



The Philippine  
**Banking Sector Outlook Survey**  
Second Semester 2019

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## Highlights of the Report

This version: 13 April 2020

Banks maintained their optimism on the country's economic prospect as majority of the Banking Sector Outlook Survey (BSOS) respondents projected the gross domestic product (GDP) to grow between 6.0 percent and 6.6 percent within the next two years. The sluggish global growth, coupled with trade tensions among the world's biggest economies have resulted in the moderation of the banking industry leaders' bullish expectations on economic growth and banking system prospects. Nonetheless, the outlook on the Philippine banking system (PBS) remained stable as the projected economic growth and strength of the PBS are expected to result in double digit growth in assets, loans, deposits and net income.

The BSOS noted the banks' increasing support on the use of technology-enabled solutions and strong interest in participating to the digital finance ecosystem. With the firm grasp of the risks and economic costs posed by cyberthreats, majority of the respondent banks disclosed their preparedness in managing cybersecurity risks.

The survey results showed that inputs from audit, risk and compliance functions are always considered in the board/senior management business decisions and strategies. Moreover, majority of the respondents mentioned that their employees are bound by a code of ethics/conduct.

Meanwhile, the results of the special section on sustainable finance reveals a low percentage of respondents that have plans to finance sustainable projects. This indicates that in general, banks are not yet prepared or willing to finance these type of projects or activities in the near term. The lack of demand, low financial returns, and the regulatory or legal constraints are considered as the main barriers from pursuing sustainable financing.

Overall, institutional risk continued to be the top-most risk to the banks' operations. Nonetheless, respondents considered enhancing their risk management systems to strengthen the banks against headwinds. Likewise, upgrading of personnel capabilities, keeping a high level of liquid assets, and strengthening client relationships were also deemed equally important by the respondents in order to protect their respective banks against internal and external shocks.

It should be highlighted that this Report does not cover the evolving impact of Corona Virus Disease (COVID-19) outbreak. A special section on the impact of COVID-19 on the banking sector outlook will be reflected in the next BSOS. Nevertheless, the Philippine financial system is projected to withstand the adverse impact of COVID-19 outbreak on account of its relatively stable and sound capital, leverage and liquidity buffers, ample loan loss reserves and robust earnings performance.

## I. Introduction

The adoption of a cohesive and pro-active supervisory approach to address the potential build-up of systemic risk is essential to achieve one of the BSP's Strategic Objectives which calls for a sound, stable and resilient banking and financial system. The Banking Sector Outlook Survey (BSOS) serves as a complementary tool in validating the assessments of banking supervisors. The conduct of the BSOS aims to gather the sentiments of the Presidents/Chief Executive Officers/Country Managers of banks in the country within a two-year horizon.<sup>1</sup> The practice of conducting periodic outlook surveys has been observed in some countries. However, the Philippine BSOS is characterized by the following: (a) it is conducted by the central bank; (b) it gathers the sentiments/outlook of industry leaders; and (c) it forms part of the prudential surveillance and supervisory framework of the BSP. This is the fourth time the BSOS is conducted, with the maiden report released in October 2018.

## II. What is the Banking Sector Outlook Survey?

**The BSOS serves as a measure of proactive and forward-looking approach to surveillance and financial supervision.** Banking sector risks have been historically concentrated in domestic traditional banking activities while the financial services industry has evolved in response to market-driven, technological, and geo-political developments. These changes have allowed financial institutions (FIs) to expand product offerings, geographic diversity, and delivery systems. However, these changes have also increased the complexity of the FIs' consolidated risk exposure. Said complexity necessitates the BSP's proactive and forward-looking approach to consider the outlook/sentiments of industry leaders in the conduct of regulatory risk surveillance and formulation of supervisory framework.

**The BSOS can complement the analysis of banks' business models moving forward.** Reducing information asymmetries is crucial to supervisors for the prompt identification of vulnerabilities, closer monitoring of financial health and comprehensive management of financial strains as they emerge. Hence, the BSOS aims to provide the BSP with additional perspective on the continuing evolution of banks' business models that can eventually help enhance prudential regulations and contribute to ensuring resilience of the PBS. Moreover, it intends to provide supervisory and market perspectives on emerging issues and trends for timely and relevant prudential reporting and related analysis. Lastly, it is also expected to promote financial innovation in the PBS.

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<sup>1</sup> The Monetary Board Resolution No. 833 dated 17 May 2018 approved the conduct of BSOS.

**Structure of the BSOS.** The BSOS is currently composed of eight sections as shown in Table 1 below:

**Table 1. The BSOS Structure**

Section	Description
Growth Outlook	This section seeks to solicit the respondents' outlook on the country's gross domestic product (GDP) growth and projections on the performance of the PBS.
Business Strategy	This section seeks to understand the business model that the banks will adopt to implement their strategies over the next two years.
Operational Performance	This section intends to understand banks' operational approach to maintain growth, address operational challenges and enhance profitability moving forward.
Fintech/Cybersecurity	This section attempts to identify the extent of fintech adoption and strategy as well as the respondents' outlook on cybersecurity risks and threats.
Organizational Conduct and Risk Culture	This section seeks to categorize banks' internal assessments of the level and maturity of risk culture and risk governance frameworks.
Sustainable Finance	This section strives to categorize the bank's view towards sustainable financing as well as their plans with respect to financing sustainable projects.
Impact of Supervision/Regulation on Bank Performance	This section plans to solicit sentiments on the concerns posed by BSP regulations to banks' operations, as well as to seek opinion in areas of regulation/supervision that the BSP needs to strengthen to promote the safety and soundness of the PBS.
Risk Assessment	This section seeks to identify the risks that banks are most wary of and the existing mitigants for identified risks.

**A New Section on Sustainable Financing.** For the second semester of 2019, a new section was introduced to categorize the banks' view towards sustainable financing since climate change and other environmental and social risks could pose financial stability concerns considering their significant and protracted implications on the bank's operations and financial interest. Specifically, respondents were asked whether they have plans to finance sustainable projects and what are the type of projects, activities, industries they intend to finance in the next two years. Moreover, respondents were also asked to determine the barriers from pursuing sustainable financing.

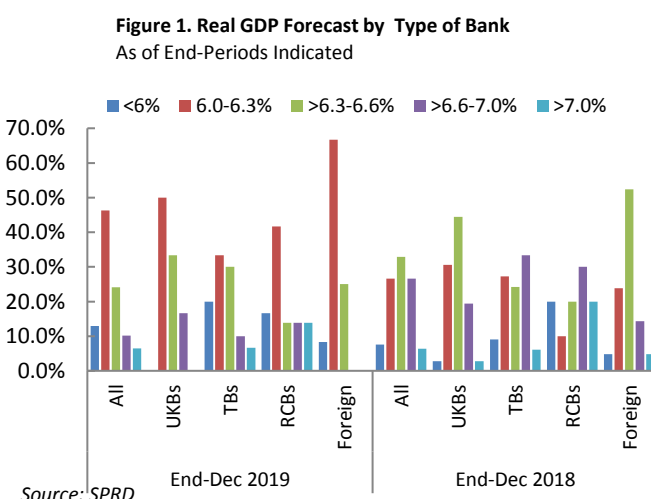
**The BSOS Methodology.** The conduct of BSOS for the second semester of 2019 covers all universal/commercial (U/KBs), thrift banks (TBs) and 80 rural/cooperative banks (R/CBs) to include top 20 R/CBs in terms of total loan portfolio plus the 60 R/CBs that were randomly selected. The updated survey questionnaire includes 28 questions and transmitted to the Presidents/Chief Executive Officers/Country Managers of the covered banks. Meanwhile, banks which responded to the survey accounted for 94.3 percent of the total assets of the PBS as of end-December 2019.

