Supervisory Policy and Research Department

The Philippine

Banking Sector Outlook Survey

Second Semester 2020

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Main Message of the Survey

This version: 9 December 2020

Following the disruptions in activities of the domestic economy due to lockdown along with the global spillovers from soft demand, weaker tourism, and lower remittances, the banking industry leaders' bullish expectations on banking system prospects have moderated, based on the results of the Banking Sector Outlook Survey (BSOS) conducted during the second semester of 2020. Majority of the BSOS respondents projected that real gross domestic product (GDP) growth will return to a range of less than 6.0 percent to 6.3 percent within the next two years. Respondents identified that economic sectors such as the accommodation (hospitality/tourism), transportation, and wholesale and retail trade are the hardest hit sectors, but these sectors are poised to recover in the next six months to two years.

Nevertheless, the outlook on the Philippine banking system (PBS) remains relatively stable as sources of strength of the PBS are expected to result in double digit growth in assets, loans, investments, deposits and net income. Meanwhile, banks anticipate a more active participation in the money and capital markets in the next two years as growth in financial assets (excluding loans) is projected to not exceed 10 percent by more than half of respondents, while the remaining banks, largely foreign banks, estimate a double-digit growth in the range of 10 percent to more than 30 percent.

Meanwhile, majority of respondents expect the non-performing loan ratio (NPL) to exceed three percent in 2021 to 2022. As an additional indicator of loan quality in this BSOS run, the ratio of restructured loans to total loans is estimated at a range of more than 3 percent to more than 5 percent by almost half of banks, mostly thrift banks, foreign banks, and rural and cooperative banks. By contrast, about 39 percent of respondents are expecting a more conservative restructured loan ratio between less than 1 percent and 3 percent. Meanwhile, the NPL coverage ratio is anticipated in the range of less than or equal to 25 percent to 50 percent by 48.9 percent of respondents, while 44.3 percent of the respondents projected an NPL coverage ratio of between 51 percent and 100 percent. In particular, 85.7 percent of universal and commercial banks (UKBs) are expecting the NPL coverage ratio to hover between 76 percent and greater than 100 percent.

The PBS also intends to maintain the so-called Basel ratios (e.g. risk-based capital, leverage, and liquidity ratios) at levels higher than domestic and global standards to promote institutional stability. This implies that banks will calibrate its strategies to maintain a loss-absorbing capital buffer while at the same time ensure confidence of the public in providing enough liquidity and funding in 2021 to 2022.

In line with the emerging market trends and evolving client needs, banks have recognized the need to integrate technology in achieving business objectives. Thus, respondent banks disclosed that they will prioritize the optimization of available technology and will leverage on financial technology for strategic efficiency in the next two years. Mindful of cyberthreats following the lockdown and remote working arrangements, more than half of the respondent banks are 'prepared' to handle and manage cyberthreats.

Following the issuance of Circular No. 1085 in April 2020 on Sustainable Finance Framework, banks expressed willingness to finance sustainable projects covering agriculture, transportation, water supply management, and solar power as almost 60 percent of banks viewed sustainable financing as a highly important strategic objective. In turn, around 73 percent of respondents are planning to finance sustainable projects in 2021 to 2022.

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

The impact of the pandemic on the overall condition and performance of the banking system, which remains the core of the domestic financial system, has been manageable. This was largely due to the BSP's implementation of timely, time-bound and crucial regulatory relief measures in the first half of 2020, which helped address the adverse repercussions of the pandemic. Moving forward, the Philippine financial system is projected to withstand the legacy risks and challenges of the COVID-19 pandemic within the next two years on account of its relatively stable and sound capital, leverage and liquidity buffers, ample loan loss reserves and buoyant 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.[1] 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.

[1] 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 below:

Section	Description
Macroeconomy and Banking System 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.

The BSOS Methodology. The conduct of BSOS for the second semester of 2020 covers all universal and commercial banks (UKBs), thrift banks (TBs) and 80 rural and cooperative banks (RCBs) to include top 20 RCBs in terms of total loan portfolio plus the 60 RCBs that were randomly selected. The updated survey questionnaire includes questions related to COVID-19 pandemic and transmitted to the Presidents/Chief Executive Officers/Country Managers of the covered banks. Meanwhile, banks which responded to the survey accounted for 73.0 percent of the total assets of the PBS as of end-September 2020.

III. Results of the Second Semester 2020 Banking Sector Outlook Survey

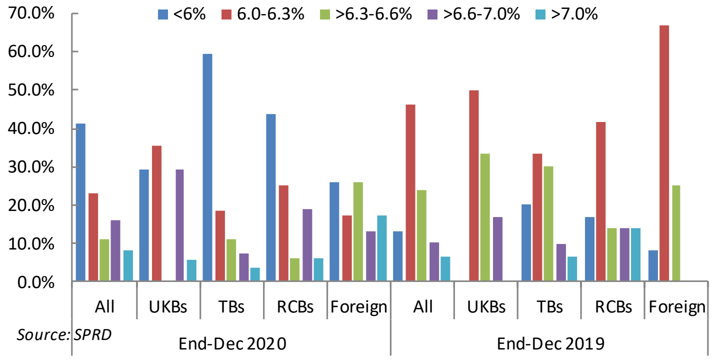
Macroeconomy and Banking System Growth Outlook

Banks pose a more subdued optimism on the country's economic prospects as risks remain tilted to the downside due to the effects of COVID-19 pandemic. During the second semester of 2020, 64.6 percent of the BSOS respondents projected that real gross domestic product (GDP) growth will return to a range of less than 6.0 percent to 6.3 percent within the next two years.

Current bank projections converged on the two lowest growth tiers <6.0% and 6.0-6.3%, with 41.4 percent of respondents expecting a GDP growth of less than 6.0 percent. By contrast, the real GDP growth forecast for the second semester of 2019 was slightly more upbeat with 43.6 percent biased towards the 6.0 percent to 6.3 percent growth range.

Across banking groups, 64.7 percent of respondent UKBs forecasted GDP growth between less than 6.0 percent and 6.3 percent while 29.4 percent of respondent UKBs are more optimistic, projecting the real GDP growth at a range of greater than 6.6 percent to 7.0 percent. Meanwhile, 59.3 percent of respondent TBs and 43.8 percent of respondent RCBs projected the real GDP growth of less than 6.0 percent. In particular, foreign bank respondents tilted the balance to the more optimistic side as 56.5 percent projected a real GDP growth range of more than 6.3 percent to more than 7.0 percent in 2021 to 2022 (Figure 1).

Figure 1. Real GDP Growth Forecast by Type of Bank
As of End-Periods Indicated



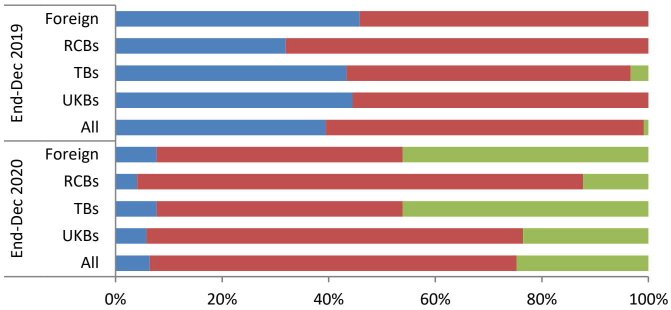
Source: SPRD

As part of the COVID-19 impact assessment, banks were asked to name the top three industries that are heavily affected by the pandemic based on evaluation of total loan portfolio. The banks revealed, in order of ranking, that accommodation (hospitality/tourism), transportation, and wholesale and retail trade are indeed the hardest hit sectors due to strict lockdowns and social distancing protocols. Further, the banks were asked to indicate the expected duration of recovery of these top 3 industries from the pandemic. Banks observed that wholesale and retail trade sector will be the fastest to recover in the next six months to one year. Transportation sector will take the longest time of about two years, while accommodation sector will take around one to two years to fully recover.

