

March 2, 2021

**Statement by Ms. Mahasandana and Mr. Bautista on Philippines
Executive Board Meeting
March 5, 2021**

Introduction

1. The Philippine authorities thank the IMF FSAP team for the insightful dialogue and meaningful exchange of views during the mission. Our authorities recognize the prompt adjustments made by the mission team to consider the impact of the COVID-19 pandemic in the assessments and to complete the mission using fully virtual platform.
2. Our authorities appreciate and broadly agree with the staff's assessments and policy recommendations. While our authorities may hold different views on certain issues covered, the analyses, observations, and recommendations in the report provide them with useful inputs in their shared interest in making the Philippine financial system more resilient to future disruptions.

Risk Assessment and Stress Testing

3. The COVID-19 pandemic continues to pose shocks to the global economy and the Philippines is not insulated from the adverse effects.
4. The long track record of structural reforms in the financial system has resulted in the build-up of ample capital and liquidity buffers. The Philippine Banking System (PBS) continues to post comfortable margin over the prescribed minimum capital ratio of 10 percent (10%) amid the pandemic. Banks have also increased their provisions for credit losses since the onset of the crisis. Based on the authorities' internal stress testing exercises, capital levels will only be affected in extremely severe scenarios. The authorities are highly confident that risks to the banking sector will be well-contained under the baseline scenario and stand ready to provide more targeted support if the worst-case scenario materializes.
5. As the spread of COVID-19 is being contained progressively— along with the availability of vaccines – normalization should ensue. One important development is the signing into law by the President a bill that will hasten the procurement of vaccines and create an

indemnity fund to cover compensation for individuals who may experience adverse side effects. This will help facilitate the normalization process and economic recovery. Amid strong headwinds, our authorities reiterate the continuing need for sustained policy support. Adequate monetary accommodation was provided to complement crucial fiscal policy measures in supporting private demand and market confidence. In the meantime, our authorities note the resilience of the financial system despite the contraction in the GDP and in other economic activities.

6. The Philippine Government has ample fiscal policy space to support priority expenditures in rebuilding the economy. It has allocated funds to address the pandemic and its economic impact, such as (i) the 2021 national budget which prioritizes health-related programs and infrastructure projects, (ii) the *Bayanihan 2* which was extended under Republic Act (RA) No. 11519 until 30 June 2021, and (iii) the 2020 national budget which was extended under RA No. 11520 until 31 December 2021. The Bangko Sentral ng Pilipinas (BSP) also extended provisional advances to the government in support of its measures to deal with the health crisis.¹ Moreover, the government has room for fiscal policy response and to borrow funds for priority projects. The country's outstanding debt-to-GDP ratio remains manageable and relatively low at 54.5 percent as of the last quarter of 2020. The bulk of the debt is denominated in local currency at about 70 percent. Overall, the country's fiscal position remains sound and favorable, providing enough fiscal policy leeway for the government to respond to crisis.
7. On the recommendation to limit dividend distribution, the BSP may limit or prohibit dividend declaration as provided in the law and the regulations governing dividends, as necessary. Dividend prohibition is handled on a case-by-case basis considering the bank's varied internal capital targets, stress testing results, risk profile, among other factors. Banks applying for relief measures may be restricted from making dividend or other forms of profit distributions. This restriction applies automatically to banks that utilize their capital conservation buffers and may be imposed on banks that have reached their internal capital targets.
8. We agree with staff's view that the results of the bank solvency test and the second-round effects should be interpreted with caution due to possible bias in the results which are sensitive to the assumptions. In addition, the conservative parameters in the FSAP assumption increase the negative impact while credit risk during a deep economic crisis may evolve differently from what historical patterns imply. Meanwhile, our authorities understand that the IMF's solvency stress test did not consider the effects of regulatory response and statutory loan moratoria. The BSP strongly considers the **time-bound** relief measures implemented as crucial in supporting banks to weather the crisis and in promoting the overall stability of the financial system. The BSP is currently assessing the appropriate timing to reduce or scale back the COVID-19 relief measures to ensure smooth transition post-pandemic. The BSP underscores that while there are regulatory reliefs implemented such as staggered booking of allowance for credit losses and delayed classification of past due or non-performing loans, the banking industry statistics

¹ This is temporary and subject to the limits provided for under the law.

published on the BSP website reflect the actual level of soured loans and do not consider said relief measures.