### III. Results of the Banking Sector Outlook Survey as of the Second Semester of 2019

**Growth Outlook.** Banks maintain their optimism on the country's economic prospect amid global uncertainties and market volatilities during the second semester of 2019 as 70.4 percent of the BSOS respondents projected that the gross domestic product (GDP) shall grow between 6.0 percent and 6.6 percent within the next two years.

Current projections converged at the lower end of the 6.0 percent to 6.6 percent range with 46.3 percent of respondents expecting the GDP growth between 6.0 percent and 6.3 percent. By contrast, the real GDP growth forecast for the second semester of 2018 was tilted towards the 6.3 percent to 6.6 percent growth range.

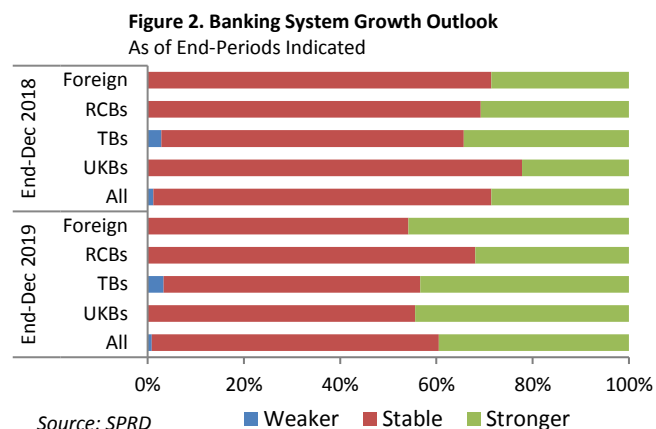
In particular, about 50.0 percent of respondent U/KBs forecasted GDP growth between 6.0 percent and 6.3 percent while 33.3 percent of respondent U/KBs were more optimistic, projecting the GDP growth at a range of greater than 6.3 percent to 6.6 percent. Meanwhile, 33.3 percent of respondent TBs and 41.7 percent of respondent R/CBs projected the GDP growth between 6.0 percent and 6.3 percent. Meanwhile, 91.7 percent of foreign bank respondents projected the GDP growth between 6.0 percent and 6.6 percent (Figure 1).



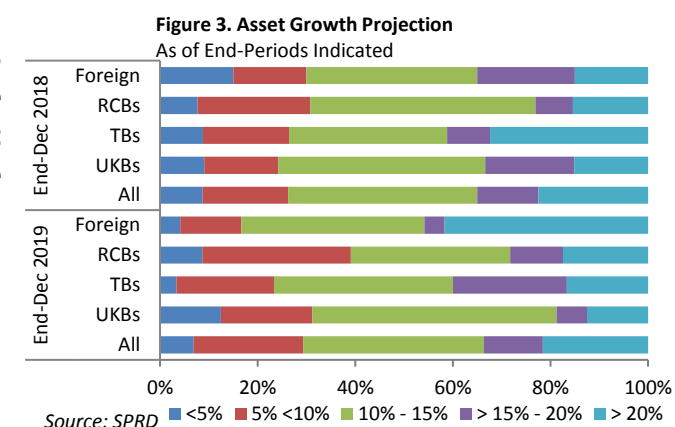
The general softening in the banks' projected domestic GDP growth was consistent with the World Bank's (WB) projection of the country's GDP growth of 6.1 percent in 2020 to 6.2 percent in 2021 and 2022.<sup>2</sup> The WB's forecast was anchored on the slowing global trade and rising uncertainty which resulted in weaker exports, disruptions in cross-border supply chains and declining private investment amid low business confidence. Meanwhile, the Asian Development Bank's growth forecast for the Philippines was maintained at 6.2 percent supported by investment as well as accommodative fiscal and monetary policies.<sup>3</sup>

## The banks' bullish economic outlook translated to continued confidence on the stability of the banking system.

This is evident as 59.7 percent of the banks projected a stable PBS in the next two years. Meanwhile, 39.5 percent of respondents expected a stronger banking system in the next two years. This is higher with the PBS overall outlook for the second semester of 2018 in which 28.6 percent of the industry leaders forecasted stronger PBS.



**The projected economic growth and strength of the PBS influenced 70.7 percent of the survey respondents to forecast double-digit growth in the banks' assets.** Nonetheless, this was slightly lower compared to the 73.8 percent projection of double-digit asset growth during the second semester of 2018. Meanwhile, 50.0 percent of U/KBs projected an asset expansion between 10 percent and 15 percent, higher than the year ago's 42.4 percent. Foreign banks are most optimistic as 41.7 percent projected an asset growth of more than 20 percent in the next two years. R/CBs were least optimistic with only 60.9 percent of respondents projecting double digit growth in assets from year ago's 69.2 percent (Figure 3).

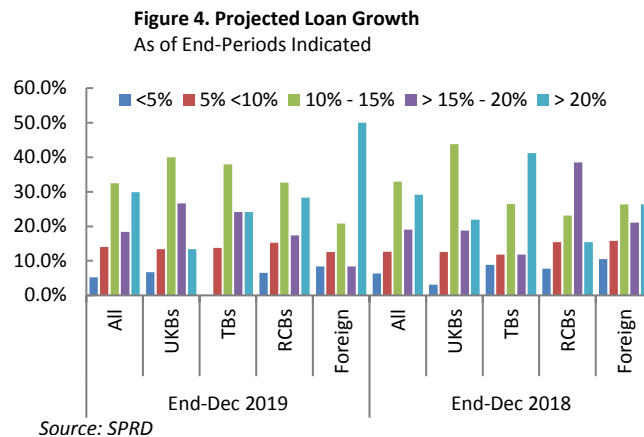


<sup>2</sup> World Bank. 2020. Global Economic Prospects, January 2020: Slow Growth, Policy Challenges. Washington, DC: World Bank.

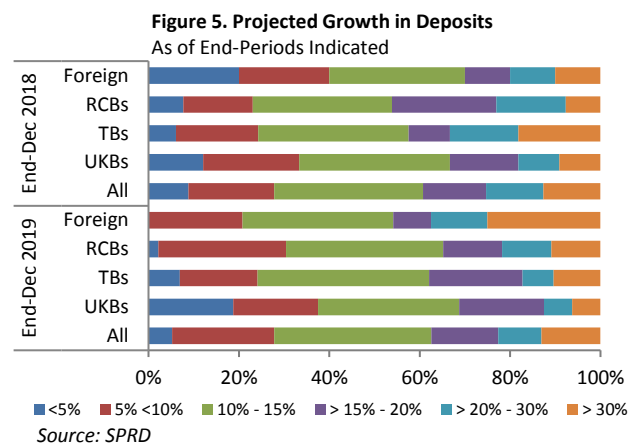
<sup>3</sup> Asian Development Bank. 2019. Asian Development Outlook Supplement.