On the whole, the general softening in banks' GDP growth outlook is consistent with that of the International Monetary Fund (IMF), which projected the country's real GDP growth to contract by 8.3 percent in 2020 before growth returns to 7.4 percent in 2021.[2] The IMF forecast was anchored on the path of the pandemic, the needed public health response, and the associated domestic activity disruptions (most notably for contact-intensive sectors), as well as the extent of global spillovers from soft demand, weaker tourism, and lower remittances. Likewise, the Asian Development Bank (ADB) revised its growth outlook for the Philippines to 7.3 percent contraction in 2020 amid the COVID-19 pandemic before growth returns to 6.5 percent in 2021.[3]

Banks' positive economic outlook translated to renewed confidence in the stability of the banking system. This is evident as 68.8 percent of the banks in Figure 2 projected a stable PBS in the next two years. Further, 24.8 percent of respondents, largely foreign banks, expected a stronger banking system in 2021 to 2022. This is higher than the PBS overall outlook for the second semester of 2019 in which a meager 0.8 percent of the industry leaders forecasted a stronger PBS. The news of a high efficacy (more than 90 percent) of the COVID-19 vaccines, being developed and soon to be rolled out by leading pharmaceutical and biotechnology companies, partly buoyed banks' risk-on sentiment.

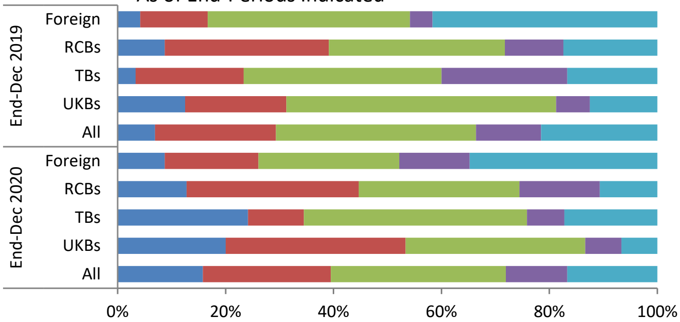
Figure 2. Banking System Growth Outlook
As of End-Periods Indicated



Source: SPRD

The projected return to economic growth and stable outlook on the PBS influenced 60.5 percent of the respondents to project double-digit growth in bank assets. Nonetheless, this is lower compared to the 70.7 percent projection of double-digit asset growth during the second semester of 2019. Meanwhile, 33.3 percent of UKBs projected an asset expansion of between 10 percent and 15 percent, a slash from the year ago's 50.0 percent. Foreign banks are most optimistic as 34.8 percent projected an asset growth of more than 20 percent in the next two years. UKBs are least optimistic (or most conservative) with only 46.7 percent of respondents projecting double-digit growth in assets from the previous survey's 68.8 percent (Figure 3). It should be noted that the average projected asset growth rate for top 10 large banks is below 10 percent.

Figure 3. Asset Growth Projection
As of End-Periods Indicated



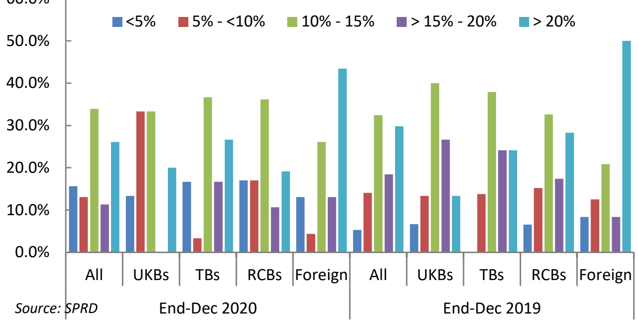
Source: SPRD

[2] International Monetary Fund (IMF), *World Economic Outlook, October 2020: A Long and Difficult Ascent*, 13 October 2020.

[3] Asian Development Bank (ADB), *Asian Development Outlook 2020 Update*, 15 September 2020.

The growth in assets is expected to be driven by credit expansion as 71.3 percent of the banks projected double-digit growth in their loan portfolio in the next two years. Majority of UKBs', TBs' and RCBs' projection of credit growth are hovering between 10 percent and 15 percent. Meanwhile, about 43.5 percent of the foreign bank respondents projected loan growth of more than 20.0 percent, a decline from the 50.0 percent of respondents in the second semester 2019 BSOS (Figure 4).

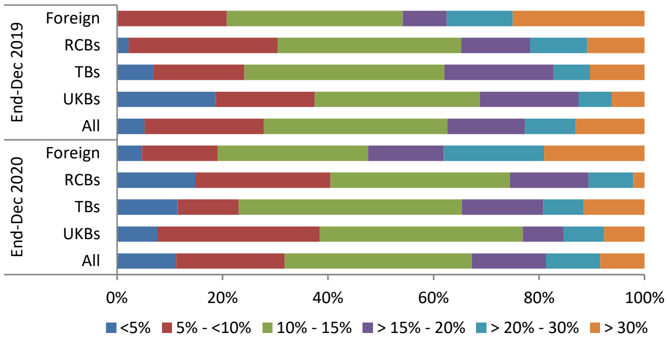
Figure 4. Projected Loan Growth
As of End-Periods Indicated



Source: SPRD

The BSOS results likewise revealed expectations for deposit growth to fund asset and loan expansion. About 68.2 percent of the current BSOS respondents projected double-digit deposit growth, though lower than that of second semester 2019 BSOS at 72.2 percent. Moreover, 28.6 percent of foreign bank respondents projected an expansion in deposits between 10.0 percent and 15.0 percent while about 19.0 percent of the foreign banks forecasted growth in deposits of more than 30.0 percent in 2021 to 2022 (Figure 5).

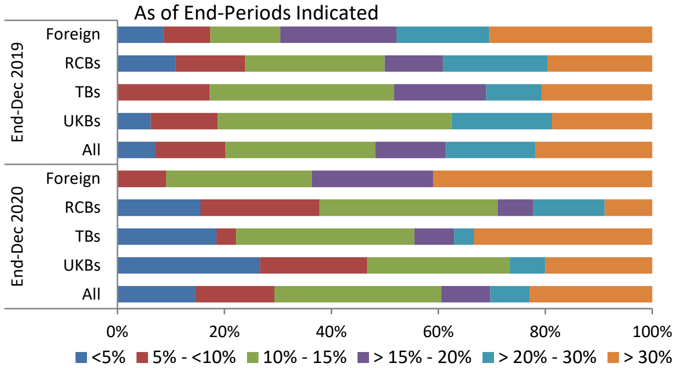
Figure 5. Projected Growth in Deposits
As of End-Periods Indicated



Source: SPRD

The banks retained their upbeat expectations on returns as 70.6 percent of the respondents for the second semester of 2020 forecasted double-digit net income growth for the next two years, albeit lower compared to the 79.8 percent of the respondents during the second semester of 2019. In particular, 26.7 percent of UKBs, 33.3 percent of TBs, and 33.3 percent of RCB respondents, respectively, projected a net income growth of between 10 percent and 15 percent, while 40.9 percent of foreign bank respondents forecasted net income to grow by more than 30 percent (Figure 6).

