Banking Sector Outlook Survey

2023

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Executive Summary

Overall, the industry outlook for the next two years remains upbeat amid macroeconomic challenges experienced in 2023. A stable outlook with double-digit growth in assets, loans, deposits, and net income over the next two years, is expected by majority of surveyed banks. In relation to this, banks intend to actively participate in the capital markets, with more than half of respondents forecasting double-digit growth in their holdings of investments in securities. Moreover, most respondent banks plan to maintain their risk-based capital, leverage, and key liquidity ratios at levels higher than domestic and global standards to ensure continued institutional stability.

Amid improving economic conditions, banks foresee that the quality of their loan portfolios will get better, and this will be accompanied by ample loan loss provisioning. The percentage of respondent banks that project their non-performing loan (NPL) ratio to exceed 5 percent in the next two years declined to 48.7 percent (from 52.4 percent[1]). Meanwhile, the remaining 29.4 and 21.9 percent believe their NPL ratio to settle below 3 percent, and between 3 and 5 percent, respectively. Across banking groups, 84.6 percent (from 77.8 percent) of universal and commercial banks (UKBs) estimate their NPL ratio to settle between 1 and 5 percent, while the remaining 15.4 percent (from 22.2 percent) post higher NPL ratio projections of greater than 5 percent. For thrift banks (TBs), rural and cooperative banks (RCBs), and digital banks (DGBs), majority foresee their NPL ratio to be over 5 percent, relatively similar to the 2022 BSOS. In contrast, foreign banks are more optimistic, as 50 percent (same at 50 percent) project an NPL ratio projection of less than 1 percent, while 20 percent (from nil) expect their NPL ratio to range from 2 to 3 percent.

On loan loss provisions, 58 percent of respondent banks (from 50.4 percent) anticipate an NPL coverage ratio of above 50 percent. Except for RCBs, most banking groups remain conservative in their NPL coverage projections. More UKBs prefer a higher NPL coverage ratio, with 46.2 percent (from 38.9 percent) indicating their NPL coverage ratio to be more than 100 percent. Similarly, 69.3 percent of foreign banks (from 63.6 percent) and 75 percent of DGBs (from 50 percent) expect an NPL coverage ratio of above 75 percent. For TBs, 58.9 percent (from 48.4 percent) converged on the projected NPL coverage ratio of between 51 and 100 percent. Meanwhile, 54.5 percent of RCBs (from 58.5 percent) tend towards an NPL coverage ratio of below 25 percent.

In terms of restructured loans, most respondent banks estimate their restructured loans to settle at less than 2 percent of their total loans. More than half of all banking groups, including foreign banks, disclose similar projections of less than 2 percent, with UKBs and DGBs recording a higher percentage of respondents at 75 percent (from 72 percent) and 100 percent (same at 100 percent), respectively. Some 44.4 percent of foreign banks (from 40 percent), however, estimate their restructured loans to exceed 5 percent of their total loans, while 55.6 percent of TBs (from 38.7

1 This pertains to the 2022 Banking Sector Outlook Survey (BSOS).

percent) and 51.2 percent of RCBs (from 52.3 percent) expect their restructured loans to hover below 2 percent.

Meanwhile, on products and services, majority of respondent banks cite that corporate and retail lending will continue to be their focus, followed by payment and settlement services, cross selling, and investment banking. Respondent banks also disclosed that their lending operations will support the financing of sustainable activities and green projects as well as key sectors such as the micro-, small, and medium enterprise (MSME), the real estate, and households (i.e., housing, car, and salary). Across banking groups, majority of UKBs (both domestic and foreign) will focus on project financing, sustainable or green financing, and trade financing. TBs and RCBs intend to lend to priority sectors such as agriculture, real estate, and wholesale and retail trade. DGBs identify MSME lending, trade financing, as well as treasury products and services as their area of priority.

Majority, or 71.9 percent of respondent banks, indicate that they have a digital transformation roadmap, which integrates digital technologies in achieving their respective business objectives. In the case of the banks with existing roadmaps, results show that 2.9 percent are ahead of schedule; 43.8 percent are on schedule in their digitalization efforts; 25.7 percent are still carefully mapping out their approach to ensure the appropriateness of digital processes to their operations and systems; and 3.8 percent are 100 percent digital. However, 23.8 percent of the respondent banks are still behind schedule in terms of improving their digital capabilities.

More than half of respondents are willing to partner with a fintech company with the objective of offering innovative digital financial products or services in the next two years. The products and services that respondent banks intend to deliver in partnership with fintech players include loans, payments, mobile and online banking, and remittance.

With regard to the sustainability agenda, results show a remarkable increase in organizational awareness towards sustainable financing, particularly 71.5 percent (from 70 percent) view such a mode of financing as highly important. Among respondent banks that have plans to be involved in sustainable finance, most indicate willingness to finance projects in support of agriculture, renewable energy, energy efficiency, and water supply management and treatment.

In terms of risk, respondent banks indicate that credit risk remains as the top risk to bank operations, followed by operational and macroeconomic risks. Overall, the primary risk across banking groups remained unchanged from the last BSOS. Cognizant of these risks, respondent banks continuously work on strengthening the various aspects of their risk governance to protect depositors, investors, and their institutions against internal and external shocks.

Parallel to these, the BSP remains committed to promoting a sustainable, digital, and inclusive banking future. In line with this, the BSP will continue to implement timely and relevant policy reforms aimed at promoting institutional stability and financial sector resilience, advocating responsible innovation, and fostering sustainability in the financial system.

I. Introduction

The Banking Sector Outlook Survey (BSOS) recognizes valuable insights from the banking sector in evaluating the safety and soundness of the Philippine financial system and in enhancing the effectiveness of the policy and supervisory frameworks of the BSP. The BSOS gathers the sentiments and outlook of presidents, chief executive officers, and country managers of Philippine banks over a two-year horizon.[1] This is the ninth time the BSOS has been conducted, with the maiden report released in October 2018.

The survey reinforces BSP's proactive and forward-looking approach to financial supervision. Market-driven and technological developments have allowed financial institutions (FIs) to expand product offerings, diversify operations, and create new channels for the delivery of financial services. However, these changes have also given rise to risks that may rapidly evolve and adversely impact the stability of the financial system. Thus, it is important for the BSP to strengthen its financial surveillance capabilities and leverage existing collaborative arrangements to obtain key information on the financial market and the financial system.

Moreover, the survey complements BSP's analysis of banks' business models. Reducing information asymmetry is crucial to supervisors for prompt identification of vulnerabilities, closer monitoring of financial health, and comprehensive management of financial issues. Hence, the BSOS aims to provide the BSP with additional perspective on the continuing evolution of banks' business models that can eventually enhance prudential regulations and contribute to the resilience of the banking system. It also intends to provide supervisory and market perspectives on emerging trends for timely and relevant prudential reporting and related analysis.

The survey[2] is composed of 44 questions and is comprised of five sections: (i) banking system growth outlook; (ii) bank's business strategy and risk assessment; (iii) bank's digital transformation and cyber-resilience; (iv) sustainable finance; and (v) impact of regulations/supervision on bank performance.

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1 The Monetary Board, in its Resolution No. 833 dated 17 May 2018, approved the BSOS.