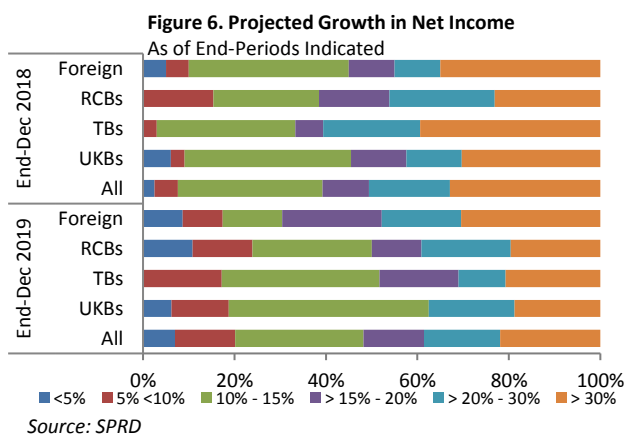
**The growth in assets was expected to be driven by credit expansion** as 80.7 percent of the banks projected double-digit growth in their loan portfolio for the current survey. Majority of U/KBs', TBs' and R/CBs' forecasts of credit growth are seen between 10 percent and 15 percent. Meanwhile, about 50.0 percent of the foreign bank respondents projected loan growth above 20.0 percent, an improvement from the 26.3 percent of respondents in the end-December 2018 BSOS (Figure 4).



**The BSOS results likewise disclosed banks' expectations for deposits to fund asset and loan growth.** About 72.2 percent of the current BSOS respondents projected double-digit deposit growth, similar to the end-December 2018 BSOS. Moreover, 33.3 percent of foreign bank respondents projected an expansion in deposits between 10.0 percent and 15.0 percent while about a quarter of the foreign banks forecasted growth in deposits of more than 30.0 percent for the next two years (Figure 5).

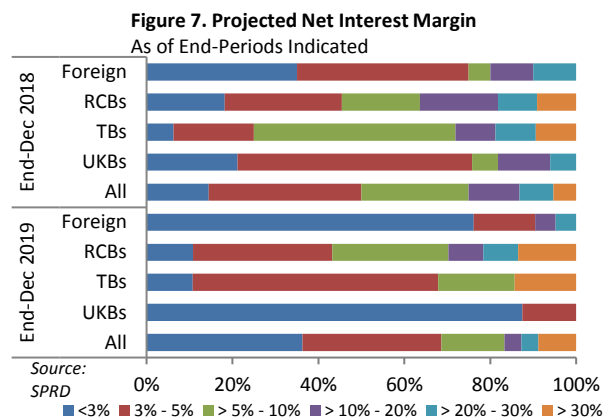


**The banks retained their buoyant expectations on returns** as 79.8 percent of the respondents for the second semester of 2019 forecasted double-digit net income growth for the next two years albeit lower compared to the 92.4 percent of the respondents during the second semester of 2018. In particular, 43.8 percent of U/KBs and at least a quarter of TB and R/CB respondents projected net income growth between 10 percent and 15 percent while 30.4 percent of foreign bank respondents forecasted net income to grow by more than 30 percent (Figure 6).

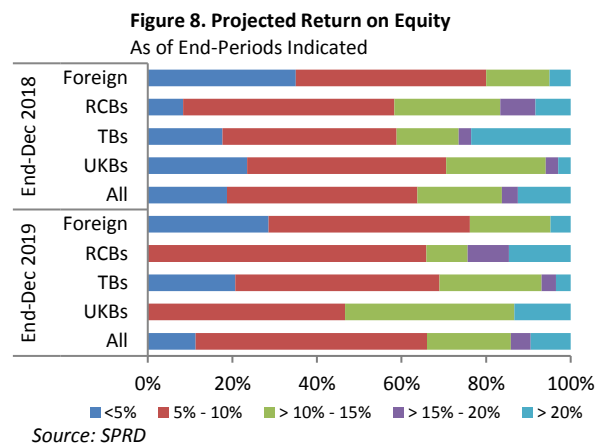




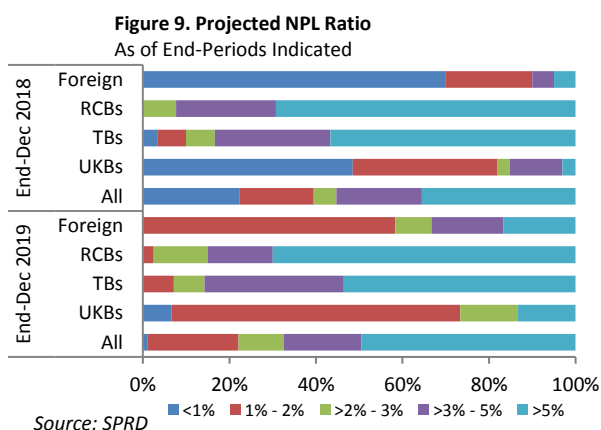
The net income forecasts were affected by the tighter projections for the banks' net interest margin (NIM) as 36.3 percent and 32.4 percent of the current respondents expected lower NIM at less than 3 percent and between 3 percent and 5 percent, respectively. Respondent U/KBs and foreign banks were most conservative with 87.0 percent and 76.2 percent expecting the NIM at less than 3.0 percent, respectively (Figure 7). R/CBs' NIM projection is tilted towards the 3.0 percent to 10.0 percent range. Meanwhile, foreign banks' projection tightened as 76.2 percent of respondents expected NIM of less than 3.0 percent from 35.0 percent last year.



Amid the optimism, the projected return on equity (ROE) generally improved with only 11.3 percent of respondent banks expecting the ROE at less than 5 percent for the current BSOS compared to 18.8 percent during the previous year. The number of less optimistic respondents apparently upgraded their projections as 54.7 percent of respondents expected the ROE between 5 percent and 10 percent compared to 45.0 percent in the previous year (Figure 8).

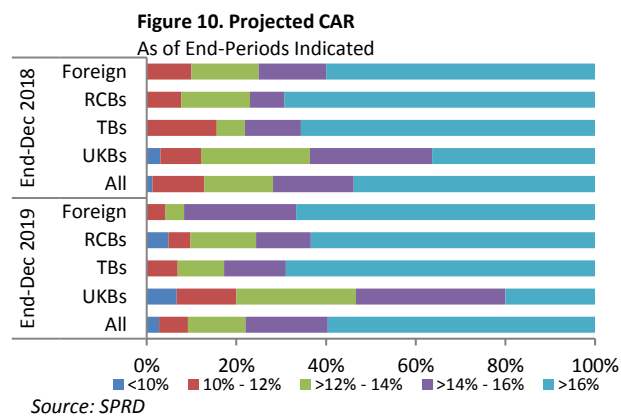


The decelerating global trade may be exerting pressure to the quality of bank loan portfolio. This may be seen from the increase of respondents expecting the ratio of non-performing loans (NPL) to total loans to exceed 3.0 percent to 67.4 percent as of end-December 2019 BSOS from the 55.3 percent in the previous year. Meanwhile, TBs and R/CBs consistently expected elevated NPL ratios. About 33.3 percent of foreign bank respondent projected NPL ratio at more than 3.0 percent from 10.0 percent of respondents with similar projection a year ago (Figure 9). The sluggish global growth, coupled with trade tensions among the world's biggest economies, may adversely

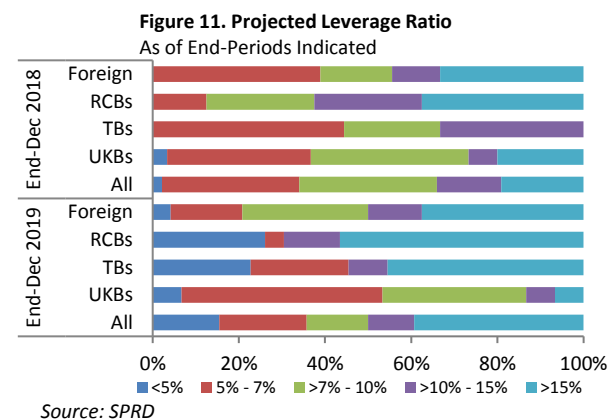


impact the domestic manufacturing sector which exports a significant portion of its output. This, in turn, may have led to the banks' forecast of an uptick in their NPL ratios.