9. More extensive measures are also underway to moderate the spillover effects of the pandemic on the real economy. The recent enactment of Republic Act No. 11523 or the Financial Institutions Strategic Transfer (FIST)² Act will facilitate the mobilization of savings and investments in the financial system to support the country's economic recovery and sustained growth. It will also ease banking system stress through the removal of soured loans and other non-performing assets (NPAs) by banks. This could serve to free up capital to augment the banking system's liquidity and capacity to expand investment and lending activities. Moreover, the proposed Government Financial Institutions Unified Initiatives to Distressed Enterprises for Economic Recovery (GUIDE)³ bill aims to reinforce the capacity of government financial institutions to give financial assistance necessary for the continued operations of micro, small, and medium enterprises (MSMEs) and other strategically important industries. Finally, the Corporate Recovery and Tax Incentives for Enterprises (CREATE)⁴ bill aims to reduce corporate income tax and rationalize fiscal incentives.
10. On climate change stress testing, our authorities agree on improving data collection to enhance analysis of climate risks, particularly physical risks and its impact on individual financial institutions and the overall financial system. Our authorities are conducting several awareness campaigns and capacity building activities in the areas of climate change and sustainable finance, which cover environmental and social risk management, among others, to equip regulators and supervisors as well as supervised entities.
11. To further improve climate stress testing, estimation of shocks and policy advice, staff may want to take into consideration the various features of the laws that has been enacted. For example, the Climate Change Act of 2009 created the Climate Change Commission to oversee the programs and action plans relating to climate change. The National Climate Change Action Plan 2011-2028 prioritizes food security, water sufficiency, ecological and environmental stability, human security, climate-smart industries and services, sustainable energy and knowledge and capacity development as the strategic themes and direction.
12. In addition, the Philippine Disaster Risk Reduction and Management Act formed the various levels of disaster risk reduction and management (DRRM) councils. This facilitates the coordination of responses to natural calamities at all levels – national, regional, provincial, and local governments units. The Philippine Disaster Risk Reduction and Management Act also established the local DRRM fund, setting aside 5% of estimated revenues for prevention, mitigation, and responses. Moreover, the national government issued catastrophe bonds to sustain the growth momentum while climate-proofing the country by providing protection against earthquake and tropical cyclone risks through the issuance of insurance-linked securities. This demonstrates the ability of the government to tap various financing mechanisms to deal with natural disasters and to ensure that ample

² FIST Act was signed into law by President Rodrigo Duterte on 16 February 2021.

³ GUIDE bill was approved on the third and final reading at the House of Representatives on 9 February 2021.

⁴ CREATE bill was ratified at both Houses of Congress on 4 February 2021 and for signature by the President.

fiscal space remains in place. That said, the authorities remain fully committed to fiscal discipline and consolidation over the medium-term, consistent with its monetary and financial sector stability objectives.

Macprudential Policy Framework and Oversight

13. The establishment of the Financial Stability Coordination Council (FSCC)⁵ in 2011, the conferment of the BSP's financial stability mandate in 2019, the creation of an *en-banc* Board-level Financial Stability Policy Committee at the BSP in 2020, and the release of the country's Macprudential Policy Strategy Framework also in 2020 are the milestone developments in macroprudential policy. Consistent with the amended BSP Charter, our authorities maintain that the financial stability policy objective requires a whole-of-market perspective, and thus a collaborative and holistic effort among the authorities. To further strengthen the FSCC and to institutionalize its legal standing, an Executive Order has been submitted for signature by the President.
14. With its legal mandate on financial stability, the BSP is fully cognizant of the need to continuously sharpen its macroprudential policy toolkit as well as its operating procedures. This reflects the authorities' recognition of the unique challenges posed by an environment of changing risks and evolving uncertainties for macroprudential policy and is also in line with the FSAP recommendation. There are ongoing initiatives to execute the provision in the amended BSP Charter that gives the BSP authority to gather data for policy and statistical purposes to enhance its quality and breadth.
15. Meanwhile, the BSP assures that it upholds strong collaboration and coordination within the organization so as to foster a balanced decision-making process to carry out its price stability and financial stability mandate effectively and to ensure effective supervision of financial institutions and management of systemic risks. There are board-level committees and mechanisms in place to ensure that interrelated issues and concerns are considered in the decision-making process. Financial stability and financial supervision implications are considered and discussed during the meetings of the Advisory Committee to the Monetary Board. Meanwhile, financial supervision related matters with financial stability implications are discussed during preparatory board meetings attended by Monetary Board members and heads of relevant units in the BSP. Discussions from these committees form the bases for appropriate policy decisions and implementation, that provide a balance between macroeconomic and financial stability objectives.

Banking Sector Supervision and the Regulation and Supervision of Financial Conglomerates

16. Our authorities welcome the recommendation and assessment on the observance of the Basel Core Principles (BCPs) for effective banking supervision, as well as the regulation and supervision of financial conglomerates. This will provide valuable inputs in crafting

⁵ An interagency body comprised of the Securities and Exchange Commission (SEC), Insurance Commission (IC), Philippine Deposit Insurance Corporation (PDIC), and Department of Finance (DOF).

the financial sector strategy roadmap and in further strengthening the conduct of effective banking supervision in the Philippines.