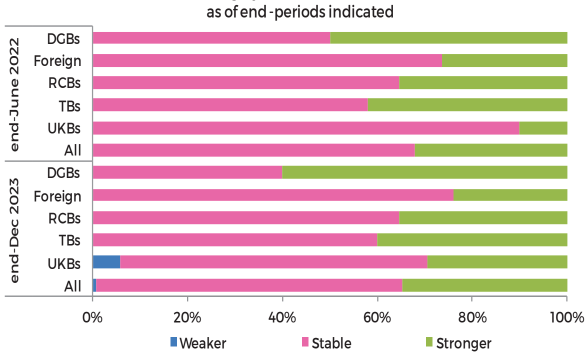
2 The digitalized survey form started with the 2021 BSOS. The survey covers all universal and commercial banks (UKBs), all thrift banks (TBs), 80 rural and cooperative banks (RCBs), and five digital banks (DGBs). The sample of RCBs includes the top 20 RCBs in terms of total assets and 60 randomly selected RCBs. The response rate for the 2023 BSOS was higher at 85 percent (147 banks responded out of the 173 banks surveyed across banking groups) compared to the 82 percent for the 2022 BSOS. The total assets of respondent banks accounted for 97.7 percent of the total assets of the Philippine banking system as of December 2023.

II. Results of the 2023 BSOS[3]

Banking System Growth Outlook

Banks' overall outlook remains upbeat amid macroeconomic concerns brought about by persistently high global and domestic inflation, and uncertainty in the global economic and geopolitical environment in 2023. There has been a noted shift in sentiment towards a stronger banking system outlook. Nevertheless, majority of respondent banks, or 64.6 percent (from 67.9 percent[4]) expect a stable banking system in the next two years, while 34.7 percent (from 32.1 percent) project a stronger banking system. However, one respondent bank (from nil) forecast a weaker banking system in 2024-2025 (*Figure 1*).

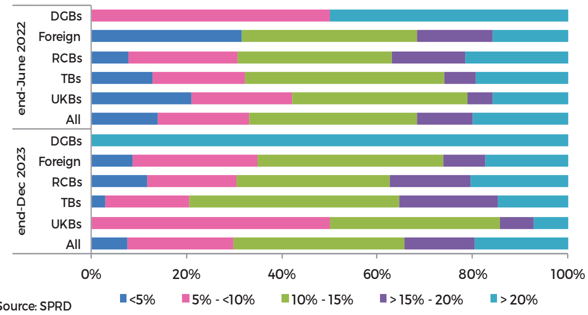
Figure 1
Banking System Growth Outlook
as of end-periods indicated



Source: Supervisory Policy and Research Department (SPRD)

Better economic prospects contributed to the industry's sustained double-digit growth projection in bank assets (*Figure 2*). More banks or 70.1 percent (from 66.9 percent) project double-digit growth in their assets, buoyed by optimistic outlook of TBs and DGBs. In particular, 79.4 percent of TBs expect an asset expansion of above 10 percent, while all DGBs believe asset growth could go up to more than 20 percent. As for other banking groups, UKBs' are divided, with 50 percent (from 42.1 percent) expecting asset growth of between 5 and 10 percent, and the remaining half (from 57.9 percent) projecting 10 to 15 percent growth. Most RCBs, and foreign banks expect their assets to grow at a rate between 10 and 15 percent, relatively unchanged from the 2022 BSOS.

Figure 2
Asset Growth Projection
as of end-periods indicated; growth rate in percent



Source: SPRD

The survey shows that loan expansion remains the key growth driver to bank operations. A higher percentage of respondent banks, or 82.2 percent (from 78.7 percent), expect double-digit growth in lending activity. UKBs, TBs, and RCBS mostly

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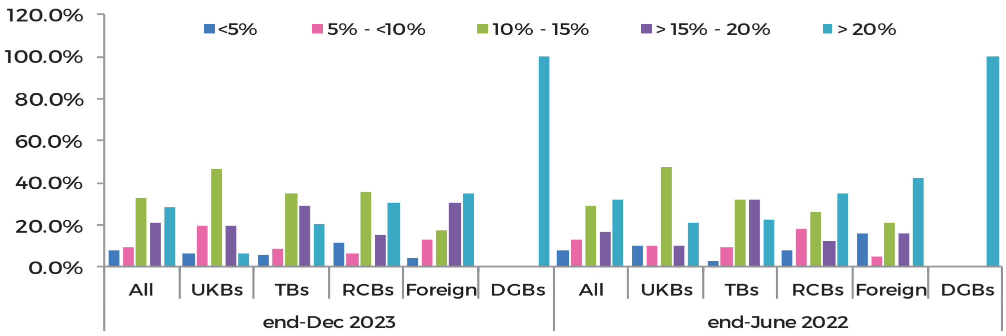
[3] Respondent UKBs pertain to domestic UKBs.

[4] Following the rationalization of the conduct and publication of the BSOS from semi-annual to annual cycle in 2022, the analysis of the banking system outlook in the 2023 BSOS (December 2023) was compared to the 2022 BSOS (June 2022). The ensuing editions will return to an annual on-cycle approach (i.e., December 2024 vs. December 2023).

report a 10 to 15 percent loan growth, while most foreign banks and all DGBs remain optimistic with loan growth projection of over 20 percent (*Figure 3*).

Figure 3
Projected Loan Growth
as of end-periods indicated; growth rate in percent



Source: SPRD

As shown in *Table 1*, consumer loans remain the top priority of UKBs, subsidiary TBs and DGBs, followed by loans for productive sectors such as wholesale and retail trade, real estate activities, information and communication as well as manufacturing. The focus of standalone TBs' and RCBs' lending is the agriculture, real estate, and wholesale and retail trade sectors. Foreign banks, on the other hand, prefer to lend to the manufacturing, financial and insurance, information and communication, and the real estate sectors. The latest data disclose that lending activity in the Philippine banking system remains broad-based, with the largest proportion supporting the important sectors in the country, i.e., real estate, households, wholesale and retail trade, manufacturing, and electricity, gas, steam, and air-conditioning supply.

Table 1
Focus of Bank Lending by Economic Sector[5]

Period	Rank	UKBs	Foreign banks	Subsidiary TBs	Stand-alone TBs	RCBs	DGBs
2023	1	Consumer loans	Manufacturing	Consumer loans	Agriculture	Agriculture	Consumer loans
	2	Wholesale and retail trade	Financial and insurance activities	Real estate activities	Real estate activities	Wholesale and retail trade	Information and communication/ Real estate activities
	3	Manufacturin g	Information and communication/ Real estate activities	Wholesale and retail trade	Wholesale and retail trade/ Accommodation and food service activities	Real estate activities	Information and communication/ Accommodation and food service activities
First Semester 2022	1	Manufacturin g	Manufacturing	Consumer loans	Agriculture	Agriculture	Consumer loans
	2	Wholesale and retail trade	Financial and insurance activities	Wholesale and retail trade/	Wholesale and retail trade	Wholesale and retail trade	Information and communication/ Real estate activities

[5] According to Philippine Standard Industrial Classification

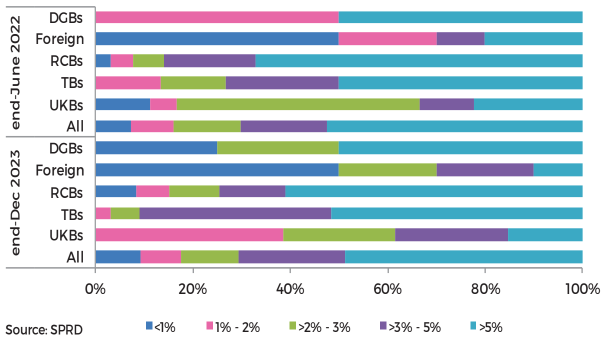
Table 1
Focus of Bank Lending by Economic Sector[5]

Period	Rank	UKBs	Foreign banks	Subsidiary TBs	Stand-alone TBs	RCBs	DGBs
				Real estate activities			
	3	Consumer loans	Information and communication/ Real estate activities	Accommodation and food service activities	Consumer loans	Real estate activities	Wholesale and retail trade

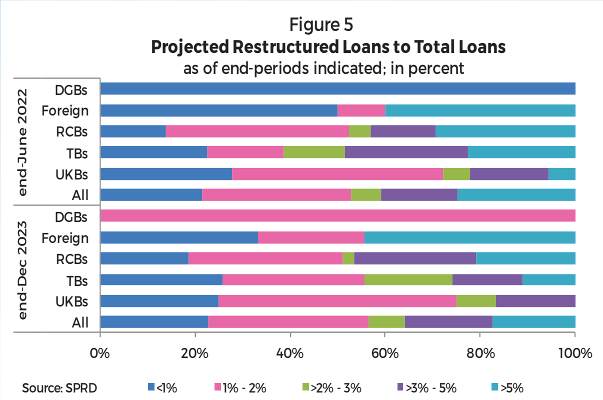
Source: SPRD

Despite the country's strong economic recovery, pockets of the economy have yet to recover. According to respondent banks, accommodation and food service activities, transportation and storage, real estate, and the construction industries would take some time to fully recover in 2024. Based on the latest data, the average loan growth of the banking system to these sectors remained below the pre-pandemic average growth rate.