**Cognizant of the importance of capital to protect the banks from unexpected losses, the PBS has been maintaining risk-based capital at levels higher than domestic (10 percent) and global (8 percent) standards, and intends to do so for the next two years.** Projection of capital adequacy ratio (CAR) was more prudent for the current year's BSOS with 78.0 percent of the respondents expecting CAR at more than 14 percent compared to 71.8 percent last year (Figure 10). Moreover, industry data showed that banks' CAR was comprised mostly of high-quality common equity tier 1 (CET 1) capital.



**As a backstop to their respective CAR, 84.5 percent of banks projected leverage ratio exceeding the BSP (5 percent) standard.** This constrains the potential build-up of excessive leverage in the banks and promote financial stability. Smaller banks, particularly, 45.5 percent of TBs and 56.5 percent of R/CBs are more reliant on capital with projected leverage ratio of more than 15 percent (Figure 11).

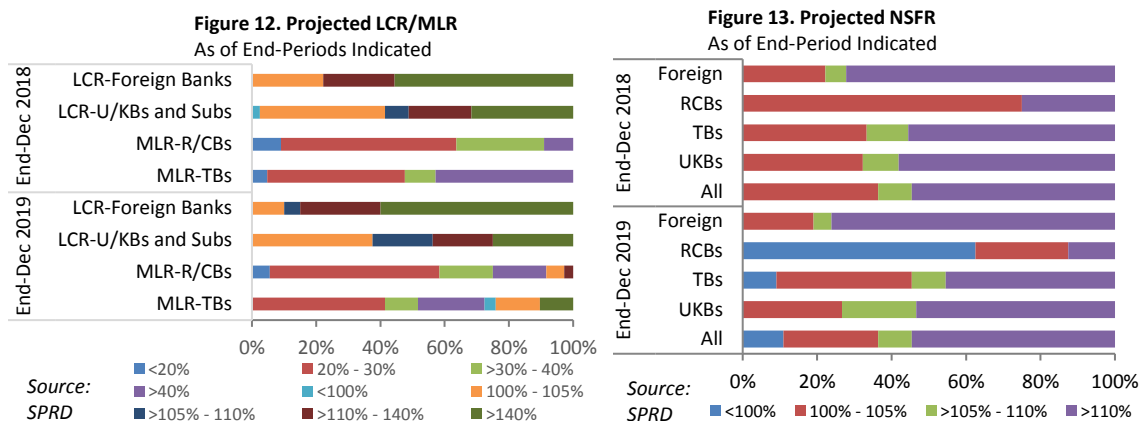


Nonetheless, the level of their gearing provides the banks with flexibility to expand their loan portfolio to support the financing needs of the economy.

**Liquidity has been a key strength of the PBS.** This is expected to be maintained up to the medium term as banks continue to project healthy liquidity metrics under the Basel III liquidity coverage ratio (LCR)<sup>4</sup> and net stable funding ratio (NSFR)<sup>5</sup> for U/KBs and their subsidiary banks and quasi-banks (QBs), and the minimum liquidity ratio (MLR)<sup>6</sup> for stand-alone TBs, R/CBs and QBs. Liquidity buffer serves as defense for banks to thrive amid a volatile market environment while enabling them to take advantage of business opportunities presented by the growing economy and the country's pursuit of better infrastructure to support domestic economic expansion.

In the current survey, the respondents disclosed that 62.5 percent of domestic U/KBs and their subsidiary banks intend to maintain LCR at more than 105 percent, higher from the 58.5 percent recorded during the end-December 2018 BSOS. More than 60.0 percent of foreign bank respondents projected the LCR at more than 140 percent. Meanwhile, 41.4 percent of TBs and 52.8 percent of R/CBs projected their respective MLRs between 20 percent and 30 percent (Figure 12).

The NSFR, which started implementation on 1 January 2019 for U/KBs, was projected by 54.5 percent of covered respondent banks to be maintained at more than 110 percent for the next two years. The strong commitment to longer term stable funding was more evident for U/KBs and foreign banks, with 53.3 percent and 76.2 percent of respective respondents projecting NSFR at more than 110 percent (Figure 13). This is evident in the banks' increased issuance of bonds to ensure longer term funding for their business.



<sup>4</sup> Circular No. 905 dated 10 March 2016, as amended, requires the U/KBs to hold sufficient High Quality Liquid Assets (HQLAs) that can be easily converted into cash to service liquidity requirements over a 30-day stress period. This provides banks with a minimum liquidity buffer to be able to take corrective action to address a liquidity stress event.

<sup>5</sup> The NSFR under Circular No. 1007 dated 6 June 2019 is a measure of the ability of a bank to fund its liquidity needs over one year and complements the LCR. Both ratios are aimed at strengthening the ability of banks to withstand liquidity stress and promote resilience of the banking sector.

<sup>6</sup> Circular No. 996 dated 8 February 2018 requires stand-alone TBs, R/CBs, 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.

**In terms of products or services, majority of the heads of banks mentioned that corporate banking will remain as their top-most priority, followed by trade financing, retail banking, and payments services.** Under corporate banking, the respondents identified Micro, Small and Medium Enterprise (MSME) lending, project financing, other corporate loans, real estate lending as primary services for the next two years. Meanwhile, real estate loans, salary loans and motor vehicle loans remained as the priority products under retail banking.

By type of bank, the respondents revealed that majority of domestic U/KBs will focus on corporate banking, retail banking, and trade financing while foreign U/KBs will mainly concentrate on corporate banking, trade financing, and payments. Meanwhile, retail loans remained as the main priority of TBs and R/CBs, which indicates that these banks were committed to their niche market.

The top three focus of lending by economic sector of domestic U/KBs were wholesale and retail trade, consumer loans, and manufacturing and for the next two years (Table 1). Moreover, foreign U/KBs preferred to lend mainly to the manufacturing sector as revealed in the results of the survey for four semesters. Subsidiary TBs underscored that consumer loans will have the largest share in their lending portfolio, while stand-alone TBs will focus on wholesale and retail trade in the next two years. Meanwhile, agriculture remained as the top market of the R/CBs' loan portfolio as revealed in the current BSOS, followed by wholesale and retail trade, and consumer loans. Based on latest available data, banks' lending activities were mainly channeled to real estate activities, wholesale and retail trade, household consumption, manufacturing sector, and electricity, gas, steam and airconditioning supply.

**Table 1. Focus of Bank Lending by Economic Sector**

Rank	Second Semester 2019					First Semester 2019				
	Domestic UKBs	Foreign UKBs	Subsidiary TBs	Stand-alone TBs	RCBs	Domestic UKBs	Foreign UKBs	Subsidiary TBs	Stand-alone TBs	RCBs
1	Wholesale and Retail Trade	Manufacturing	Consumer Loans	Wholesale and Retail Trade	Agriculture	Agriculture	Manufacturing	Consumer Loans	Consumer Loans	Agriculture
2	Consumer Loans	Financial and Insurance Activities	Wholesale and Retail Trade	Consumer Loans	Wholesale and Retail Trade	Wholesale and Retail Trade	Wholesale and Retail Trade	Wholesale and Retail Trade	Wholesale and Retail Trade	Real Estate Activities
3	Manufacturing	Electricity, Gas, Steam, and Airconditioning Supply	Real Estate Activities	Real Estate Activities	Consumer Loans	Consumer Loans	Financial and Insurance Activities	Real Estate Activities	Agriculture	Consumer Loans

Source: SPRD

**Business Strategy.** The top two strategic priorities by banking group for the two semesters are shown in Table 2. **Overall, the respondents revealed that the top two strategic priorities of the bank executives surveyed were: (1) to grow the bank; and (2) to optimize the available technology for growth and efficient banking operations.** Majority of the respondents believed that there is a need to grow the bank by expanding client base, by deepening customer relationships, and by developing new products. In line with the emerging market trends and evolving client needs, the rapid pace of digital technology is considerably reshaping the financial services landscape. Thus, respondent banks disclosed that they will prioritize the optimization of available technology through digital operations and customer service as well as leverage on financial technology for strategic efficiency in the next two years.

