

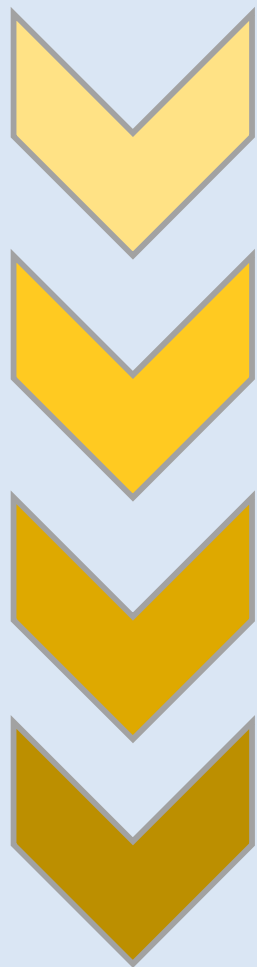
# Overview on Risk Management and Policy Environment in the Banking Sector

28 July 2017



BANGKO SENTRAL NG PILIPINAS

# Presentation Outline



**ABOUT BANGKO SENTRAL NG PILIPINAS (BSP)**

**ROLE OF THE BANGKO SENTRAL NG PILIPINAS**

**RISK MANAGEMENT IN THE BANKING SECTOR**

**POLICIES AND REGULATIONS IN PLACE**



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# ABOUT BSP



- ✓ Central monetary authority



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# ABOUT BSP: THE THREE PILLARS

## Price Stability

Through proper conduct of monetary policy (to maintain low and stable inflation).

## Financial Stability

Through prudent regulation and banking supervision

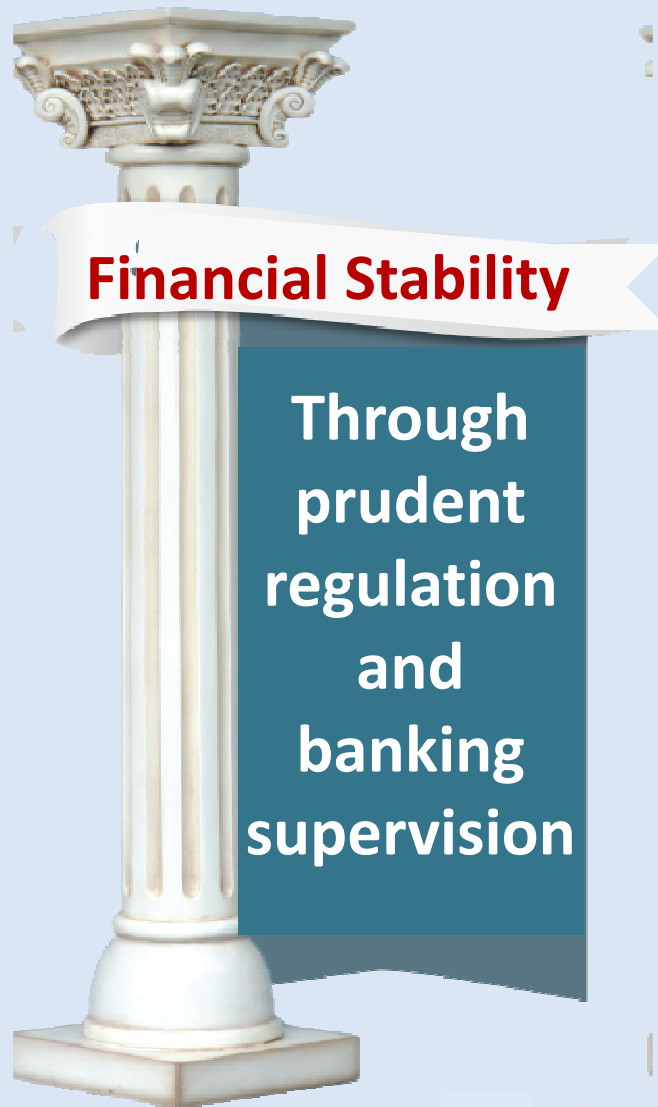
## Payments and Settlements System

Through necessary infrastructure to facilitate high value transactions



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# ABOUT BSP: THE THREE PILLARS



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# ABOUT BSP: ROLE and MANDATE