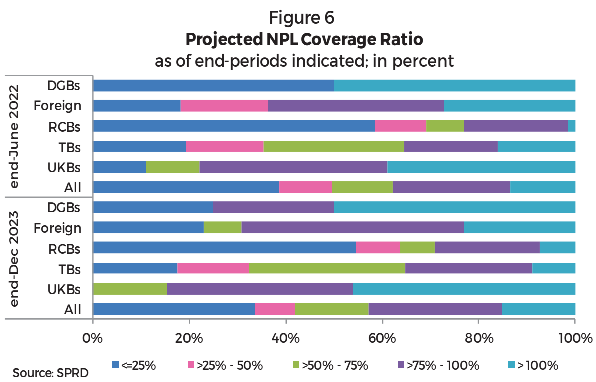
Figure 4
Projected NPL Ratio
as of end-periods indicated; in percent



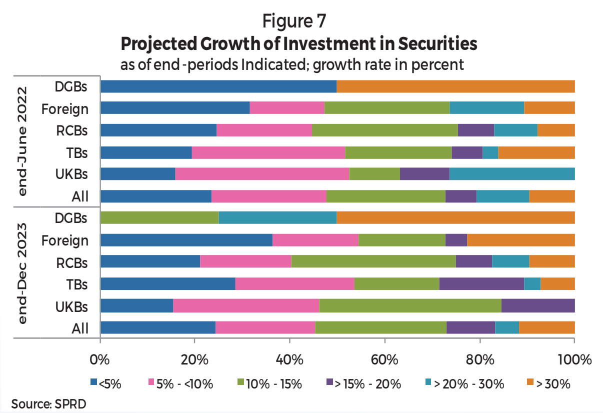
Notably, banks foresee further improvement of loan quality in view of the country's economic rebound. A lower percentage of respondent banks, or 48.7 percent (from 52.4 percent) expect their non-performing loan (NPL) ratio to exceed 5 percent in the next two years, while the remaining 29.4 and 21.9 percent believe their NPL ratio to settle below 3 percent, and between 3 and 5 percent, respectively. Bulk of UKBs, or 84.6 percent (from 77.8 percent), estimate their NPL ratio to settle between 1 and 5 percent, while the remaining 15.4 percent (from 22.2 percent) post higher NPL ratio projections of greater than 5 percent. Moreover, a higher number of UKBs, or 38.5 percent (from 5.6 percent), estimate their NPL ratio to settle between 1 and 2 percent, a shift from their projection of between 2 and 3 percent in the 2022 BSOS. For TBs, RCBs, and DGBs, majority foresee their NPL ratio to be over 5 percent, almost similar to their 2022 BSOS projection. In contrast, foreign banks are more optimistic, as 50 percent (same at 50 percent) maintain an NPL ratio projection of less than 1 percent, while 20 percent (from nil) expect their NPL ratio to range from 2 to 3 percent (*Figure 4*).



Similarly, most respondent banks estimate their restructured loans to settle at less than 2 percent of their total loans. More than half of all banking groups, including foreign banks, disclose similar projections of less than 2 percent, with UKBs and DGBs recording a higher percentage of respondents at 75 percent (from 72 percent) and 100 percent (same at 100 percent), respectively. Some 44.4 percent of foreign banks (from 40 percent), however, estimate their restructured loans to exceed 5 percent of their total loans, while 55.6 percent of TBs (from 38.7 percent) and 51.2 percent of RCBs (from 52.3 percent) expect their restructured loans to hover below 2 percent (*Figure 5*).

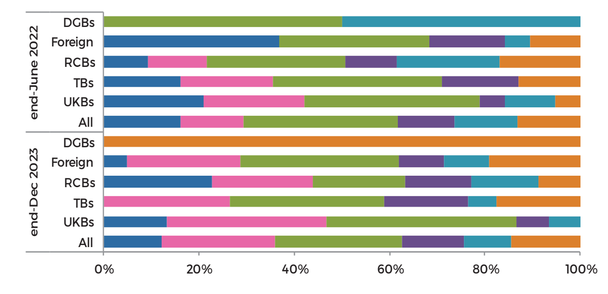


Banks opt to maintain their provisions at an ample level to manage potential losses arising from a prolonged high-interest-rate environment. As shown in *Figure 6*, more than half, or 58 percent (from 50.4 percent), of respondent banks plan to register an NPL coverage ratio of above 50 percent. Except for RCBs, most banking groups remain conservative in their NPL coverage projections. More UKBs prefer a higher NPL coverage ratio, with 46.2 percent (from 38.9 percent) indicating their NPL coverage ratio to be more than 100 percent. Similarly, 69.3 percent of foreign banks (from 63.6 percent) and 75 percent of DGBs (from 50 percent) expect an NPL coverage ratio of above 75 percent. For TBs, 58.9 percent (from 48.4 percent) converged on the projected NPL coverage ratio of between 51 and 100 percent. Meanwhile, 54.5 percent of RCBs (from 58.5 percent) tend towards an NPL coverage ratio of below 25 percent.



Banks maintain a steady growth outlook in their investment portfolio, with 54.6 percent (from 52.2 percent) of respondent banks projecting double-digit growth in investments in securities (*Figure 7*). Across banking groups, around half of UKBs, or 53.8 percent (from 47.4 percent) and 50 percent of RCBs (from 47.7 percent) expect their investment portfolio to grow between 10 and 30 percent, while DGBs continue to project growth rates in the range of over 20 percent and over 30 percent. In contrast, more than half of TBs, or 53.6 percent, and 54.6 percent of foreign banks continue to expect a single-digit growth outlook for their investments.

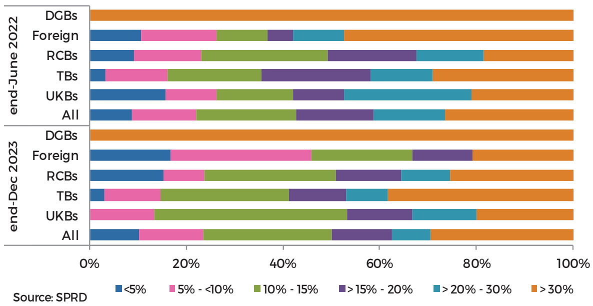
Figure 8
Projected Growth in Deposits
as of end -periods indicated; growth rate in percent



Source: SPRD

Sustained depositors' confidence enabled banks to maintain double-digit deposit growth projection, underscoring dependability of deposits to fund bank operations. Nearly two-thirds, or 64.1 percent (from 70.6 percent), of respondent banks expect their deposits to post double-digit growth in the next two years. The projections of majority of UKBs, TBs, and foreign banks for deposit growth continue to range between 10 and 15 percent, while all DGBs are more upbeat, with an estimated growth rate of over 30 percent (from less than 30 percent). RCBs, however, have mixed outlook, with 43.9 and 19.3 percent of respondents (from 21.5 percent and 29.2 percent, respectively) predicting a growth rate of less than 10 percent and between 10 and 15 percent, respectively (*Figure 8*).