**Table 2. Top Two Strategic Priorities per Type of Bank**

Type of Bank/ Period	U/KBs	TBs	R/CBs
<b>Second Semester 2019</b>	Grow the business	Grow the business	Grow the business
	Optimize technology	Optimize technology	Optimize technology
<b>Second Semester 2018</b>	Grow the business	Grow the business	Grow the business
	Optimize technology	Optimize technology	Protect operations

Source: SPRD

**Meanwhile, 76.5 percent of the total respondents disclosed their preferred strategic direction as domestic banks engaged in target retail and business customers, underscoring the overall inward-looking nature of the PBS.** This finding is consistent with the results of the end-December 2018 BSOS in which 69.9 percent of respondents revealed similar strategic direction. Likewise, bank reports to BSP show limited, albeit increasing, cross-border transactions, primarily in the financial markets and remittance business.

Among foreign bank respondents, 42.9 percent aimed to be global banks providing specialized products and services to global clients while 23.8 percent intended to be regional champions specializing in the Philippine market.

**Operational Performance.** The strong macroeconomic fundamentals of the country remained intact amid the presence of risks both in the external and domestic front. Nonetheless, the stability and soundness of the PBS encourage foreign banks to establish presence in the Philippines. Consequently, banks are facing new aspects of competition and will benefit from a good competitive strategy. In the survey, banks were asked how they will maintain growth in an era of intense competition, heightened customer expectation and non-traditional market entrants. The top three plans of banks for the four semesters of the conduct of BSOS remained the same. **The banks have deemed it important to develop new capabilities, expand**

market reach and leverage on client relationship to maintain growth in the presence of intense competition as shown in Figure 14.

**Figure 14. Top 3 Plans to Maintain Growth in the Presence of Intense Competition and Other Factors**

Second Semester of 2019

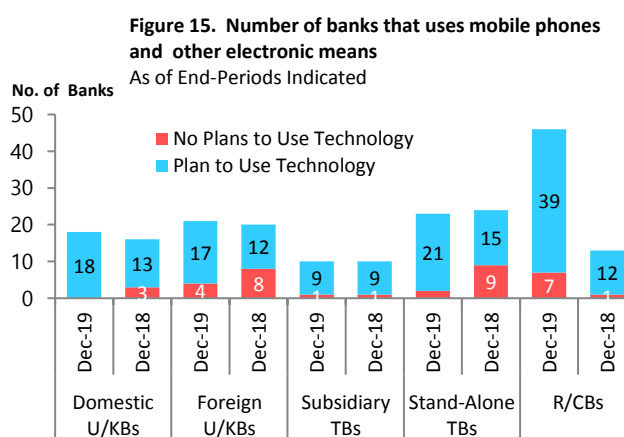


Source: SPRD

Meanwhile, about **92.4 percent of the respondents believed that efficient operation is important to sustain profitability**. Likewise, the respondents also viewed that hiring or retaining key talents, pursuing organic growth, and leveraging on technology to reduce costs were likewise of utmost importance to maintain banks' profitability amid market and regulatory pressures.

**Fintech/Cybersecurity Plans.** The survey results showed **that technology and operating models<sup>7</sup> are most applicable in addressing brand management and margin pressure**. Likewise, technology and operating models were also deemed useful in enhancing customer experience and expanding client base.

The banking industry increasingly supports the use of technology-enabled solutions and exhibits strong interest in participating in the digital finance ecosystem (Figure 15). The responses for the second semester of 2019 showed that **87.4 percent of respondent banks have plans to use technology in the banking transactions**, higher than the 73.5 percent of banks which

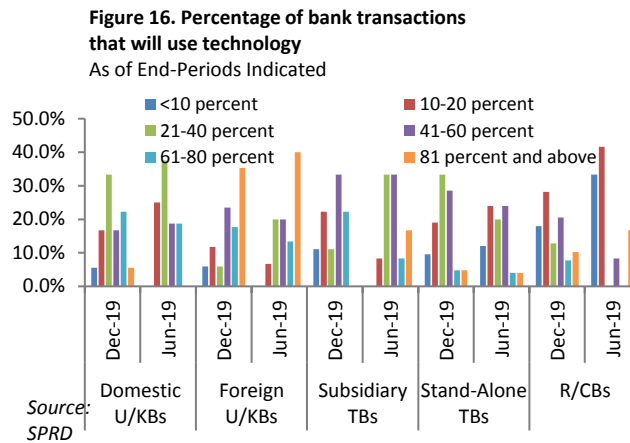


Source: SPRD

<sup>7</sup> How the bank runs its operations (e.g., decentralizing operations or introducing more cost efficient processes and technologies) or delivers value to customers (e.g., moving low-value transactions to self-service channels such as ATMs and online and/or mobile banking).

reported the same in the second semester of 2018 survey. The finding is consistent with the increase in the value of electronic money (e-money) transactions processed by the PBS, which increased by 13.1 percent from P664.8 billion in the first three quarters of 2018 to P752.0 billion for the same period this year.

For the second semester of 2019, 33.3 percent of respondents from domestic U/KBs that have plans to use technology revealed that 21 percent to 40 percent of their banking transactions will be conducted through the use of digital technology in the next two years (Figure 16). Moreover, 35.3 percent foreign U/KBs stated that more than 80 percent of their banking transactions will utilize digital means. Meanwhile, 61.9 percent of stand-alone TBs mentioned that 21 percent to 60 percent of their banking transactions will be conducted through the use of digital technology. R/CBs' fintech strategy is quite fragmented in the biggest group at only 28.2 percent revealed that 10 percent to 20 percent of their banking transactions will utilize the internet, mobile phones or other electronic means.



**Table 3. Top 5 Most Important Technology Application Areas**

Rank	Second Semester 2019				
	Domestic UKBs	Foreign UKBs	Subsidiary TBs	Stand-alone TBs	RCBs
1	Data security and privacy	Data security and privacy	Deposit services	Deposit services	Data security and privacy
2	Payment system	Know your customer (KYC)	Collection	Data security and privacy	Know your customer (KYC)
3	Loan scoring	Deposit services	Loan scoring	Loan scoring/Collection	Collection
4	Know your customer (KYC)	Customer services/Loan scoring	Customer service	Know your customer (KYC)	Deposit services
5	Customer service	Payment system	Know your customer (KYC)	Marketing	Payment system/Know your customer (KYC)

Source: SPRD

Likewise, banks that have plans to use digital technology were also asked on the most important application of technology in their respective organizations. **In general, data security and privacy remained as the most important applications**



**of technology**, followed by know your customer (KYC) procedures and loan scoring. The top five most important technology application areas by banking group is shown in Table 3. For the two consecutive semesters, data security and privacy continued to be the topmost important technology application for U/KBs and R/CBs. Meanwhile, deposit services emerged as the most important application of technology for TBs from data security and privacy in the previous semester. This indicates TBs' resolve to compete with the bigger banks for deposit markets through the use of technological innovations.