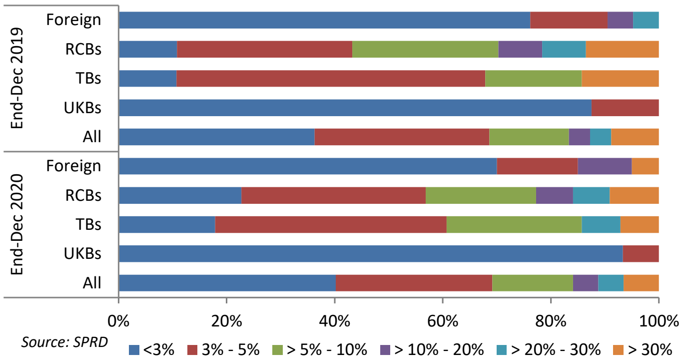
Figure 6. Projected Growth in Net Income
As of End-Periods Indicated



Source: SPRD

The net income forecasts are driven by the tightening of projected net interest margin (NIM) as 40.2 percent and 29.0 percent of the current respondents expected lower NIM at less than 3 percent and between 3 percent and 5 percent, respectively. UKBs and foreign banks are the most conservative with 93.3 percent and 70.0 percent expecting a NIM at less than 3 percent, respectively (Figure 7). TBs' and RCBs' NIM projections are tilted towards the less than 3 percent to 10 percent range.

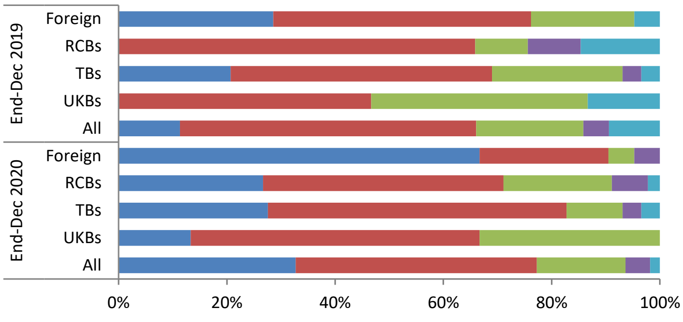
Figure 7. Projected Net Interest Margin
As of End-Periods Indicated



Source: SPRD

Amid the subdued optimism, **the projected return on equity (ROE) generally tightened** with 32.7 percent of respondent banks expecting it to be less than 5 percent for the current BSOS compared to only 11.3 percent during the previous year. The number of relatively more optimistic respondents apparently downgraded their projections as 44.5 percent of respondents expected an ROE of between 5 percent and 10 percent compared to 54.7 percent in the previous year (Figure 8).

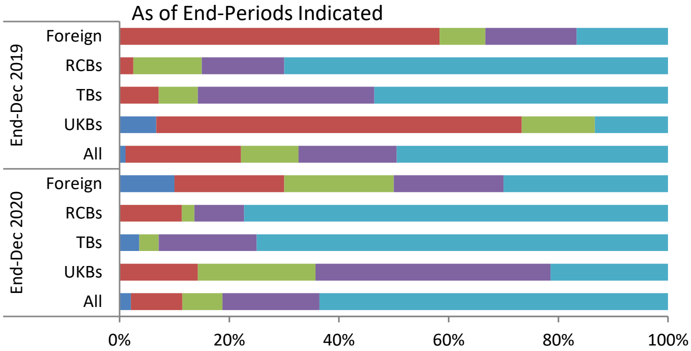
Figure 8. Projected Return on Equity
As of End-Periods Indicated



Source: SPRD

The slowdown in economic activities may have exerted pressure on the quality of bank loan portfolio. This could be seen in the increase of respondents expecting the ratio of non-performing loans (NPL) to total loans to exceed 3 percent in the next two years to 81.3 percent during the second semester of 2020 from the 67.4 percent in the previous survey. Meanwhile, TBs and RCBs consistently expected elevated NPL ratios. About 50.0 percent of foreign bank respondent projected an NPL ratio of more than 3 percent from 33.3 percent of respondents with similar projection a year ago (Figure 9). The extent and path of the COVID-19 pandemic is hampering the full reopening of the different economic sectors, especially the highly retail or contact-intensive segments. This, in turn, may have led banks to downgrade the quality of their loan exposures to these sectors, resulting in an uptick in their NPL forecasts.

Figure 9. Projected NPL Ratio
As of End-Periods Indicated



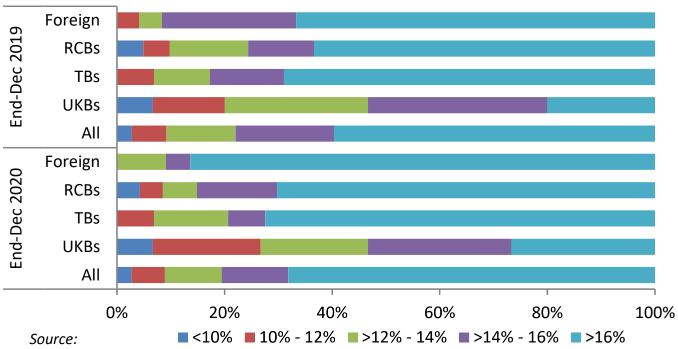
Source: SPRD

As an enhancement of the current BSOS, the banks were asked to project **the ratio of restructured loans to total loans** within the next two years. This new item in the survey will look into **the propensity of banks to modify the terms of the loan when borrower is facing financial stress** due to unforeseen events like the COVID-19 pandemic and natural disasters. About 54.4 percent of respondent banks, mostly niche marketers like TBs, foreign banks, and RCBs, projected a restructured loan ratio in the range of more than 3 percent to more than 5 percent. By contrast, 39.2 percent of respondents, skewed by UKBs, are expecting a more conservative restructured loan ratio between less than 1 percent and 3 percent.

Another added feature to this enhanced BSOS is the banks' baseline projection of the **NPL coverage ratio**. This is important because the projected NPL coverage ratio will indicate the banks' (perceived) ability to absorb future losses. In the survey, 48.9 percent of the respondent banks projected an NPL coverage ratio in the range of less than or equal to 25 percent to 50 percent, while 44.3 percent of the respondents projected an NPL coverage ratio of between 51 percent and 100 percent. In fact, 85.7 percent of UKBs are expecting the NPL coverage ratio to hover between 76 percent and greater than 100 percent. Around 88.9 percent of TBs converged on the projected NPL coverage ratio of between 26 percent and 100 percent, while 86.1 percent of RCBs are tilted towards the NPL coverage ratio range of less than or equal to 25 percent to 75 percent.

Prior to the pandemic, income from financial assets (excluding loans) represented a material source of income for banks that have ready and active market access. Thus, banks were asked to have an initial forecasts of investment growth in the next two years to indicate their risk appetite towards this business segment. More than half of the respondent banks (55.3 percent) forecasted an investment portfolio growth not exceeding 10 percent, while 44.7 percent of the banks projected a double-digit growth in financial assets specifically in the range of 10 percent to more than 30 percent.