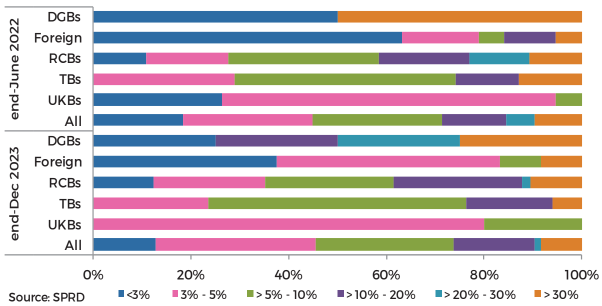
Figure 9
Projected Growth in Net Income
as of end -periods indicated; growth rate in percent



Source: SPRD

Profitability prospects remain encouraging on the back of a high-interest-rate environment and improving macroeconomic conditions. Majority of respondent banks, or 76.5 percent (from 77.9 percent), disclose double-digit growth in net income. All DGBs view growth in their net income to be higher than 30 percent, while 53.3 percent of UKBs (from 26.3 percent) are more conservative in their estimates, projecting a net income growth rate of between 10 and 20 percent. Foreign banks, TBs and RCBs report mixed projections (*Figure 9*).

Figure 10
Projected Net Interest Margin
as of end -periods indicated; in percent

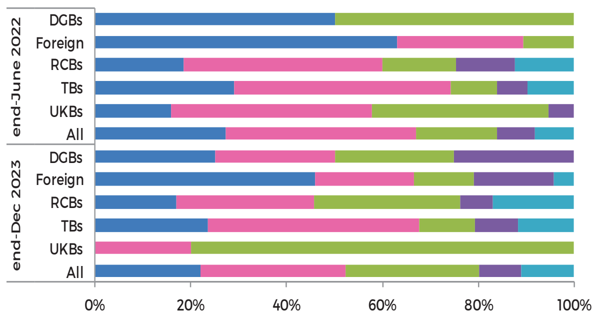


Source: SPRD

A larger proportion of respondent banks project a high net interest margin (NIM), supported by high interest rates. More than half of respondent banks, or 61.2 percent (from 52.9 percent), estimate their NIM to hover between 3 and 10 percent. Across banking groups, UKBs and foreign banks are quite conservative, with majority expecting their NIM to range from 3 to 5 percent and below 5 percent, respectively, almost similar to the 2022 BSOS. For TBs, projections are skewed toward the greater than 5 to 10 percent range, while most DGBs forecast an upper NIM tier above 10 percent. RCB respondents continue to report mixed outturn in their NIM projections (*Figure 10*).

Favorable returns are expected as banks reap benefits from the country's robust economic growth. Nearly half, or 47.8 percent (from 33.1 percent) of respondents, expect a return on equity (RoE) of above 10 percent. By banking group. majority of UKBs and RCBs project higher RoE of more than 10 percent (from 5 to 10 percent), while RoE of 44.1 percent of TBs will continue to settle between 5 and 10 percent. DGBs, meanwhile, reported mixed results, with half estimating an above 10 to 20 percent RoE, and the remaining half projecting an RoE of below 10 percent. The outlook of foreign banks improved, with lower respondents at 45.8 percent (from 63.2 percent), indicating an RoE of below 5 percent (*Figure 11*).

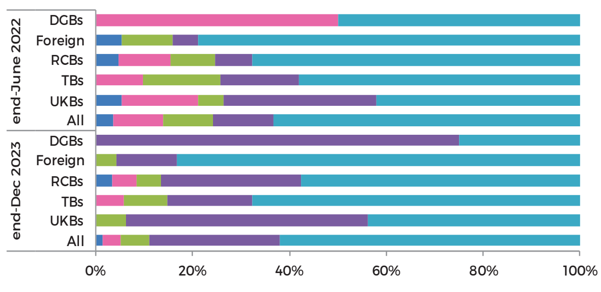
Figure 11
Projected Return on Equity
as of end-periods indicated; in percent



Source: SPRD

Underpinned by continuous earning expansion, banks are more optimistic about maintaining a high level of risk-based capital that exceeds both BSP and international standards. A higher percentage of respondent banks, or 89.1 percent (from 75.7 percent), believe their capital adequacy ratio (CAR) would be above 16 percent (*Figure 12*). Majority of UKBs and DGBs expect their CARs to be in the range of more than 14 percent, while the expectations of majority of TBs, RCBs, and foreign banks are in the upper band of more than 16 percent. Notably, the CAR projections across all banking groups improved, except for RCBs, which report a slight downward shift in their CAR projection from above 16 percent to more than 14 percent.

Figure 12
Projected CAR
as of end-periods Indicated; in percent

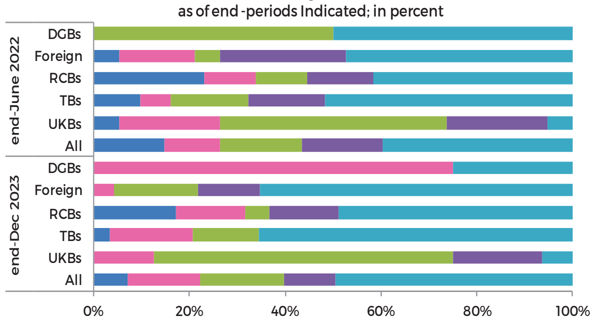


Source: SPRD

Moreover, most respondent banks, or 89.4 percent (from 78.5 percent), intend to maintain their common equity tier 1 (CET1) ratio within the range of more than 10 percent to more than 20 percent. By banking group, the expected CET1 ratio of at least half of UKBs and DGBs are tilted to the more than 10 to 15 percent range, while majority of TBs, RCBs, and foreign banks are more optimistic, with CET1 ratio projection of more than 20 percent.

Banks' capital buffers remain high, with higher number of respondent banks, or 92.9 percent (from 85.3 percent), intending to keep their Basel leverage ratio (BLR) above BSP's 5 percent minimum threshold. Among banking groups, higher number of UKBs, or 62.5 percent (from 47.4 percent), forecast their BLR to be above 7 to 10 percent, respectively. More DGBs report lower BLR of 5 to 7 percent. For the remaining banking groups, most TBs, RCBs, and foreign banks continue to plan to have their BLRs over 15 percent (*Figure 13*).

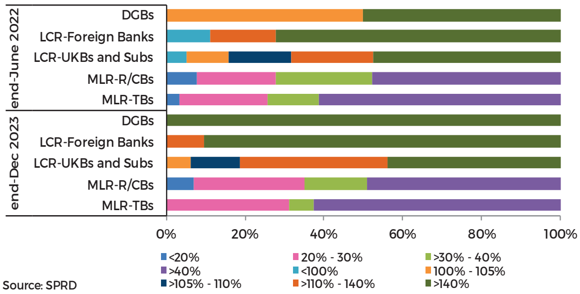
Figure 13
Leverage Ratio
as of end-periods Indicated; in percent



Source: SPRD

Healthy liquidity metrics across all types of banks over the next two years, supportive of the banking system's expanding lending and investment activities. All respondent UKBs and their subsidiary banks and quasi-banks (QBs) forecast their liquidity coverage ratio (LCR) at over 100 percent, well above the 100 percent minimum requirement of the BSP and international standards. All DGBs (from 50 percent) and a higher percentage of foreign banks, or 90.5 percent (from 72.2 percent), estimate their LCR to be more than 140 percent. Most UKBs, or 81.3 percent (from 68.4 percent), intend to maintain their LCR at above 110 percent. For stand-alone banks, particularly all TBs (from 96.8 percent) and 93 percent of RCBs (from 92.3 percent) project their minimum liquidity ratio (MLR)[6] to remain above the 20 percent MLR set by the BSP, some as high as more than 40 percent (*Figure 14*).