The result of the BSOS showed that **59.7 percent of banks are 'prepared' to handle and manage cyberthreats from 65.1 percent of banks during the previous semester.** The decline maybe attributed to the increase in the number of respondents from R/CBs in which 40.4 percent revealed that they are 'somewhat prepared' in dealing with cybersecurity risks and threats. Meanwhile, 14.3 percent and 22.7 percent of the respondents expressed that they are 'very prepared' and 'somewhat prepared' in managing cybersecurity risks, respectively.

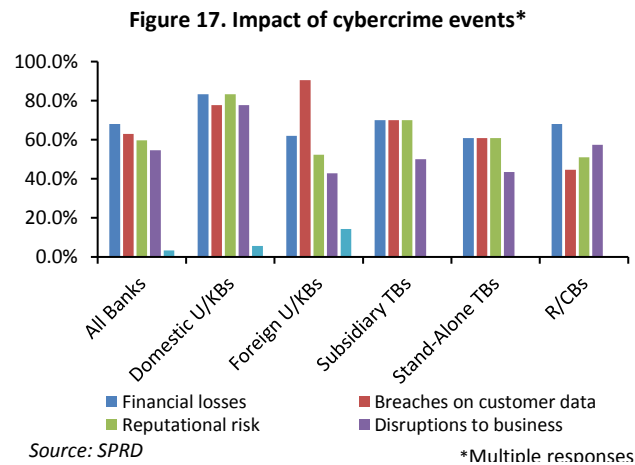
The top five cybersecurity threats that are of concern to banks is listed in Table 4. **Cyberattacks (i.e. to disrupt, to steal money, to steal IP) topped the list of cybersecurity threats that respondent banks were most worried about.** Moreover, phishing and malware are the other types of cybersecurity threats common to U/KBs, TBs and R/CBs.

**Table 4. Top 5 Cybersecurity Threats**

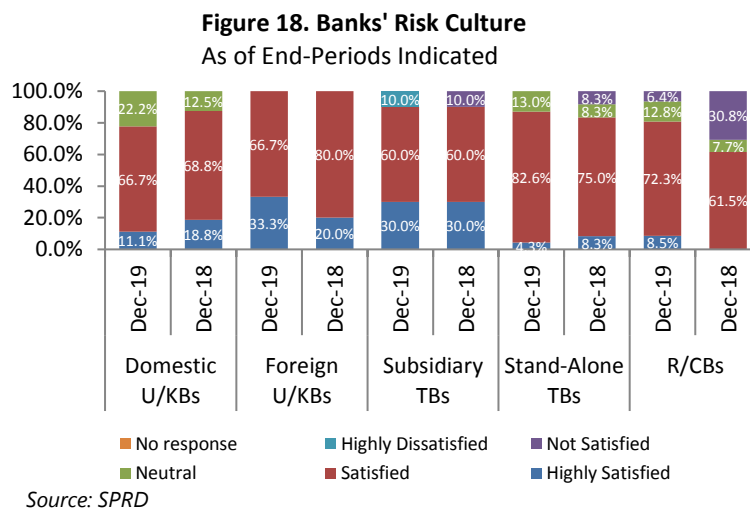
Rank	Second Semester 2019				
	Domestic UKBs	Foreign UKBs	Subsidiary TBs	Stand-alone TBs	RCBs
1	Cyberattacks	Cyberattacks	Cyberattacks	Cyberattacks	Cyberattacks
2	Direct Hacking/APTs	Phishing	Malware/Insider Attacks	Fraud	Fraud
3	Denial of Service Attacks	Malware	Fraud	Phishing	Direct Hacking/APTs
4	Malware	Fraud	Phishing	Insider Attacks	Malware
5	Phishing	Denial of Service Attacks/Direct Hacking/APTs	Insider Attacks	Malware	Phishing

Source: SPRD

Meanwhile, **68.1 percent of surveyed banks indicated financial losses as the most worrisome in terms of the impact of cybercrime events followed by breaches on customer data and reputational risk.** By banking group, financial losses and reputational risks were viewed by 83.3 percent of domestic U/KBs while breaches on customer data were indicated by 90.5 percent of foreign U/KBs as the most worrisome impact of cybercrimes (Figure 17).



**Organizational Conduct and Risk Culture.** The survey disclosed the extent of satisfaction in terms of the level and maturity of banks' risk culture, as well as the strength of risk governance standards. **Overall, 71.4 percent of respondents revealed that they were satisfied with the risk culture in their respective banks while 14.3 percent of respondents disclosed that they were highly satisfied.** Three R/CBs were not satisfied while one subsidiary TB is highly dissatisfied with the level and maturity of the bank's risk culture (Figure 18).



The banking environment has been constantly affected by changes in technology, competition, and the evolving regulations and international standards. **As new risks emerge due to these factors, banks recognize the necessity to protect their depositors, investors and institutions from these undue risks through strong risk governance standards.** These have been underscored in the results of the survey in which majority of the respondents are satisfied with the level and maturity of risk culture in their respective banks.

The respondents identified the **top 3 strengths of the bank's risk governance framework.** These are as follows: (a) the board of director and senior management oversight; (b) **strong risk culture and values** within the bank; and (c) **appropriate risk appetite** for the bank's business, resources and capital. **The need for a highly**

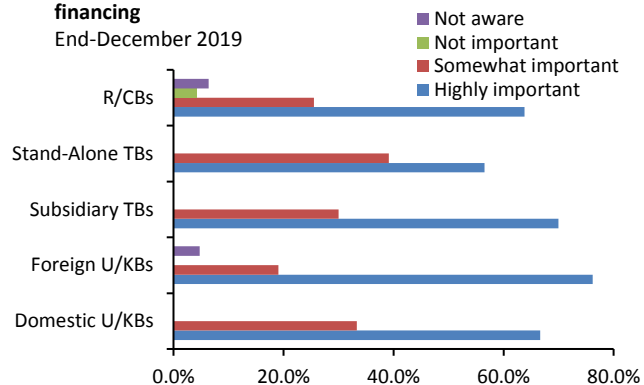
**effective models/system for risk management** as one of the areas for improvement was likewise highlighted by 35.3 percent of the respondents.

**The survey results also showed that inputs from audit, risk and compliance functions were always considered in the board/senior management business decisions and strategies.** About 95.0 percent of the respondents mentioned that their employees were bound by a code of ethics/conduct in which majority was formulated by the bank. Moreover, the survey results revealed that personnel recruitment and termination topped the list among the different aspects of business covered by their respective Codes of Ethics. This was followed by whistleblowing and grievance escalation policies and customer dealings.

**Sustainable Finance.** This new section consisting of four questions was introduced to have an insight on the banks' view towards sustainable financing. This is deemed important since climate change and other environmental and social risks could pose financial stability concerns considering their significant and protracted implications on the bank's operations and financial interest. In the past years, the rise in interest from global investors and fund managers to direct funds toward sustainable projects and activities has been noted. The increase in demand was complemented by the development of various financing mechanism for sustainable projects. Thus, climate financing, green financing and sustainable financing have emerged. **The survey results showed that 65.6 percent and 28.6 percent of respondents view sustainable financing as highly important and somewhat important, respectively.** The views by banking group towards sustainable financing is shown in Figure 19.