Figure 10. Projected CAR
As of End-Periods Indicated

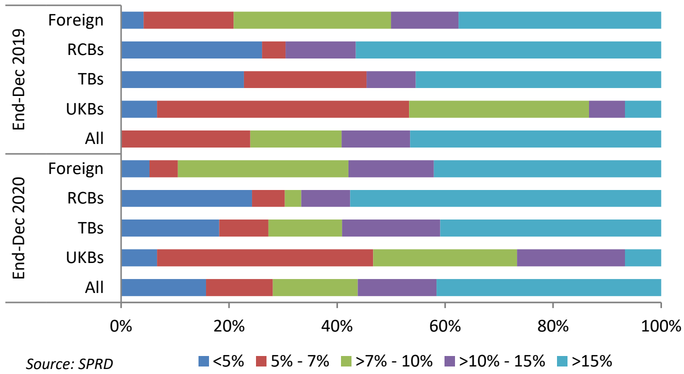


Source: SPRD

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 BIS global (8 percent) standards, and intends to do so in the next two years. Projection of capital adequacy ratio (CAR) is more prudent for the current year's BSOS with 80.5 percent of the respondents expecting CAR at more than 14 percent compared to 78.0 percent last year (Figure 10). Moreover, industry data showed that banks' CAR is 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 standard constrains the potential build-up of excessive leverage in the banks and promote financial stability. Smaller banks, particularly 40.9 percent of TBs and 57.6 percent of RCBs 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.

Figure 11. Projected Leverage Ratio
As of End-Periods Indicated



Source: SPRD

Liquidity has been a key strength of the PBS. This is expected to be maintained up to 2022 as banks continue to project healthy liquidity metrics under the Basel III liquidity coverage ratio (LCR)[4] and net stable funding ratio (NSFR)[5] for UKBs and their subsidiary banks and quasi-banks (QBs), and the minimum liquidity ratio (MLR)[6] for stand-alone TBs, RCBs 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.

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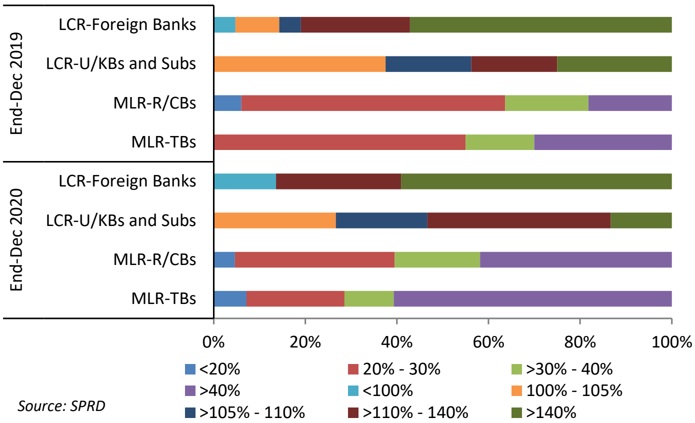
[4] Circular No. 905 dated 10 March 2016, as amended, requires the UKBs to hold sufficient High Quality Liquid Assets (HQLAs) that can be easily converted into cash to service liquidity requirements over a 30-day stress period. This provides banks with a minimum liquidity buffer to be able to take corrective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

[5] 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.

[6] Circular No. 996 dated 8 February 2018 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.

In the current survey, the respondents disclosed that 73.3 percent of domestic UKBs and their subsidiary banks intend to maintain LCR at more than 105 percent, higher than the 62.5 percent recorded during the second semester 2019 BSOS. About 59.1 percent of foreign bank respondents projected the LCR at more than 140 percent. Meanwhile, 21.4 percent of TBs and 34.9 percent of RCBs projected their respective MLRs between 20 percent and 30 percent (Figure 12).

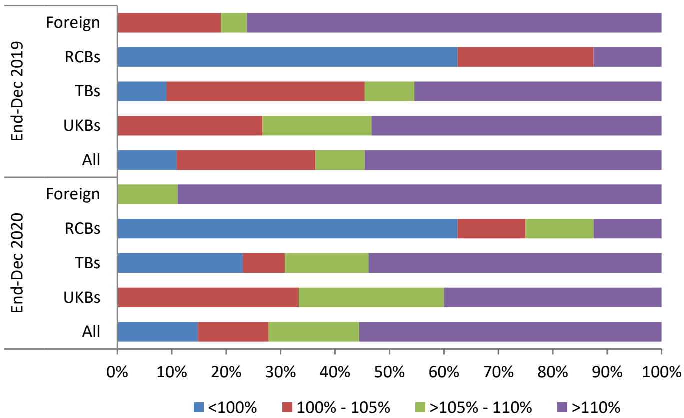
Figure 12. Projected LCR/MLR
As of End-Periods Indicated



Source: SPRD

Implemented on 1 January 2019 for UKBs, the NSFR is projected to be maintained at more than 110 percent for the next two years by 55.6 percent of respondents. The strong commitment to longer term stable funding is more evident for UKBs and foreign banks, with 40.0 percent and 88.9 percent of respective respondents projecting NSFR at more than 110 percent (Figure 13). This is evident in the banks' heightened issuance of bonds to ensure longer term funding for their business.

Figure 13. Projected NSFR
As of End-Period Indicated



Source: SPRD

In terms of products or services, majority of the heads of banks mentioned that corporate and retail banking will be their top most priorities, followed by payments and settlement services, cross-selling, and trade financing. 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 will remain as the priority products under retail banking.

By type of bank, the respondents revealed that majority of domestic UKBs will focus on corporate banking, retail banking, payments and settlement services, and cross-selling while foreign UKBs will mainly concentrate on corporate banking, trade financing, and treasury operations. Meanwhile, retail loans remained as the main priority of TBs and RCBs, which indicates that these banks were committed to their niche market.

The top three focus of lending by economic sector of domestic UKBs are consumer loans, wholesale and retail trade, and manufacturing and for the next two years (Table 1). Moreover, foreign UKBs preferred to lend primarily to the information and communication sector as revealed in the results of the recent survey. Subsidiary and stand-alone TBs underscored that consumer loans will have the largest share in their lending portfolio in the next two years. Meanwhile, agriculture remains the top market of the RCBs' loan portfolio, followed by wholesale and retail trade, and consumer loans. Based on latest available data, banks' lending activities were mainly channeled to real estate activities, household consumption (consumer finance), wholesale and retail trade, manufacturing sector, and electricity, gas, steam and airconditioning supply.

