination is the currency of choice for the initial release of polymer Philippine banknotes. The design adopted for the 1000-Piso polymer banknotes is consistent with the principles of currency integrity, social relevance, efficiency, unified theme and aesthetics, and enhanced security features. The obverse side features the portrait of the Philippine Eagle (*Pithecophaga jefferyi*) as its focal point. The Philippine Eagle is deemed a strong image to represent the country's highest banknote denomination (Figure 3). On the reverse side, the images of the Tubbataha Reefs National Park, declared as a UNESCO World Heritage Site, and the South Sea Pearl, have been retained (Figure 4).