Figure 14
Projected LCR/MLR
as of end-periods indicated; rate in percent



Source: SPRD

[6] Circular No. 996 dated 8 February 2018, as amended, requires stand-alone TBs, RCBs, and QBs to maintain liquid assets at 20 percent of their liabilities to promote short-term resilience to liquidity shocks. It illustrates the BSP's commitment to the application of proportionality in its approach to supervision.

Figure 15
Projected NSFR
as of end-periods indicated; rate in percent

Source: SPRD

In addition, the projected net stable funding ratio (NSFR)[7] of the 78.3 percent respondent banks (from 77.6 percent) is above 100 percent. Except for subsidiary RCBs, majority of UKBs and their subsidiary TBs and DGBs, and foreign banks estimate their NSFR to be above 110 percent. *Figures 14* and *15* reflect the robust liquidity position of Philippine banks, underscoring their funding resilience over short- to broader-time horizons.

In terms of corporate banking operations, most respondent banks cite that lending to MSMEs and real estate activities, as well as financing sustainable activities and green projects, will be their priority corporate banking products and services for the next two years. By banking group, UKBs are focused on MSME lending, project financing, and sustainable or green financing, while foreign banks are keen on sustainable finance and project financing. TBs and RCBs plan to prioritize lending to MSMEs and the real estate activities, as well as financing sustainable activities and green projects. For DGBs, lending to MSMEs, trade financing, and treasury products and services are their top priorities. **Meanwhile, for retail banking operations, housing loans, motor vehicle loans, and salary loans are the top retail banking products and services of most respondent banks over the next two years.** Payment and settlement services, cross-selling, and investment banking, emerged as the top three other banking business lines that most respondent banks will focus on over the same period.

Business Strategy and Risk Assessment

Figure 16
Top Strategic Priorities

Banks are expected to continue to contribute to the country's growth momentum through delivery of financial products and services to their clients. Parallel to this, **all banking groups cite loan portfolio growth as their top strategic priority over the next two years**, followed by operational efficiency and digitalization (*Figure 16*).

Table 2 presents the top priorities across banking groups.

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[7] The NSFR under Circular No. 1007 dated 6 June 2019, as amended, is a measure of the ability of a bank to fund its liquidity needs over one year. As a complement to the LCR, both ratios are aimed at strengthening the ability of banks to withstand liquidity stress and promote the resilience of the banking sector. The BSP requires UKBs, and their subsidiary banks, to comply with a minimum NSFR of 100 percent. Stand-alone TBs and RCBs are not required to comply with the NSFR requirement.

Table 2
Top Three Strategic Priorities by Banking Group

Period	Rank	UKBs	Foreign banks	TBs	RCBs	DGBs
2023	1	Growth in loan portfolio	Expand the target market	Growth in loan portfolio	Growth in loan portfolio	Growth in loan portfolio
	2	Expand the target market	Sustainable finance/ Digitalization	Operational efficiency	Operational efficiency	Digitalization/ Growth in deposit
	3	Digitalization	Operational efficiency/ Product expansion	Digitalization	Digitalization	Product expansion
First Semester 2022	1	Digitalization of products and services	Digitalization of products and services	Digitalization of products and services; Growth in loan portfolio	Digitalization of products and services/ Expand target market	Pursue digitalization initiatives/ Focus on reaching unserved and underserved market
	2	Expand the target market	Expand the target market	Expand the target market	Focus on sustainable finance business strategies	Focus on sustainable finance business strategies/ Streamline operational costs

Source: SPRD

In terms of risk, **credit risk remains as the top risk to bank operations, followed by operational and macroeconomic risks** (*Table 3*). In general, the primary risk across banking groups remains unchanged from the 2022 BSOS. Meanwhile, a shift can be seen in the second and third risks identified by UKBs and TBs. Credit risk moved up to the second position as one of UKBs' top risks, after ranking third in the 2022 BSOS. Macroeconomic risk remains as the top risk to foreign banks. Operational risk advanced to the second position among identified risks of TBs, up from third in the 2022 BSOS.

Table 3
Top Three Risks to Banks' Operations

Period	Rank	UKBs	Foreign banks	TBs	RCBs	DGBs
2023	1	Macroeconomic risks	Global risk/ Macroeconomic risks	Credit risk	Credit risk	Cybersecurity threats
	2	Credit risk	Operational risk	Operational risk	Operational risk	Credit risk
	3	Cybersecurity threats	Financial market risk	Macroeconomic risks/Financial market risk/	Climate and environmental and social risks	Operational risk

Table 3
Top Three Risks to Banks' Operations

Period	Rank	UKBs	Foreign banks	TBs	RCBs	DGBs
				Cybersecurity threats		
First Semester 2022	1	Macroeconomic risks	Macroeconomic risks	Credit risk	Credit risk	Global risks/ Cybersecurity threats
	2	Cybersecurity threats	Credit risk	Macroeconomic risks	Operational risk	Macroeconomic risks/Credit risk
	3	Credit risk/ Financial market risks/ Operational risk	Money laundering risk	Operational risk	Macroeconomic risks	Operational risk

Source: SPRD

Moreover, credit as well as operational risk, continued to be the top two risks to RCBs, while climate risk emerged as third. Cybersecurity threats remained as the top risk to DGBs, which is expected given their business model.

In view of these risks, banks have taken specific steps to manage, mitigate, or control the top three risks. Banks highlighted several measures, such as tightening their credit underwriting procedures, improving their collection process, and using a credit scoring model to manage and mitigate credit risk. They also underscore the importance of strengthening internal controls to manage operational risk and monitoring market and economic developments, identifying macroeconomic risks that can affect their lending and investment activities, as well as maintaining a team with expertise on both global and domestic markets.

Digital Transformation and Cyber-resilience

The rapid advancement of new technology influenced the design of banks' financial products and services, including how they serve their clients. Banks recognize the importance of pursuing digitalization as one of their strategic objectives as an offshoot of their experience during the health crisis.

The following shows the percentage of respondent banks which recognize the use of technology and operating models in enhancing various business objectives: (i) operational performance (79 percent); (ii) compliance (75 percent); (iii) internal controls (73 percent); (iv) business continuity (71 percent); (v) risk management (68 percent); (vi) customer experience (68 percent); (vi) client base expansion (60 percent); and (vii) brand management (57 percent). The importance of technology was relatively high for DGBs (84 percent), UKBs (80 percent), foreign banks (72 percent), and subsidiary TBs (68 percent); while relatively low for RCBs (54 percent) and stand-alone TBs (48 percent).

In terms of functionality, most banking groups, except foreign banks, view **deposit services as the most important technology area in the organization** (*Table 4*). Foreign banks deem payment system to be the most essential area of technology.