Table 1. Focus of Bank Lending by Economic Sector

Rank	Second Semester 2020					Second Semester 2019				
	Domestic UKBs	Foreign UKBs	Subsidiary TBs	Stand-alone TBs	RCBs	Domestic UKBs	Foreign UKBs	Subsidiary TBs	Stand-alone TBs	RCBs
1	Consumer Loans	Information and Communication	Consumer Loans	Consumer Loans	Agriculture	Wholesale and Retail Trade	Manufacturing	Consumer Loans	Wholesale and Retail Trade	Agriculture
2	Wholesale and Retail Trade	Financial and Insurance Activities	Wholesale and Retail Trade	Real Estate Activities	Wholesale and Retail Trade	Consumer Loans	Financial and Insurance Activities	Wholesale and Retail Trade	Consumer Loans	Wholesale and Retail Trade
3	Manufacturing	Manufacturing	Transportation	Wholesale and Retail Trade	Consumer Loans	Manufacturing	Electricity, Gas, Steam, and Airconditioning Supply	Real Estate Activities	Real Estate Activities	Consumer Loans

Source: SPRD

Business Strategy

Overall, the respondents revealed that the top two strategic priorities of the bank executives surveyed are: (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 especially during the lockdown period due to COVID-19, banks have recognized the need to integrate technology in achieving business objectives. 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.

The top two strategic priorities by banking group are shown in Table 2. For the Second Semester BSOS, the topmost strategic priority of UKBs and TBs is to grow the business while RCBs viewed that they need to protect the bank by managing reputational and operational risks, revisiting their Business Continuity Management (BCM), enhancing data/cybersecurity, among others.

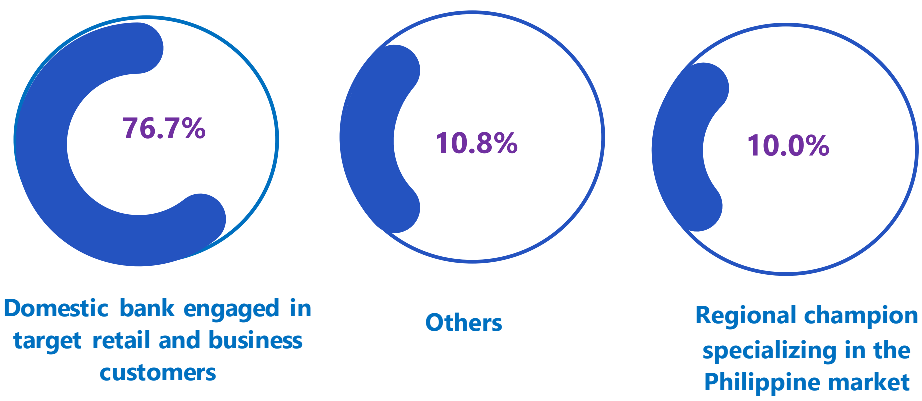
Table 2. Top Two Strategic Priorities per Type of Bank

Type of Bank/ Period	UKBs	TBs	RCBs
Second Semester 2020	Grow the business	Grow the business	Protect the bank
	Optimize technology	Optimize technology	Optimize technology
Second Semester 2019	Grow the business	Grow the business	Grow the business
	Optimize technology	Optimize technology	Optimize technology

Source: SPRD

Meanwhile, 76.7 percent of the total respondent banks disclosed their preferred strategic direction as domestic banks engaged in target retail and business customers, underscoring the overall inward-looking nature of the PBS (Figure 14). This finding is consistent with the results of the second semester 2019 BSOS in which more than 60 percent of respondents revealed similar strategic direction.

Figure 14. Top 3 Strategic Business Direction



Source: SPRD

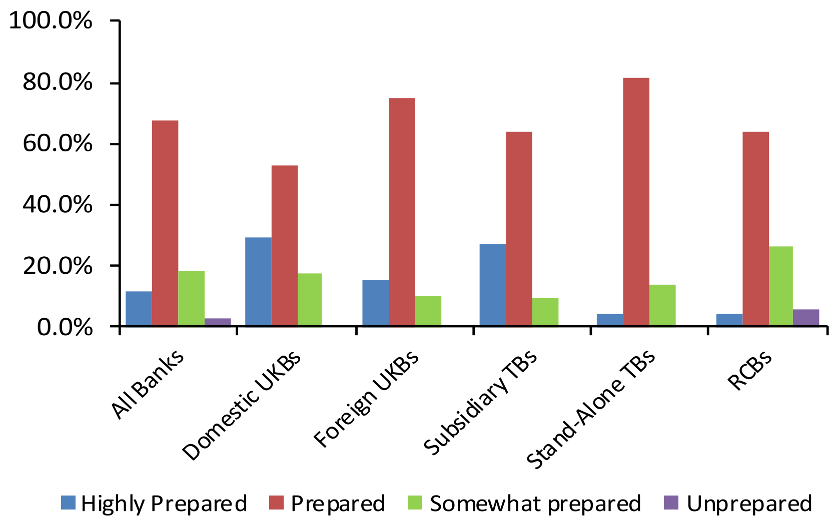
Among foreign bank respondents, 45.0 percent aimed to be global banks providing specialized products and services to global clients. This was higher compared to last year's 42.9 percent. Meanwhile, 20.0 percent of foreign UKBs intended to be regional champions specializing in the Philippine market.

Operational Performance

Amid global and domestic economic growth slowdown brought about by the COVID-19 pandemic, **the Philippine banking system (PBS) remains on relatively stable footing as shown by growth in assets, loans, and deposits, profitable operations, as well as stable capital and liquidity buffers.** However, the restrictive lockdowns, social distancing, and other health safety protocols pushed the banks to adjust their operations while maintaining proactive control measures for the continued delivery of financial services. In the survey, banks were asked their preparedness in handling the COVID-19 pressures and how they will maintain growth in an era of intense competition, heightened customer expectation, and non-traditional market entrants.

The result of the BSOS revealed that 67.5 percent and 18.3 percent of respondent banks are prepared and somewhat prepared, respectively, in managing the effects of COVID-19 pandemic (Figure 15). Meanwhile, the top three plans of banks for the five semesters of the conduct of BSOS remain the same. **Banks have deemed it important to develop new capabilities, expand market reach and leverage on client relationship to maintain growth** in the new economy arrangement as shown in Figure 16.

Figure 15. Preparedness in Managing Covid-19



Source: SPRD

Figure 16. Top 3 Plans to Maintain Growth in the Presence of Intense Competition and Other Factors

Source: SPRD

About **91.7 percent of the respondents believed that efficient operation is important to maintain profitability amid regulatory, market, and COVID-19 pandemic pressures.** The respondents also underscored that pursuing organic growth, leveraging on technology to reduce costs, and hiring or retaining key talents are likewise of utmost importance to sustain banks' profitability amid pressures.

Fintech/Cybersecurity Plans

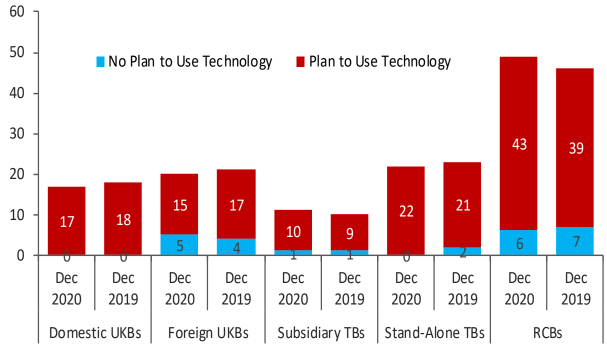
The COVID-19 pandemic highlighted the significant role of technology in banking operations. The enhanced community quarantine (ECQ) in the country has expedited the digital transformation of the banking system with the significant increase in the use of digital payments and electronic money platforms. The survey results noted **that technology and operating models[7] are important in performance, business continuity, internal controls and compliance.** Likewise, technology and operating

[7] This refers to 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).

models are also deemed useful in enhancing customer experience and expanding client base.