**Figure 19. Organization's view on sustainable financing**

End-December 2019



Source: SPRD

Despite the high level of importance, BSOS results also revealed that 68.1 percent of respondents will not finance sustainable projects while only 30.3 percent have plans to finance these type of projects. Specifically, about 83.3 percent of domestic U/KBs will not engage in financing sustainable projects in the near term. The banks' reluctance to engage in sustainable financing was mainly attributed to the lack of demand and relatively low financial returns for the venture. Nonetheless, banks expressed willingness to finance sustainable projects covering agriculture, transportation, water supply management, and solar power. Relative to this, the BSP has taken a two-pronged approach to sustainable finance: first is undertaking capacity building and awareness campaigns, and second is mainstreaming environmental and social governance through the issuance of enabling regulations that will encourage the growth of the market while maintaining the soundness and

stability of the PBS. The relevant policy framework is scheduled for release in the first half of 2020.

**Impact of Supervision on Bank Performance.** Banks were also asked to rank five areas which they find challenging in terms of regulatory compliance. This is intended to evaluate the impact of BSP regulations. Except for R/CBs, **compliance with mandatory credits to Agri-Agra remained as the most challenging** since the complex business models of bigger banks may not be suited to lend to the agri-agra sector.<sup>8</sup> As of end-December 2019, the PBS's 11.8 percent compliance for other agricultural credit, for instance, was below the 15.0 percent statutory credit requirement under the Agri-Agra Law. Moreover, compliance ratio for agrarian reform credit, which stood at 1.1 percent, was way below the required 10 percent.

Nonetheless, penalties have been collected from banks which have failed to fully comply with the mandatory agri-agra credit allocation. Meanwhile, the BSP is working with relevant government agencies on the amendments to R.A. No. 10000. Likewise, the BSP supports the amendment of R.A. No. 10000 to strengthen rural development by providing for a holistic approach that takes into account the broader agricultural financing ecosystem and rural community development requirements.

**Banks also cited regulations on credit risk management, anti-money laundering, IT risk management, and operational risk management as the most challenging areas in terms of compliance with the BSP's regulatory framework.**

Table 5 presents the five most challenging areas by banking group. Most banking groups' difficulty with compliance to the mandatory credits to Agri-Agra was noted during the previous conducts of BSOS.

**Table 5. Most Challenging Areas in Terms of Compliance**

Rank	Domestic U/KBs	Foreign U/KBs	Subsidiary TBs	Stand-alone TBs	R/CBs
1	Mandatory credits to agri-agra	Mandatory credits to agri-agra	Mandatory credits to agri-agra	Mandatory credits to agri-agra	Credit risk management
2	Anti-money laundering	Single Borrowers' Limit	Anti-money laundering	Credit risk management	IT risk management
3	Reportorial requirements	Anti-Money Laundering	ICAAP/BASEL 3 capital requirements	Operational risk management	Operational risk management
4	IT risk management	Basel III Liquidity requirements	Credit risk management	Anti-money laundering	Other areas of risk management

<sup>8</sup> Under the Agri-Agra Law, banks are required to set aside 25 percent of their loanable funds (10 percent for agrarian reform beneficiaries and 15 percent for other agricultural credit) to the agriculture sector.

5	Philippine Financial Reporting Standards 9	Liquidity risk management	Liquidity risk management	Philippine Financial Reporting Standards 9	Anti-money laundering/ BASEL 3 capital requirements
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Source: SPRD

Increase in Ranking from BSOS Second Semester 2018  
 Decrease in Ranking from BSOS Second Semester 2018

Meanwhile, domestic U/KBs, and subsidiary TBs considered compliance with anti-money laundering in the second rank among the most challenging areas in terms of compliance. Notably, there was a shift in the ranking of the most challenging areas by some banking groups. For instance, reportorial requirements ranked number five for domestic U/KBs in the second semester of 2018, but ranked third in the second semester 2019 survey.

**Risk Assessment.** Table 6 presents the top five risks to the banks' operation. **Overall, institutional risk continued to be the top-most risk to the banks' operation.** Technology risk emerged as one of the risks common to banks due to the increasing support on technology-enabled solutions. Likewise, financial market risk transpired as one of the risks common to U/KBs, TBs and R/CBs. Meanwhile, domestic U/KBs and foreign U/KBs considered cybersecurity threat and money laundering risk as the main risk under institutional risks, respectively. Subsidiary TBs considered market competition and hiring/retaining of talents as the leading risks under institutional risk while market competition topped the list of institutional risk for stand-alone TBs and R/CBs..

**Table 6. Top Five Risks to Banks' Operation**

Rank	Second Semester 2019			Second Semester 2018		
	UKBs	TBs	RCBs	UKBs	TBs	RCBs
1	Institutional Risk	Institutional Risk	Institutional Risk	Institutional Risk	Institutional Risk	Institutional Risk
2	Technology Risk	Financial Market Risk	Financial Market Risk	Financial Market Risk	Financial Market Risk	Financial Market Risk
3	Global Risks	Macroeconomic Risk/Global and/or Domestic Geopolitical Risks	Technology Risk	Macroeconomic Risk	Macroeconomic Risk	Technology Risk
4	Macroeconomic Risk	Possible Downturn in the Real Estate Market	Macroeconomic Risk	Technology Risk	Technology Risk	Over-regulation
5	Global and/or Domestic Geopolitical Risks	General Risk	General Risk	Global and/or domestic geopolitical Risk	Global and/or domestic geopolitical Risk	Macroeconomic Risk

Source: SPRD

**Enhancing their risk management systems was considered by banks as the primary tool to strengthen the bank against external headwinds.** Likewise, upgrading of personnel capabilities, keeping a high level of liquid assets, and strengthening client relationships were also deemed equally important by the respondents in order to protect their respective banks against internal and external shocks.

## IV. Conclusion

The sluggish global growth may have largely beset business sentiments during the second semester of 2019. This factor has resulted **in the moderation of the banking industry leaders' bullish expectations on economic growth and banking system prospects.** Amid such global uncertainty, the outlook on the economy and the PBS are still optimistic, with most of the BSOS respondents projecting double-digit growth in assets, loans, deposits and net income. Meanwhile, the highly competitive banking environment may have led to narrower projections of net interest margin. With the banks' increasing support on the use of technology-enabled solutions and strong interest in participating to the digital finance ecosystem, banks in general are prepared to handle and manage cyberthreats.

Nevertheless, **prudence remains** as banks intended to keep a high level of risk-based capital and liquidity; to enhance their risk management systems; and to strengthen organizational conduct and risk culture in order to thrive amid the volatility and complexity of the operating environment. Moreover, the banks intended to solidify their respective shares in the domestic market leveraging on their existing client relationships while harnessing technology to expand the banking business and achieve strategic and operational efficiencies.

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### Microprudential policy implications

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Meanwhile, a number of policy reforms to enhance the **resilience of individual banks**, to **strengthen risk governance** in the financial system, and to promote **financial innovation, financial inclusion as well as consumer protection** have been issued during the second semester of 2019, or will be adopted in the medium term. These reforms take into consideration the enhancements of the BSP Charter embodied under Republic Act (R.A.) No. 11211, as well as R.A. No. 11127 or the National Payment Systems Act and R.A. No. 11439, An Act Providing for the Regulation and Organization of Islamic Banks.

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## Strengthening risk governance

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**Governance and risk management standards were enhanced to promote a sound risk culture.** In strengthening risk governance, the BSP is guided by the concept of proportionality towards achieving an enhanced risk management system and sound capital position of BSP-supervised financial institutions (BSFIs). This objective is complemented by the deployment of prompt and calibrated enforcement actions as well as dynamic and forward-looking assessment framework.