17. In particular, the financial sector regulators affirm the views of the FSAP mission team on the critical benefits of lifting the bank deposit secrecy laws. The legislative amendments will empower the BSP and other financial sector regulators in executing their supervisory mandates towards the promotion of the safety and soundness of the financial system and protection of the depositing public.
18. With respect to conglomerate supervision, the Financial Sector Forum (FSF)⁶ had contemplated the idea of designating a lead coordinating regulator for particular groups of conglomerates. However, since conglomerates have mixed interest in both financial and non-financial sectors, this raises a fundamental issue that challenged the effective implementation of said approach. It is in this light that the FSF member-agencies decided to adopt common standards across the financial sector. Cross cutting issues are being discussed in the Forum while specific enforcement actions in relation to said issues are being referred to relevant supervisors for appropriate action. Moreover, the FSF has drafted, following the IMF Technical Assistance on Conglomerate Supervision, the Memorandum of Agreement on the establishment of a supervisory college as a regulatory platform for the effective supervision of financial conglomerates, particularly in conducting a group-wide risk assessment and discussing cross-cutting issues.
19. On the recommendation to establish regulatory powers on the transfer of significant ownership or controlling interest, our authorities wish to emphasize that the amended BSP Charter has authorized the BSP to disapprove transfer of shares to parties who are deemed unfit and improper to hold or own shares of banks. The BSP is well able to assess the fitness and propriety of the ultimate beneficial owners even though existing BSP regulations do not explicitly include the term ‘ultimate beneficial ownership’ in the ‘control’ or ‘significant controlling interest’ definitions. There have been instances where the BSP rejected applications for transfer of bank shares to parties who were unable to meet the fitness and propriety criteria.
20. It is also worth mentioning that the BSP recently amended its regulations to require ultimate beneficial owners to provide documents for the BSP to better assess the ownership and control structure for the establishment of new banks or in cases of transfer of bank shares.
21. The SEC has also issued the Beneficial Ownership Transparency Guidelines⁷ in January 2021 which will enhance the accuracy and availability of beneficial ownership information of companies. The guidelines include prohibition of bearer shares and requires mandatory disclosure of the identity of beneficial owners.

⁶ An interagency body comprised of the BSP, SEC, IC and PDIC.

⁷ SEC Memorandum Circular No. 1 Series of 2021 on the Guidelines in Preventing the Misuse of Corporations for Illicit Activities through Measures Designed to Promote Transparency of Beneficial Ownership <https://www.sec.gov.ph/mc-2021/mc-no-01-s-2021/>

22. Building on the ongoing policy initiatives and the FSAP recommendations, the BSP will continue to pursue risk-based, relevant, and responsive regulatory reforms to further improve the effectiveness of banking supervision. The BSP, along with relevant financial sector authorities, is working closely with both Houses of Congress for the approval to amend the Bank Deposit Secrecy Laws, expand the BSP's authority on conglomerate supervision and pass other critical legislative reforms necessary to reinforce the strengthened nexus of banking supervision and financial system resilience.

Anti-Money Laundering and Countering the Financing of Terrorism (AML/CFT) and Bank Secrecy

23. In November 2018, the Philippines formally adopted a “one-nation approach” in combating money laundering and terrorism financing through Executive Order No. 68, adopting the National AML/CFT Strategy (NACS). The NACS is a strategic and collective response in the form of action plan to address the risks, gaps, and problem areas identified in the National Risk Assessment (NRA) on Money Laundering and Terrorism Financing (ML/TF) exercise. Under the NACS, relevant government agencies are required to implement action plans that would contribute to the effectiveness of the AML/CFT system. One of the key action plans under the NACS is the enhancement of financial intelligence sharing. In particular, the Anti-Money Laundering Council (AMLC) can share bank account information, among others, to support supervisory actions, including for prudential supervision, when requested by the relevant agencies.
24. Our authorities wish to emphasize that the bank deposit secrecy laws do not impede the implementation of the AML/CFT framework. Section 24 of the Anti-Money Laundering Act, as amended, has expressly repealed the existing bank deposit secrecy laws (i.e., Republic Act Nos. 1405 and 6426) by providing the AMLC with unimpeded access to bank account information. The Asia Pacific Group on Money Laundering (APG) rated the Philippines “Largely Compliant” and “Compliant” on Recommendations 9 and 29. This recognized that the bank secrecy law does not inhibit the implementation of the FATF Recommendations and does not impede the AMLC's ability to obtain information from banks as needed to perform its analyses properly.
25. In addition, there are defined circumstances that allow the BSP to examine bank accounts in compliance with the AML Act and in cases of unsafe and unsound banking. Our authorities strongly view that analysis of available information, market surveillance, and intelligence gathered from collaborative engagements with other agencies enable them to effectively assess and monitor any institutional and sectoral money laundering and terrorist financing risks.
26. Moreover, the recent passage of Republic Act No. (RA) 11521 or An Act Further Strengthening the Anti-Money Laundering Law has already addressed the recommendations to (i) designate tax crimes as predicate money laundering offenses; and (ii) establish a comprehensive legal framework for targeted financial sanctions against proliferation financing. The related implementing rules and regulations, particularly on the

implementation of the targeted financial sanctions, was also published on 31 January 2021.