Meanwhile, the results of the comprehensive Baseline Survey[8] revealed that digital platforms allowed customers to perform financial transactions during the ECQ. Moreover, as mentioned in previous section, banks lagging behind in terms of digital transformation realized the need to fast track their digitization initiatives in order to continue serving their customer base. This is consistent with the results of the BSOS in which the banking industry supports the use of technology-enabled solutions and exhibits strong interest in participating in the digital finance ecosystem in the next two years as shown in Figure 17. In particular, the responses for the second semester of 2020 indicated that 89.2 percent of respondent banks have plans to use technology in the banking transactions, higher than the 87.4 percent of banks which reported during the same period in 2019.

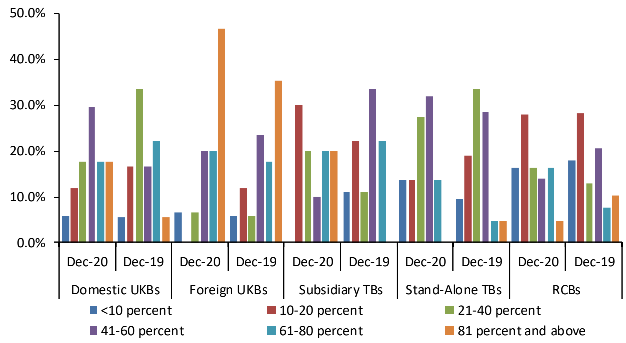
Figure 17. Banks' plan on the use of techonology in the next 2 years
As of End-Periods Indicated



Source: SPRD

For the second semester of 2020, 29.4 percent of respondents from domestic UKBs that have plans to use technology revealed that 41 percent to 60 percent of their banking transactions will be conducted through the use of digital technology in the next two years (Figure 18). Likewise, 46.7 percent of foreign UKBs stated that more than 80 percent of their banking transactions will utilize digital means. Meanwhile, 59.1 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. About 27.9 percent of respondents from RCBs revealed that 10 percent to 20 percent of their banking transactions will utilize the internet, mobile phones or other electronic means.

Figure 18. Percentage of bank transactions that will use technology
As of End-Periods Indicated



Source: SPRD

8 This survey was conducted by the Financial Supervision Sector of the BSP in April 2020 among the top 20 universal/commercial banks (UKBs) and their subsidiaries, thrift banks (TBs) and rural and cooperative banks (RCBs) aimed to assess the impact of the Covid-19 pandemic on the financial and operational performance.

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, deposit services emerged as the most important application of technology**. The top five most important technology application areas by banking group is shown in Table 3.

Table 3. Top 5 Most Important Technology Application Areas

Rank	Second Semester 2020				
	Domestic UKBs	Foreign UKBs	Subsidiary TBs	Stand-alone TBs	RCBs
1	Customer Service	Payment system	Deposit Services	Deposit Services	Deposit Services
2	Deposit Services	Customer service/Loan scoring	Payment system	Collection	Collection
3	Payment system	Marketing/Know your customer (KYC)	Loan Scoring	Loan Scoring	Marketing/Loan Scoring
4	Marketing/Loan Scoring	Deposit Services	Collection/Know your customer (KYC)	Customer Service	Payment system
5	Know your customer (KYC)	Customer Service	Marketing/ Customer Service	Payment system	Know your customer (KYC)

Source: SPRD

As expected, payment system turned out as the most important application of technology for foreign UKBs from data security and privacy in the second semester 2019 BSOS. For two consecutive years, deposit services continued to be the topmost important technology application for both subsidiary and stand-alone TBs. This indicates TBs' resolve to compete with the bigger banks for deposit markets through the use of technological innovations.

The disruption caused by the lockdown and remote working arrangements led to cyberthreats and attacks. Based on the Reports on Crimes and Losses filed by banks during the ECQ covering the period 15 March to 18 May 2020, 98.4 percent of all criminal incidents reported were classified as cyber.[9] Relative to this, the result of the BSOS showed that **58.3 percent of banks are 'prepared' to handle and manage cyberthreats**, slightly lower from 59.7 percent of banks in the end-December 2019 BSOS. Meanwhile, 13.3 percent and 24.2 percent of the respondents expressed that they are 'very prepared' and 'somewhat prepared' in managing cybersecurity risks, respectively.

[9] Report on the Philippine Financial System, First Semester 2020. *Box article 2: Digital Payments and Cybercrimes During the Lockdown* prepared by Atty. Marie Tanya Z. Recalde, Bank Officer V, Department of Supervisory Policy and Research.

The top five cybersecurity threats that are of concern to banks are listed in Table 4. In general, **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, direct hacking/apts and phishing are the other types of cybersecurity threats common to UKBs, TBs and RCBs.

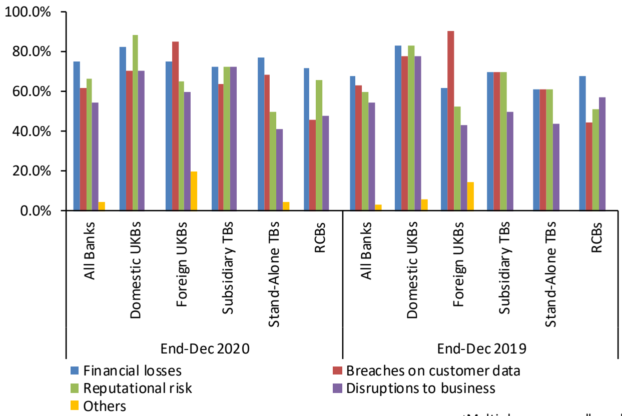
Table 4. Top 5 Cybersecurity Threats

Rank	Second Semester 2020				
	Domestic UKBs	Foreign UKBs	Subsidiary TBs	Stand-alone TBs	RCBs
1	Cyberattacks	Cyberattacks	Phishing	Cyberattacks	Cyberattacks
2	Direct Hacking/APTs	Phishing	Insider Attacks	Fraud	Fraud
3	Malware	Malware	Direct Hacking/APTs/Card Skimming Attacks	Phishing	Insider Attacks
4	Fraud	Direct Hacking/APTs	Cyberattacks	Insider Attacks	Direct Hacking/APTs
5	Phishing	Insider Attacks	Fraud	Direct Hacking/APTs	Phishing

Source: SPRD

Overall, **75.0 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, reputational risk and breaches on customer data are viewed by 88.2 percent of domestic UKBs and 85.0 percent of foreign UKBs as the most worrisome impact of cybercrimes, respectively (Figure 19).

