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March 3, 2021

**Statement by Mr. Huh and Mr. Yoo on Philippines  
(Preliminary)  
Executive Board Meeting  
March 5, 2021**

We thank staff for their FSSA report and Ms. Mahasandana and Mr. Bautista for their informative buff statement. The Philippine economy was hit hard by the COVID-19 pandemic with its real GDP contracting by 9.5 percent in 2020. However, strong macro-financial fundamentals and structural reforms undertaken prior to the pandemic in addition to the authorities' forceful pandemic responses have allowed the financial system to weather the COVID shock. We take positive note of the fact that the exchange rate appreciated, sovereign spreads came down closer to pre-pandemic levels, and internal reserves rather increased during 2020, a year like no other. We are pleased to see that most of the 2010 FSAP recommendations have gained traction from the authorities. **We broadly concur with the thrust of the staff's assessment and policy recommendations and offer the following comments for emphasis.**

**On bank solvency stress tests, we note that banks would withstand the severe baseline scenario with their capital adequacy ratio (CAR) staying above the 10 percent minimum requirement.** In the adverse scenario, banks' CAR would fall below the hurdle rate but stay above the BASEL III requirement (8 percent). However, we note that about a third of the banks in the system could not meet the hurdle rate even in the baseline and the macro-financial feedback through weaker credit growth could be working in the adverse. We therefore agree with staff that the authorities should limit bank dividend distributions and be ready to take additional measures to strengthen bank capital should downside risks materialize. The non-performing loan ratio for 2020 projected in the baseline is way above the actual figure as of September 2020 (3.4 percent). The discrepancy could be accounted for by the effects of regulatory forbearance measures or FSAP assumptions of conservative parameters or distinct features of the COVID-19 shock from other crises. *We invite staff to further elaborate on this discrepancy and its implications, including the contribution of forbearance measures.* Regarding the design of the severe adverse scenario, staff assume a 6.8 standard deviation shock to GDP in the main analysis and once in a 500-year events in the climate change risk analysis.

While we see merit in risk analysis with extreme tail risk, we are of the view that the severity of the adverse scenario needs to be carefully designed not to stray too far from realism. *Staff's comments are welcome.*

**Given the significance and dominance of financial conglomerates in credit intermediation and interconnectedness, the group-wide supervision should be strengthened.** Regulatory powers and standards for transferring significant ownership, controlling interest, and assessing beneficial owners' suitability should be enhanced. It is also necessary to enhance cross-agency collaboration, update large exposure requirements, and enhance large and related party exposure reporting requirements for effective group-wide supervision. In this regard, we welcome that the authorities have already contemplated the idea of how to coordinate financial conglomerate supervision, including adopting common standards across the financial sector and establishing a supervisory college as a regulatory platform.

**The effectiveness of the AML/CFT regime should be substantially enhanced.** We note with concern the staff's assessment that the Financial Action Task Force (FATF) may include the Philippines in the list of jurisdictions with serious AML/CFT deficiencies without substantial reforms by June 2021. We urge the authorities to make every effort to effectively comply with FAFT recommendations.

**We agree with staff that promoting digital payments could facilitate advancing financial inclusion.** We note that digital payments in the Philippines are used much less than in Asian emerging market peers. Encouraging all financial institutions to participate in the core domestic retail transfer systems could boost competition, reduce transaction costs, and thus contribute to financial deepening.

With these remarks, we wish the people and authorities of the Philippines every success.