Financial Safety Net, Bank Resolution and Crisis Management

27. The resolution authorities, the BSP and the PDIC, appreciate the staff's recognition of the significant progress on crisis management, resolution, and safety nets since the 2010 FSAP. This includes amendments to the legal framework on resolution enshrined under the PDIC and BSP Charters, strengthened collaboration with the establishment of the FSCC, introduction of the recovery plan for Domestic Systemically Important Banks (D-SIBs), enhanced legal protection of BSP and PDIC personnel, streamlining of the BSP's early intervention measures and prompt corrective action framework, and establishment of the banks for resolution (BRes) framework. Moreover, the BSP revised its guidelines in October 2020 to tighten the implementation of Section 30(c) of Republic Act No. 7653, as amended, allowing the BSP to resolve banks concerned more promptly.
28. The resolution authorities welcome the observations and recommendations as these are essential in strengthening the country's resolution regime. In particular, they acknowledge the need to conduct resolvability assessments and to formulate resolution plans for individual banks to ensure timely and orderly resolution in case of bank failure.
29. On the recommendation to designate the PDIC as a resolution authority, our authorities, however, wish to highlight that the legal framework already vests the resolution authority to both the BSP and the PDIC. The laws are also clear on where the power and responsibilities of the BSP on banks end and at what point the power of the PDIC begins with respect to resolution. The resolution power ultimately resides with the BSP with respect to operating financial institutions under its jurisdiction while the PDIC's resolution authority comes into play when the BSP cannot act due to conflict of interest or because it is beyond the BSP's mandate. Meanwhile, after a bank is closed/prohibited from doing business in the Philippines, the legal framework is clear that PDIC shall be designated as receiver and it shall proceed with the takeover and liquidation of the closed bank.
30. We believe that the present set-up where the BSP exercises both supervisory and resolution authorities, promotes efficiency and evenhanded action as the BSP has the necessary information to support the resolution of a bank. Moreover, the PDIC is onboarded early on in the resolution process through the conduct of joint BSP-PDIC examinations, regular meetings to discuss banks under PCA or BRes frameworks and information sharing arrangement. This effectively addresses the perceived conflict of interest. In addition, the BSP processes in resolving banks are covered by Quality Management System subject to internal and third-party assessments.
31. Meanwhile, although there are certain processes or coordination mechanisms not found in the law, the same can be found in the respective regulations of the authorities and bilateral arrangements. Our authorities thus believe that the current resolution structure is working well in the Philippine context.

32. The concept of a bridge bank authority has been proposed in the past, but legislation was unsuccessful. Our authorities recognize that a bail-in framework is yet to be formalized but the BSP requires loss absorption features in Additional Tier 1 and Tier 2 capital instruments issued by banks which can be tapped as a bail-in tool for the meantime. Moving forward, our authorities will continue to push for initiatives that will further improve our resolution toolkit.
33. With respect to the recommendation to ensure timely corrective action and resolution of weak banks, the BSP is already in the process of revising and streamlining its early intervention and remedial framework (i.e., Prompt Corrective Action Framework, Letter of Commitment). The BSP has also tightened the basis of prohibiting a bank from doing business under Section 30 of the amended BSP Charter to further improve timely resolution of banks. Our authorities wish to emphasize that its continuous effort in enhancing supervisory policies and implementation has resulted in a significant decline in the portfolio of problem banks since the 2010 FSAP.
34. Lastly, our authorities deem that the legal framework on Emergency Liquidity Assistance (ELA) is already sufficient as it explicitly provides the specific conditions for availing ELA and the broad range of acceptable ELA collaterals. While Section 84 of the amended BSP Charter specifies the acceptable prime collaterals, the BSP is also provided with the flexibility to accept other kinds of collaterals as may be authorized by the Monetary Board in accordance with sound risk management principles. Nonetheless, issuance of more specific guidelines on the conditions/collaterals for the grant of ELA may be considered. Meanwhile, our authorities wish to emphasize that the BSP has not provided uncollateralized loans under Section 83 of the amended BSP Charter, as it is not operational up to this time. All availments under the ELA are secured by first class collaterals as required under Section 84 of the amended BSP Charter. The BSP will consider the mission team's insights in the ongoing study covering Section 83 of the amended BSP Charter.