Figure 19. Impact of cybercrime events*
As of End-Periods Indicated



Source: SPRD

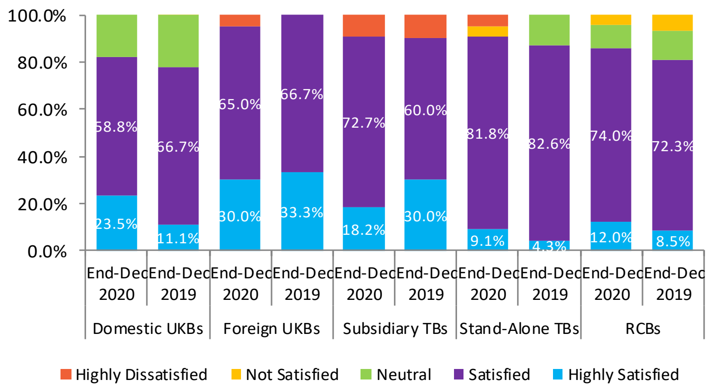
*Multiple response allowed

Organizational Conduct and Risk Culture

The banking environment has been constantly driven by changes in technology, competition, and the evolving regulations and international standards. Following the outbreak of the COVID-19 pandemic, **banks recognize the need 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 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. **On the whole, 71.7 percent of respondents revealed that they are satisfied with the risk culture in their respective banks while 2.5 percent of respondents disclosed that they are not satisfied**. Meanwhile, one subsidiary TB and one stand-alone TB are highly dissatisfied with the level and maturity of the bank's risk culture (Figure 20).

Figure 20. Banks' Risk Culture Satisfaction
As of End-Periods Indicated



Source: SPRD

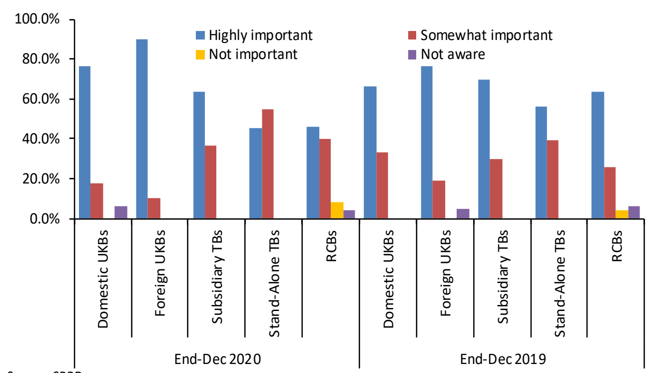
The respondents identified the top 3 strengths of banks' risk governance framework. These are: (a) the board of director and senior management oversight; (b) strong risk culture and values within the bank; and (c) appropriate risk appetite for the bank's business, resources and capital. **The need for a highly effective models/system for risk management and comprehensive risk management policies** are the two areas that need to be improved in the next two years as indicated by 42.0 percent and 38.0 percent of the respondents, respectively.

The survey results also showed that inputs from audit, risk and compliance functions are always considered in the board/senior management business decisions and strategies. Meanwhile, 100 percent of the respondents mentioned that their employees are bound by a code of ethics/conduct in which majority was formulated by the bank. The survey results also bared that personnel recruitment and termination topped the list among the different aspects of business covered by their respective Codes of Ethics. This is followed by customer dealings and whistleblowing and grievance escalation policies.

Sustainable Finance

With the global move towards sustainable development and the growing demand for sustainable investments, the rise in interest from global investors and fund managers to direct funds toward sustainable projects and activities has been noted. Following the issuance by the BSP in April 2020 of Circular No. 1085 on the Sustainable Finance Framework, the increase in demand has been complemented by the development of various financing mechanism for sustainable projects. Circular No. 1085 provides high-level expectations on the integration of sustainability principles in the corporate governance, risk management systems, business objectives and operations of banks. **The survey results showed that 59.2 percent and 34.2 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 21.

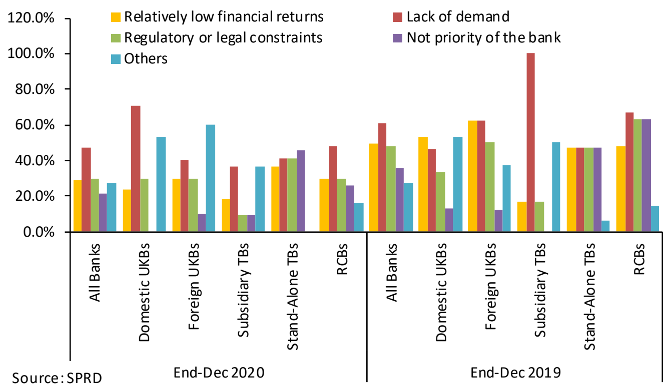
Figure 21. Organization's view on sustainable financing
As of End-Periods Indicated



Source: SPRD

BSOS results also revealed that 73.3 percent of respondents are planning to finance sustainable projects while only 24.2 percent of banks have no plans to finance these type of projects. Meanwhile, banks expressed willingness to finance sustainable projects covering agriculture, transportation, water supply management, and solar power. Majority of the banks indicated the lack of demand and the presence of regulatory and legal constraints as the top two barriers from pursuing sustainable financing (Figure 22). 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.

Figure 22. Barriers in pursuing sustainable financing
As of End-Periods Indicated



Source: SPRD

Impact of Supervision on Bank Performance

In order to evaluate the impact of the BSP regulations, banks were also asked to rank five areas which they find challenging in terms of regulatory compliance. Except for RCBs, **compliance with mandatory credits to Agri-Agra remains as the most challenging** since the complex business models of bigger banks may not be suited to lend to the agri-agra sector.[10] As of end-March 2020, the PBS's 11.02 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 0.97 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. 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.

Further, domestic UKBs, and subsidiary TBs consider compliance with anti-money laundering in the second rank among the most challenging areas in terms of compliance, while foreign UKBs found compliance with reportorial requirements as the second most burdensome. Notably, banks with simple business models found it challenging to comply with the basic areas of credit risk and operational risk management.

[10] 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.

Table 5. Most Challenging Areas in Terms of Compliance

Rank	Domestic UKBs	Foreign UKBs	Subsidiary TBs	Stand-alone TBs	RCBs
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	Reportorial requirements	Anti-money laundering	Credit risk management	IT risk management
3	IT risk management	Anti-money laundering	Operational risk management	Operational risk management	Mandatory credits to agri-agra
4	Operational risk management	Single Borrowers' Limit	Credit risk management	IT risk management	Operational risk management
5	Basel III capital requirements	Foreign exchange regulations	Other areas of risk management	Anti-money laundering/ Philippine Financial Reporting Standards 9	Other areas of risk management

Source: SPRD

Increase in Ranking from BSOS Second Semester 2019

Decrease in Ranking from BSOS Second Semester 2019

Risk Assessment

Overall, institutional risk continued to be the top-most risk to the banks' operations (Table 6). Technology risk also remained 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 TBs and RCBs.

Table 6. Top Five Risks to Banks' Operation

Rank	Second Semester 2020			Second Semester 2019		
	UKBs	TBs	RCBs	UKBs	TBs	RCBs
1	Institutional Risk	Institutional Risk	Institutional Risk	Institutional Risk	Institutional Risk	Institutional Risk
2	Macroeconomic Risk	Technology Risk/Financial Market	Financial Market Risk	Technology Risk	Financial Market Risk	Financial Market Risk
3	Global Risk and/or Domestic Geopolitical Risks	Possible Downturn in the Real Estate Market	Over-regulation	Global Risks	Macroeconomic Risk/Global and/or Domestic Geopolitical Risks	Technology Risk
4	Possible Downturn in the Real Estate Market	Macroeconomic Risk	Technology Risk	Macroeconomic Risk	Possible Downturn in the Real Estate Market	Macroeconomic Risk
5	Technology Risk	Global and/or Domestic Geopolitical Risks/Climate Change	General Risk	Global and/or Domestic Geopolitical Risks	General Risk	General Risk

Source: SPRD

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

Conclusion

The evolving effects of COVID-19 pandemic on economies led to sluggish global growth, slowdown in domestic economic activities and subdued optimism of banks on the country's economic prospects for 2021 to 2022 based on the results of second semester 2020 BSOS. At this point in time, the uncertainties in the operating environment pose the biggest hurdle in the banking system's amount of loans, loan quality, and profitability. A fast rebound in the GDP growth in the next two years will be crucially important.