**The BSP issued the guidelines on investment activities of BSFIs which set out the regulatory expectations in managing risks arising from investment activities** of banks/quasi-banks (QBs) to a wide range of instruments. This includes bonds issued by emerging economies, complex structured products, and other tradable assets.<sup>9</sup> Likewise, the guidelines on the management of interest rate risk in the banking book (IRRBB) and the amendment of the guidelines on market risk management aim to provide clear expectations on how a bank/QB should manage IRRBB and align the same with the BSP's supervisory framework on interest rate risk with international standards.<sup>10</sup>

**The BSP enhanced the guidelines on LCR and MLR in response to feedback received from the BSP's continuing dialogue with the industry.** Moreover, the BSP introduced intraday liquidity reporting guidelines which aims to enable banking supervisors to better monitor a bank's management of intraday liquidity risk and its ability to meet payment and settlement obligations on a timely basis under both normal and stressed conditions.<sup>11</sup>

**The BSP issued the amendments to the framework for dealing with domestic systemically important banks (D-SIBs).**<sup>12</sup> The amendments to the D-SIBs framework include: (1) revision in the differential weights of categories/ indicators and the composition of indicators including adoption of threshold level; and (2) calibration of the level of additional capital requirement.

**The BSP also approved the Shari'ah Governance Framework (SGF)** for Islamic banks (IBs) and Islamic banking units (IBUs).<sup>13</sup> The guidelines also aim to protect consumers and other stakeholders by requiring that an IB or an IBU of a conventional bank complies with the SGF. The SGF complements the existing regulatory corporate governance framework.

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<sup>9</sup> Circular No. 1042 dated 25 July 2019.

<sup>10</sup> Circular No. 1044 dated 06 August 2019.

<sup>11</sup> Circular No. 1064 dated 03 December 2019.

<sup>12</sup> Circular No. 1051 dated 27 September 2019.

<sup>13</sup> Circular No. 1070 dated 27 December 2019.



**The BSP approved the adoption of the Supervisory Assessment Framework (SAFr).** This framework aims to further strengthen the assessment of BSP-supervised financial institutions (BSFIs). The SAFr explicitly links the systemic importance and risk profile of a BSFI to the crafting of supervisory plans for each supervised institution. The key feature of the SAFr is the use of business model analysis. **The SAFr will replace the various rating systems currently employed by the BSP, including the CAMELS Rating and Risk Assessment System.**

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## Promoting digital innovation and financial inclusion

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**Use of technology will continue to define the future landscape of the PBS.**

The BSP issued the rules and regulations on the registration of payment systems operators<sup>14</sup> as part of the implementation of Republic Act No. 11127 or the National Payment Systems Act. Moreover, the BSP approved the policy requiring the adoption of a National Quick Response (QR) Code Standard under the National Retail Payment System (NRPS) umbrella that will enable interoperability of QR-enabled payment and financial services.<sup>15</sup> Initiatives were likewise implemented to allow the use of technology to streamline the conduct of banking activities and to mitigate and/or address technology-related risks, including anti-money laundering (AML) and other concerns with respect to fintech.

**The BSP pursues the effective implementation of its internal cybersecurity roadmap through capacity building, collaborative engagements, as well as policy framework and supervisory enhancements.** As systems, customers, and institutions become more interconnected and accessible, the cyber threats have magnified as well.

**The BSP recognizes that the financial system is an important stakeholder in driving investments to activities that promote climate-resilient, green, and sustainable growth.** Thus, financial regulation is viewed as a useful tool that will contribute in achieving national and international environmental objectives. The BSP's policy framework on sustainable finance provides high level principles and broad expectations on the integration of environmental and social governance and sustainability principles in the corporate and risk governance framework as well as business strategies and operations of banks. The Sustainable Finance Framework was approved by the BSP in March 2020.

**Other BSP initiatives on financial inclusion included enabling regulations and consumer empowerment through financial literacy.**

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<sup>14</sup> Circular No. 1049 dated September 2019.

<sup>15</sup> Circular No. No. 1055 dated 17 October 2019.

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## Continuing stakeholder collaboration

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**Moreover, collaboration with BSP stakeholders through conduct of regular dialogues will be strengthened.** This includes the regular conduct of Bank Supervision Policy Committee (BSPC)<sup>16</sup> meetings with financial industry associations, cooperation with co-regulators under the Financial Sector Forum (FSF)<sup>17</sup> and Financial Stability Coordination Council (FSCC)<sup>18</sup>, participation in forums organized by industry organizations, bilateral discussions and written queries with banks.

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## Maintaining financial stability and stabilizing the financial market amid the COVID-19 pandemic

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As of the writing of this Report, the impact of COVID-19 outbreak on the domestic economy is evolving. It is expected to pose a serious challenge to both the health of the population and the domestic economy. Amid the COVID-19 outbreak, the BSP has adopted some measures to lessen the potential impact on the BSFIs through the grant of regulatory and rediscounting relief measures. For instance, the 25 percent single borrower's limit (SBL) on loans granted by banks and quasi-banks was raised to 30 percent for a period of six (6) months from 19 March 2020. The increase in the SBL also covers the 25 percent SBL for project finance loans for the purpose of undertaking initiatives that are in line with the priority programs and projects of the government.

The BSP also relaxed the requirement for customers to present valid identification cards (IDs) for financial transactions, including electronic or online customer onboarding transactions, subject to certain conditions. Further, financial assistance, in the form of loans, advances or other credit accommodations, may be granted by financial institutions to their employees that are affected by the COVID-19, subject to subsequent regularization with the BSP, if necessary.

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<sup>16</sup> The BSPC is comprised of the heads of the Financial Supervision Sector (FSS) and its Subsectors, the Reserves Management Departments I and II, the Department of Economic Research, the Center for Monetary and Financial Policy and the Department of Economic Statistics. It is at the forefront of the BSP's initiatives to enhance strategic partnership with the financial community. Through the BSPC, the BSP is apprised of financial industry developments which ensure the continued relevance and responsiveness of supervisory policy. The platform is an interactive venue in informing the industry of the BSP's policy direction, supervisory approach and stakeholder expectations.

<sup>17</sup> The FSF is a voluntary cooperative endeavor of domestic financial regulators (i.e. the BSP, the Securities and Exchange Commission [SEC], the Insurance Commission [IC], and the Philippine Deposit Insurance Corporation [PDIC]) to provide an institutionalized framework for coordinating the supervision and regulation of the financial system, while preserving each agency's mandate.

<sup>18</sup> The FSCC is a voluntary interagency council composed of the Department of Finance (DOF), the SEC, the IC, the PDIC, the Bureau of the Treasury (BTr) and the BSP. The FSCC's main task is to identify, manage and mitigate the buildup of systemic risks consistent with the overall prudential objective of financial stability.

The set of measures provides incentives for financial institutions to promote continued access to credit/financial services, extend financial relief to their borrowers, and support uninterrupted delivery of financial services to enable consumers to complete financial transactions during the enhanced community quarantine period.

Likewise, extraordinary measures have been undertaken by the BSP to ensure sufficient domestic liquidity and serve the need of the economy. This includes the purchase of government securities from the Bureau of Treasury (BTr) under a repurchase agreement in the amount of P300 billion; reduction of the reserve requirement ratio by 200 basis points and policy rate by 50 basis points; remittance of the P20 billion advance dividends to support the national government programs.

The BSP reassures the Filipino people of its commitment and readiness to deploy its full range of instruments to provide liquidity and ensure the efficient functioning of the domestic financial market. The BSP will continue to work closely with market participants and other relevant government agencies in monitoring the situation and carrying out appropriate policy responses in a timely manner, in support of the National Government's broader efforts to mitigate the adverse impact of the health crisis on the economy at large and to the banking system in particular.



# BANKING SECTOR OUTLOOK SURVEY

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