Table 4
Top Three Most Important Areas of Technology Application

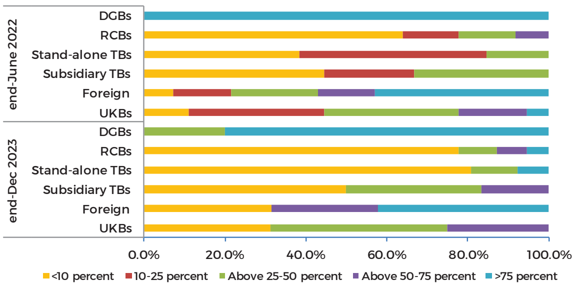
Period	Rank	UKBs	Foreign banks	Subsidiary TBs	Stand-alone TBs	RCBs	DGBs
2023	1	Deposit services/ Trust and investment services/Know your customer (KYC)	Payment system	Deposit services	Deposit services	Deposit services	Deposit services/Credit scoring/ Trust and investment services
	2	Marketing/ Credit scoring	Deposit Services	Credit scoring/ Loan Collection/ Customer service	Marketing/ KYC	Customer service	Marketing/ Customer service
	3	Customer service	KYC	Payment system	Customer service	KYC	Loan Collection/ Payments
First Semester 2022	1	Deposit services	Payment system	Deposit services	Deposit services	Deposit services	-
	2	Payment system/ Loan scoring	Loan scoring	Payment system	Payment system/ Loan scoring	Loan Collection	-
	3	Treasury and investment activity/ Customer service	Treasury and investment activity	Customer service	Marketing/ Loan Collection	Marketing/ KYC	-

Source: SPRD

While the benefits of using digital technology were evident especially during the pandemic, it is anticipated that the growing significance of digital platforms in people's financial lives will continue even beyond the pandemic, as more transactions and services shift to the digital realm. Survey results reveal that fund transfers, loan payments and repayments, and bills payment remain the top three financial services that can be provided through digital channels without requiring clients to physically visit branches or offices. By banking group, fund transfer topped the list of financial services that can be done online by majority of UKBs, foreign banks, subsidiary TBs, and DGBs. Loan payments/repayments were viewed by more than half of respondent stand-alone TBs and RCBs as one of the services that can be accomplished using digital channels.

More than two-thirds (69 percent) of UKBs mention that between 26 and 75 percent of their clients are actively using digital channels to access banking services or products (*Figure 17*).[8] Likewise, 42.1 percent of foreign banks reveal that more than 75 percent of their clients are actively using digital means, while most subsidiary TBs, stand-alone TBs and RCBs disclose that less than 10 percent of their customers access banking services or products through digital means. Meanwhile, 4 out of 5, or 80 percent of DGBs indicate that more than 75 percent of their clients are actively using digital platforms.

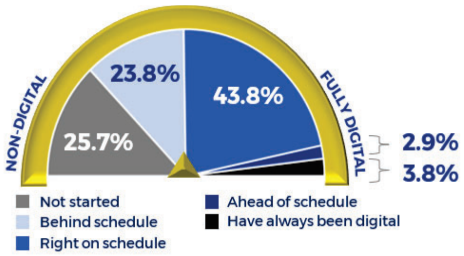
Figure 17
Percentage of Customers Actively Using Digital Channels
as of end-periods indicated



Source: SPRD

Most of the respondent banks disclose that digital or remote processing will be part of banks' essential business operations. Specifically, 68.6 and 69.5 percent of respondent banks mention that their client-oriented activities[9] and internal business processes, respectively,[10] will be done through digital means or remote processing in the next two years.

Figure 18
Status of Digital Transformation



Source: SPRD

Nearly three-fourths, or 71.9 percent, of respondent banks indicate that they have a roadmap, which integrates digital technologies in achieving their respective business objectives. Banks with existing roadmaps were also asked about the status of accomplishing their digital plans. Results show that 43.8 percent are on schedule in their digitalization efforts, while a low 2.9 percent are ahead of schedule (*Figure 18*). Meanwhile, 25.7 percent of respondent banks are still conscientiously planning their approach to ensure proper integration of digitalization with their existing operations and systems and 23.8 percent are behind schedule, while 3.8 percent reveal their business was 100 percent digital[11].

Majority of respondent banks anticipate that their digital transformation efforts would result in an increase of up to 30 percent in revenue, market share, and number of better talents hired and retained. Likewise, most respondent banks foresee an improvement of between 31 and 60 percent in business speed and agility, as well as customer satisfaction. In addition, majority of respondent banks anticipate a cutback in operating cost and in development time for new products or services by 30 percent because of their digital transformation initiatives.

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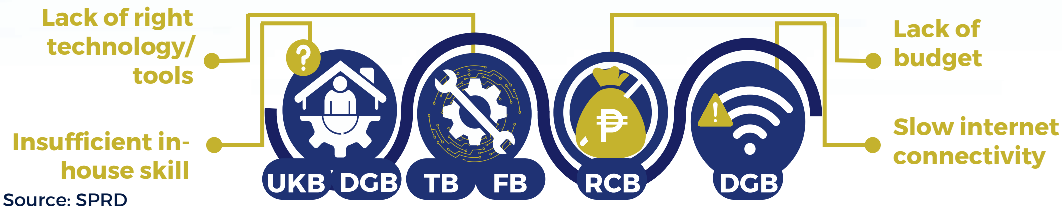
8 A total of 126 banks, comprising 35 UKBs, 32 TBs, 54 RCBs and 5 DGBs, indicated the active use of digital channels by their customers.
9 This includes account opening, deposit, transfers, and placements.
10 This consists of approvals and underwriting.
11 This comprises four DGBs.

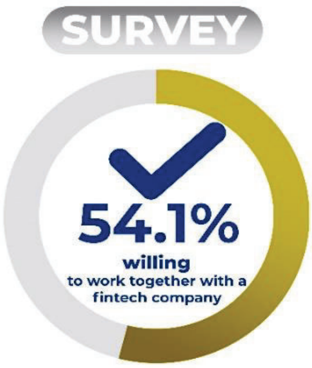
The lack of right technology or tools topped the list of challenges encountered by most respondent banks in undertaking digital transformation, followed by insufficient in-house skills, tendency for short-term thinking over long-term planning, lack of appropriate data governance, and lack of budget. By banking group, most foreign banks and TBs indicate the lack of right technology or tools as the leading challenge in implementing digital transformation. On one hand, majority of UKBs view insufficient in-house skills while the lack of budget by RCBs as the topmost challenges encountered in undertaking digital transformation. DGBs, on the other hand, have varied responses on what they consider as most challenging in undertaking digital transformation such as slow internet connectivity in the country, and insufficient in-house skills, among others (*Figure 19*).

Figure 19
Challenges in Undertaking Digital Transformation



Source: SPRD

Given the significant role played by fintech in the banking sector, respondents were asked about their willingness to collaborate with a fintech company with the objective of offering innovative digital financial products or services in the next two years. **Survey results show that 54.1 percent of respondent banks are willing to collaborate with a fintech company while the remaining 45.9 percent have no plans to do so.** In particular 72.7 percent of foreign banks, 54.1 percent of TBs, 40 percent of DGBs, 38.1 percent of RCBs and 26.3 UKBs are not yet open to teaming up with a fintech company in the next two years. The products or services that respondent banks intend to deliver in partnership with fintech players include loans, payments, mobile and online banking, and remittance. Banks were also asked about the ways BSP can further help with their digitalization journey. Some of the responses include continuous oversight on IT-related transactions, more training activities, and seminars to guide and assist banks in their digital efforts and streamlining of licensing processes.



The accelerated shift of financial transactions toward digital platforms, as well as the proliferation of new technologies, has exposed banks to fraudulent behavior, new vulnerabilities, and cybersecurity threats, which raise concerns as to the stability of the financial system. **Results show an improvement in banks' state of preparedness. More than half of respondent banks, or 52.1 percent (from 47.5 percent), are 'prepared' to handle and manage cyberthreats**. More than a quarter, or 26.5 percent (from 29.5 percent), of respondent banks, mention that they are 'somewhat prepared' in managing cybersecurity risks. With greater digital touchpoints brought about by developments in the digital financial space, the BSP will remain committed to providing an enabling policy and regulatory environment to ensure that digitalization will be carried out with caution and adequate risk management.