Nevertheless, **prudence remains** as banks intend to keep a reasonable risk-based capital and liquidity; to enhance their risk management systems to safeguard financial system stability; and to strengthen organizational conduct and risk culture in order to thrive amid the volatility and complexity of the operating environment. This implies that banks will calibrate its strategies to maintain a loss-absorbing capital buffer while at the same time ensure confidence of the public in providing enough liquidity and funding in 2021 to 2022.

Moreover, the banks plan 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.

Microprudential policy implications

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 in 2020, 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.

The BSP also issued timely, time-bound and crucial monetary and regulatory relief measures to assist the BSP supervised financial institutions (BSFIs) endure the COVID-19 crisis as well as to continue their support to households and business enterprises. These measures provide incentives for the BSFIs to extend financial relief to their borrowers, make credit available to consumers and particularly micro, small and medium enterprises (MSMEs), promote continued access to credit/financial services, support continued delivery of financial services to enable consumers to complete financial transactions during the enhanced community quarantine (ECQ) period, and support the level of domestic liquidity.

The BSP approved the adoption of the Supervisory Assessment Framework (SAFr). This framework aims to further strengthen the assessment of 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.**

Strengthening risk governance

Governance and risk management standards have been 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 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.[11] 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.[12] Meanwhile, the BSP extended the transition period for the implementation of the requirements on the management of IRRBB until 31 December 2021 to give banks ample time to comply in light of the impact of COVID-19. [13]

[11] Circular No. 1042 dated 25 July 2019.
[12] Circular No. 1044 dated 06 August 2019.
[13] Circular No. 1101 dated 19 October 2020.

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.[14] The BSP likewise extended the effectivity of the temporary reduction in the MLR for stand-alone TBs and RCBs for an additional year in view of the COVID-19 pandemic.[15]

The BSP issued the amendments to the framework for dealing with domestic systemically important banks (D-SIBs).[16] 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).[17] 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. Further, the BSP has released the proposed guidelines for the management of liquidity risks by IBs and IBUs for Shariah-compliant instruments. Based on the issuance, IBs and IBUs should not assume that Shariah-compliant money market instruments are identical to the characteristics of their conventional counterparts.[18]

Promoting digital innovation and financial inclusion

The 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[19] 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.[20] Initiatives were likewise implemented to allow the use of technology to streamline the conduct of

[14] Circular No. 1064 dated 03 December 2019.
[15] Memorandum No. M-2020-085 dated 01 December 2020.
[16] Circular No. 1051 dated 27 September 2019.
[17] Circular No. 1070 dated 27 December 2019.
[18] Draft Circular.
[19] Circular No. 1049 dated September 2019.
[20] Circular No. No. 1055 dated 17 October 2019.

banking activities and to mitigate and/or address technology-related risks, including anti-money laundering (AML) and other concerns with respect to fintech.

It would be noted that the COVID-19 pandemic has accelerated the use of digital payments under the "New Economy" environment. The BSP has designed a three-year Digital Payments Transformation Roadmap with a twin goal by 2023. First, driving the share of digital payments to 50 percent of total retail transactions by offering faster and more affordable payment options that provide greater convenience. Second, expanding the financially included to 70 percent of Filipino adults by onboarding them to the formal financial system through the use of payment or transaction accounts. The BSP's priority policy initiatives aim to broaden the use of digital payment platforms as well as ensure that these are supported by robust infrastructure and governed by sound data standards.

Related to the second goal of the Digital Payments Transformation Roadmap, the BSP has approved the inclusion of "digital banks" as a distinct classification of banks and the corresponding guidelines for their establishment. Digital bank is defined as a bank that offers financial products and services that are processed end-to-end through a digital platform and/or electronic channels with no physical branches.[21]

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.

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

Continuing stakeholder collaboration

Moreover, collaboration with BSP stakeholders through conduct of regular dialogues will be strengthened. This includes the regular conduct of Bank Supervision Policy

[21] Circular No. 1105 dated 02 December 2020.

Committee (BSPC)[22] meetings with financial industry associations, cooperation with co-regulators under the Financial Sector Forum (FSF)[23] and Financial Stability Coordination Council (FSCC)[24], participation in forums organized by industry organizations, bilateral discussions and written queries with banks.

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

As of the writing of this Report, the impact of COVID-19 outbreak on the domestic economy is evolving. While, it is widely expected to pose a serious challenge to both the health of the population and the domestic economy, the initial results point to some green shoots. Firms and corporations should be monitored vigorously to determine emerging pressures. Stress-testing exercise and scenario simulations should be conducted. For instance, to determine the overall quality of bank capital, stress testing exercises are conducted on bank loan exposures to Top 30 borrowers using end-December 2019 and preliminary end-March 2020 data. The results show that both the PBS and banking groups have adequate capital to withstand an assumed 20 percent write-off in their exposures to NFCs and Top 30 borrowers.

[22] 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.

[23] 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.

[24] 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.

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.

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; and a short-term provisional advances to the national government in the amount of P540 billion.

With the passage of R.A. No. 11439, the BSP is clothed with clear authority to issue broader set of rules and regulations on Islamic banking. The supervisory and regulatory powers of BSP over Islamic banks are also reiterated in the law. Further, establishment of Islamic banking units (IBUs) by conventional banks is expressly allowed. The BSP has a Task Force on Islamic Banking which serves as its arm in drafting rules and regulations on Islamic banking and coordinating efforts on Islamic Banking matters. The BSP may need to establish a dedicated unit for Islamic banking if and when more Islamic banking players operate in the Philippines.

The BSP is committed to promote sustainable growth by fostering environmentally responsible and sustainable policies and work practices. Likewise, "leading by example" is one of the best ways to usher the transition and shape the behavior of supervised institutions towards the adoption of sustainability principles in their corporate governance, risk management systems, strategic objectives and operations. These are embedded in the recently-issued Sustainable Finance Framework.

Several green initiatives have been launched prior to the formalization of the Sustainable Central Banking Program. These include, among others, the participation in the Green Bond Fund launched by the Bank for International Settlements (BIS) as part of sustainable investing in reserve management. The BSP also implemented the Monetary Board (MB)

Paperlite Facility that resulted in the significant reduction of paper usage during MB meetings, and installed energy-efficient mechanisms such as solar panels and inverter technology in air-conditioning systems.

The BSP is now a member of the Network for Greening the Financial System (NGFS), a group of central banks and supervisors organized to enhance the role of the financial sector in managing climate and other environment-related risks and mobilize capital to support the transition towards a sustainable economy.

The NGFS membership will strengthen BSP's collaboration with counterpart regulators in building awareness and contributing to the effective management and mitigation of the impact of climate and other environment-related risks in the financial sector. Moreover, we have a lot to share with respect to the country's experience in coping with calamities and natural disasters.

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

Second Semester of 2020

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