Overall, malware[12] ranked first among cybersecurity threats that majority of respondent banks are most concerned about, followed by phishing[13] and insider attacks. Meanwhile, UKBs indicate that malware is now their top cybersecurity threat, from phishing in the 2022 BSOS. Phishing remained the topmost cybersecurity threat for foreign banks, while both subsidiary TBs and stand-alone TBs view malware as most worrisome. The top three cybersecurity threats that are of concern per banking group are listed in *Table 5*.

Table 5
Top Three Cybersecurity Threats

Period	Rank	UKBs	Foreign banks	Subsidiary TBs	Stand-alone TBs	RCBs	DGBs
2023	1	Malware	Phishing	Malware	Malware	Hacking[14]	Cyberattacks[15]/ Hacking/Data breach[16]
	2	Phishing	Data breach	Phishing	Phishing	Phishing	Phishing
	3	Hacking	Malware	Cyberattacks/ Hacking/Data breach	Hacking	Malware	Malware
First Semester 2022	1	Phishing	Phishing	Cyberattacks	Phishing	Cyberattacks	Phishing/ Cyberattacks
	2	Malware	Malware	Malware	Malware	Malware	Malware/ Denial of service attacks

[12] Under Section 148 of the BSP's Manual of Regulations for Banks (MORB), malware refers to malicious software that compromises the confidentiality, availability, or integrity of information systems, networks, or data. It includes ransomware, trojans, adware, botnets, bugs, and spyware, among others.

[13] Under Section 148 of the BSP's MORB, phishing refers to the use of electronic communications such as e-mail to masquerade with trusted identity to capture sensitive information to gain access to accounts. It involves tricking customers into giving sensitive information through fraudulent emails or websites.

[14] Under Section 148 of the BSP's MORB, hacking refers to unauthorized access into or interfere in networks, systems and computers without the knowledge and consent of the system/information owner. Hacking is a broad term or catch-all term that refers to any type of misuse of a computer to break the security of another computing system to steal data, corrupt systems, or files, control the environment or disrupt activities in any way. Phishing and Malware is a component of the hacking process, which may be a part of the reconnaissance and execution of the hacking activity.

[15] Under Section 148 of the BSP's MORB, cyberattack can be used synonymously with cyber-threat, cyber-fraud, or cyber-related incidents. Cyber-threat refers to a deliberate act of omission or commission by any person carried out using the internet and/or other electronic channels to communicate false or fraudulent representations to prospective victims, to conduct fraudulent transactions, or to illegally obtain proprietary data or information related to the institution, their customers, and other stakeholders.

[16] Under Section 148 of the BSP's MORB, data breach refers to an incident in which sensitive, protected, or confidential data or information has potentially been viewed, stolen, leaked used, or destroyed by unauthorized persons.

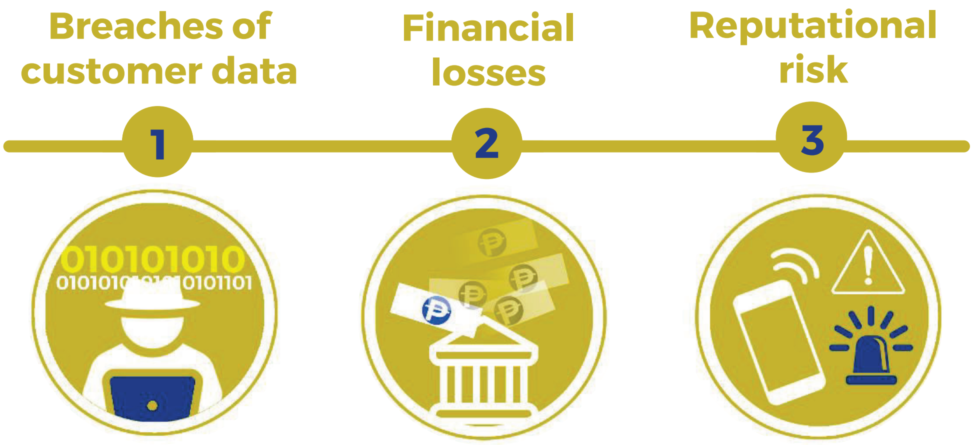
Table 5
Top Three Cybersecurity Threats

Period	Rank	UKBs	Foreign banks	Subsidiary TBs	Stand-alone TBs	RCBs	DGBs
	3	Cyberattacks/ Direct hacking/ Advance persistent threats	Cyberattacks	Phishing	Fraud	Fraud	Fraud

Source: SPRD

The survey reveals that **breaches in customer data are considered by majority of respondent banks as the most concerning consequence of cybercrime events followed by financial losses and reputational risk** (*Figure 20*). By banking group, reputational risk is viewed by 31.6 percent of UKBs and 50 percent of subsidiary TBs as the most troublesome impact of cybercrimes. Breaches in customer data are considered by 27.3 percent of foreign banks and 33.3 percent of RCBs as the most worrisome consequence of cybercrime, while financial losses are the topmost concern by 44.4 percent of stand-alone TBs and 60 percent of DGBs.

Figure 20
Top Three Most Worrisome Impact of Cybercrime Events



Source: SPRD

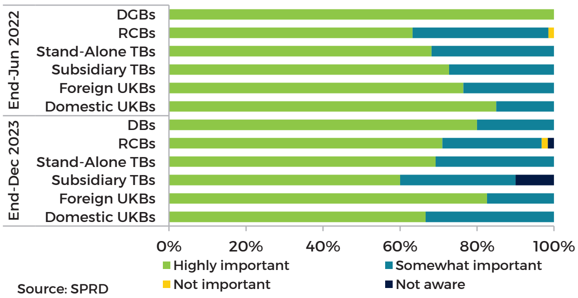
Cybersecurity improvements, periodic evaluation of cybersecurity threats, implementation of threat intelligence infrastructure, constant vulnerability assessment, and continuous upgrade of systems are some of the measures undertaken by the bank to identify and protect vulnerable systems, and detect, respond to, and recover from cyberattacks.

Sustainable Finance

Sustainable finance has been getting increasing attention in recent years, reflecting institutions' cognizance of climate change as a macro-critical issue and of the global movement towards more responsible lending and investing practices.

Survey results indicate a slight increase in organizational awareness toward sustainable financing, with 71.5 percent (from 70 percent) of respondent banks considering such a mode of financing as highly important. This sentiment was observed by most foreign banks and RCBs at 82.6 and 71 percent, respectively, while other banking groups report a slightly tempered view that sustainable finance is somewhat important (*Figure 21*).

Figure 21
Organization's View on Sustainable Financing
as of end-periods indicated



Source: SPRD

To promote sustainable finance, banks have implemented various initiatives, such as developing sustainable finance frameworks, conducting environment risk assessments, environmental, social and governance portfolio profiling, green financing, and capacity building through training activities and round table discussions.

The survey also reveals that 90.3 percent (from 85 percent) of respondent banks plan to finance sustainable projects.[17] Most respondent banks express willingness to finance projects supporting key areas such as agriculture, renewable energy, energy efficiency, and sustainable water and wastewater management. Specific to the renewable energy sector, there is significant interest in financing projects related to solar power, hydropower, and bioenergy. To support these projects, banks are looking to issue green, social, and sustainability bonds, as well as grant sustainable loans.

When identifying projects and activities contributing to climate change mitigation or adaptation, environmental benefits, or positive social impact, 42.4 percent of respondent banks have employed specific or defined criteria. One-third, or 38.9

[17] Among the respondent banks, 9.7 percent did not express intent to finance sustainable projects in the next two years. Those who did not indicate their interest cite various reasons. UKB and TB respondents highlight that sustainable finance is currently not the priority of their banks. They also cite lack of data and resources as challenges in developing a sustainable finance program and mitigating credit risk. RCBs cite lack of funds and knowledge on sustainable finance as their primary reasons for not yet venturing into financing sustainable projects. Meanwhile, DGBs intend to review and evaluate available sustainable financing options.

percent, of respondent banks are still in the process of learning more to identify appropriate criteria, while 16 percent have their criteria already under development and for implementation in the next 12 months.

The Philippine Sustainable Finance Guiding Principles was identified by more than half, or 57.4 percent, of respondent banks as their reference for evaluating potential financing of green or sustainable projects or priority sectors. This was followed by the Securities and Exchange Commission Guidelines on the Issuance of Sustainable Bonds (32.8 percent of respondent banks), the ASEAN Taxonomy for Sustainable Finance (21.3 percent), and the Philippine Nationally Determined Contributions (11.5 percent). Other common resources used by banks are the United Nations Sustainable Development Goals (SDGs), as well as the financing principles of the International Capital Market Association (ICMA), the International Finance Corporation (IFC), and the Asia Pacific Loan Market Association (APLMA). There are also other banks that developed their own internal frameworks.

In designing inclusive green or social financial products for MSMEs, banks embed various attributes to attract interest and participation. These include special lending programs offering lower interest rates and/or longer terms or grace periods (46 percent), lower guarantee or collateral requirements for lending (28 percent), and training or technical assistance (23 percent).

More than half of respondent banks have integrated climate risk into their stress test frameworks particularly 56.9 percent have incorporated climate risk, primarily through scenario analysis. However, 43.1 percent have not yet done so due to data availability issues, insufficient knowledge, and ongoing development of their climate risk management frameworks. Meanwhile, around half of respondent banks out of the 43.1 percent that have not yet included climate risk indicate that they will incorporate this risk into their stress test framework within one to three years. About 35.5 percent of these respondent banks inform that they would include climate risk in the stress test framework in three years up to more than five years while 6.4 percent specified that they would incorporate this type of risk into their stress test framework within a year.

In terms of availability of climate risk-related data, 27.8 and 26.5 percent of respondent banks indicate that they have information on the likelihood of potential physical risk events such as natural disasters and estimates of the severity of this risk events, respectively. Moreover, only 12.2 percent reveal that they have information on climate strategies and targets for corporate counterparties.

Figure 22
Barriers to Pursuing Sustainable Financing

Source: SPRD

From this year's results, it is evident that interest towards sustainable finance has made significant strides. Yet, recognizing that sustainable finance is still an emerging field within the financial landscape, banks face hurdles in aligning new regulations and frameworks with their current practices. Respondent banks highlight that lack of expertise or skills necessary as the primary obstacle for pursuing sustainable financing, followed by lack of demand (*Figure 22*).

In response to these challenges, most foreign banks, TBs, RCBs, and DGBs believe that BSP could help banks in their sustainability journey through capacity building and training, while UKBs opine that incentives can contribute to the promotion of sustainable finance.

Impact of Supervision on Bank Performance

To assess the impact of BSP regulations, banks were also asked to identify their top three challenges in terms of regulatory compliance. This year, diverse responses emerged across banking groups, in contrast to the previous year's predominant concern over compliance with the mandatory credit to agri-agra[18].

UKBs identify compliance with anti-money laundering (AML) regulations as their foremost compliance challenge owing to the complex and constantly evolving AML regulatory landscape, which involves large volumes of data and entails continuous system and process enhancements to carry out due diligence activities. Foreign banks cite reportorial requirements as their primary hurdle as they try to adjust and address validation issues with the transition to automated regulatory reporting. RCBs point to sustainable finance initiatives as their most pressing issue as they seek guidance and capacity building to craft their frameworks and policies, while TBs grapple the most with the implementation of the new mandatory Agriculture, Fisheries, and Rural Development (AFRD) Financing Enhancement Act due to the high credit risk associated with qualified borrowers. DGBs indicate a mix of concerns, citing mandatory AFRD financing, AML regulations, credit risk management, and compliance with the Application Programming Interface-Extensible Markup Language (API-XML) as their key challenges.

In addition to these key concerns, respondent banks cite other areas within the BSP's regulatory framework – such as regulations on Information Technology (IT) risk management, financial consumer protection, stress testing, reportorial requirements, and operational risk management – as other challenges in terms of compliance. *Table 6* presents the top five most challenging areas by banking group.

[18] The Agri-Agra Law was superseded by Republic Act No. 11901, also known as The Agriculture, Fisheries and Rural Development (AFRD) Financing Enhancement Act of 2022. This change aims to better address the financing needs of farmers, fisherfolk, and agri-based MSMEs, while also enhancing the capacity of farmers and fisherfolk.

Table 6
Most Challenging Areas of Compliance by Banking Group

Rank	UKBs	Foreign banks	Subsidiary TBs	Stand-alone TBs	RCBs	DGBs
1	AML	Reportorial requirements	Mandatory AFRD financing	Mandatory AFRD financing	Sustainable finance	AML Mandatory AFRD financing Credit risk management API-XML
2	Reportorial requirements Sustainable finance	Mandatory AFRD financing	Sustainable finance	Credit risk management	Credit risk management	IT risk management; Cyber security
3	Financial consumer protection framework	Stress testing	AML Reportorial requirements	IT risk management/ Cyber security	Operational risk management	Sustainable finance Reportorial requirements

Source: SPRD
Legend
No change in ranking from the 2022 BSOS
Increase in ranking from the 2022 BSOS
Decrease in ranking from the 2022 BSOS

The BSP Policy Reform Agenda

The BSP remains steadfast in ensuring the transition of the Philippine financial landscape towards a sustainable, digitally enabled, and inclusive banking future. In line with this, the BSP will continuously adopt progressive reforms and prudential standards that ensure institutional stability and financial sector resilience, advance inclusive and sustainable finance, and promote and enable the continuing digital transformation in the financial system.

For 2024 and beyond, the BSP is working on operational resilience standards for supervised banks and developing an enhanced crisis management and resolution framework. The National Risk Assessment on ML/TF for the banking sector is well underway, with the final report expected in 2025. The Financial Services Cyber Resilience Plan, 2024-2029 has also been launched. These reforms will be accompanied by the BSP's strengthened macroprudential oversight, and enhanced stress testing framework.

The enhancement of supervisory processes, likewise, remains a core priority for the BSP in 2024. Thus, the BSP will focus on improving data analytics and SupTech capabilities through the launch of the Digital Supervision Platform and the live implementation of the Comprehensive Credit and Equity Exposures Report (COCREE 2.0), and supervisory use cases of the COCREE data.

On the sustainability agenda, the BSP continues to employ a phased approach to the issuance of enabling regulations on sustainable finance, which, to the extent practicable, are aligned with national strategies and policies as well as regional and international standards or frameworks. The policy priorities are geared towards strengthening sustainability-related information architecture to promote greater transparency and facilitate the flow of domestic and foreign investments to green or sustainable projects. In this regard, the BSP, together with other financial sector regulators under the umbrella of the Financial Sector Forum, released the Philippine Sustainable Finance Taxonomy Guidelines in February 2024. Following this, the BSP will harmonize sustainability disclosure requirements, in line with the release of the International Financial Reporting Standards (IFRS) Sustainability Disclosure Standards. The taxonomy and disclosure requirements are important policy tools for improving accountability, comparability, and transparency as well as in establishing necessary safeguards to prevent greenwashing. The BSP will also amend the prudential reports submitted by banks to obtain granular data to assist in the surveillance of ESG-related risks in the banking system.

To further develop the sustainable finance market, the BSP will implement measures that will help broaden the range of sustainable financial instruments for retail and institutional investors. These include the promotion of innovative sustainable finance solutions that are responsive to the country's climate change adaptation requirements.

Furthermore, the BSP remains in close coordination with government agencies and with the House of Representatives and the Senate, providing strong support for key legislative reforms that continuously promote the development of the Philippine economy, as well as strengthen and modernize the financial ecosystem.

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