## ✓ **Regulates and supervises** financial institutions

- **Issues rules and regulations** for safe and sound banking operations
  - General Banking Law of 2000 (Sec 40, 43 and 44 for microfinance)
  - Basel Principles
  - Other Applicable laws

- **Conducts annual and special examination** of financial institutions to promote safety and soundness of banks
- **Checks compliance** with banking laws, rules and regulation and uses the CAMELS\* ratings in bank supervision
- Applies **risk-based supervisory approach**

\* **C**apital Adequacy; **A**sset Quality; **M**anagement; **E**arnings; **L**iquidity; **S**ensitivity to Market Risk





# ABOUT BSP: ROLE and MANDATE

## Enabling Policy and Regulatory Environment

- ❖ **General Banking Law of 2000 (Republic Act No. 8791)**
  - Mandated the BSP to:
    - recognize MF as a legitimate banking activity
    - draft the guidelines for its operations within the banking sector
  
- ❖ BSP has declared MF as its flagship program for poverty alleviation in Year 2000



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# ABOUT BSP: ROLE and MANDATE

## Enabling Policy and Regulatory Framework

- ✓ Greater role of private MFIs in the provision of financial services
- ✓ Promote savings mobilization
- ✓ Market-oriented financial and credit policies
- ✓ Government support for capacity building purposes only
- ✓ Mandates government FIs to act as wholesaler of funds

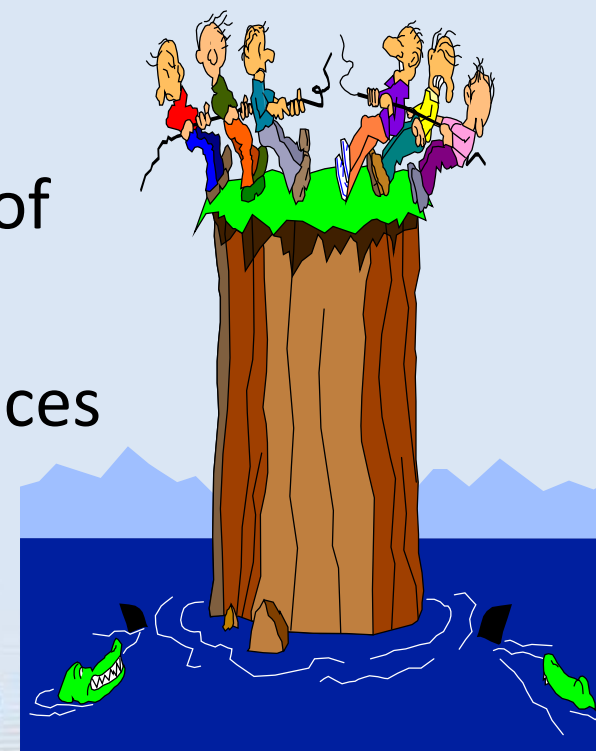


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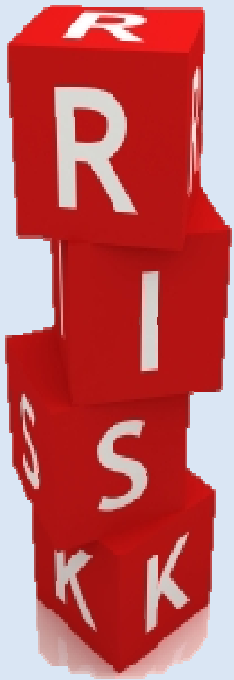
# RISK MANAGEMENT IN THE BANKING SECTOR

- **WHY** manage risks efficiently and effectively?
  - Banking is a business of taking risk in order to earn profits and provide for capital accretion
  - Risks can translate into losses very quickly
  - The types of products and services are continuously evolving
  - Expensive and labor-intensive (in the case of microfinance)
  - Better information on potential consequences
  - More efficient resource allocation



# RISK MANAGEMENT IN THE BANKING SECTOR

**WHAT** are the major risk categories?  
(for microfinance)



- **Financial**: credit & liquidity
- **Operational**: transaction, fraud and legal & compliance risks
- **Strategic**: governance, reputation & external business risks



# RISK MANAGEMENT IN THE BANKING SECTOR

**HOW** should risks be managed?

## **BSP EXPECTATIONS/REQUIREMENTS**

- Supervision by Risks/Risk Management System - **Section X173** of the MORB\*
- Risk Management Function - **Section X174**

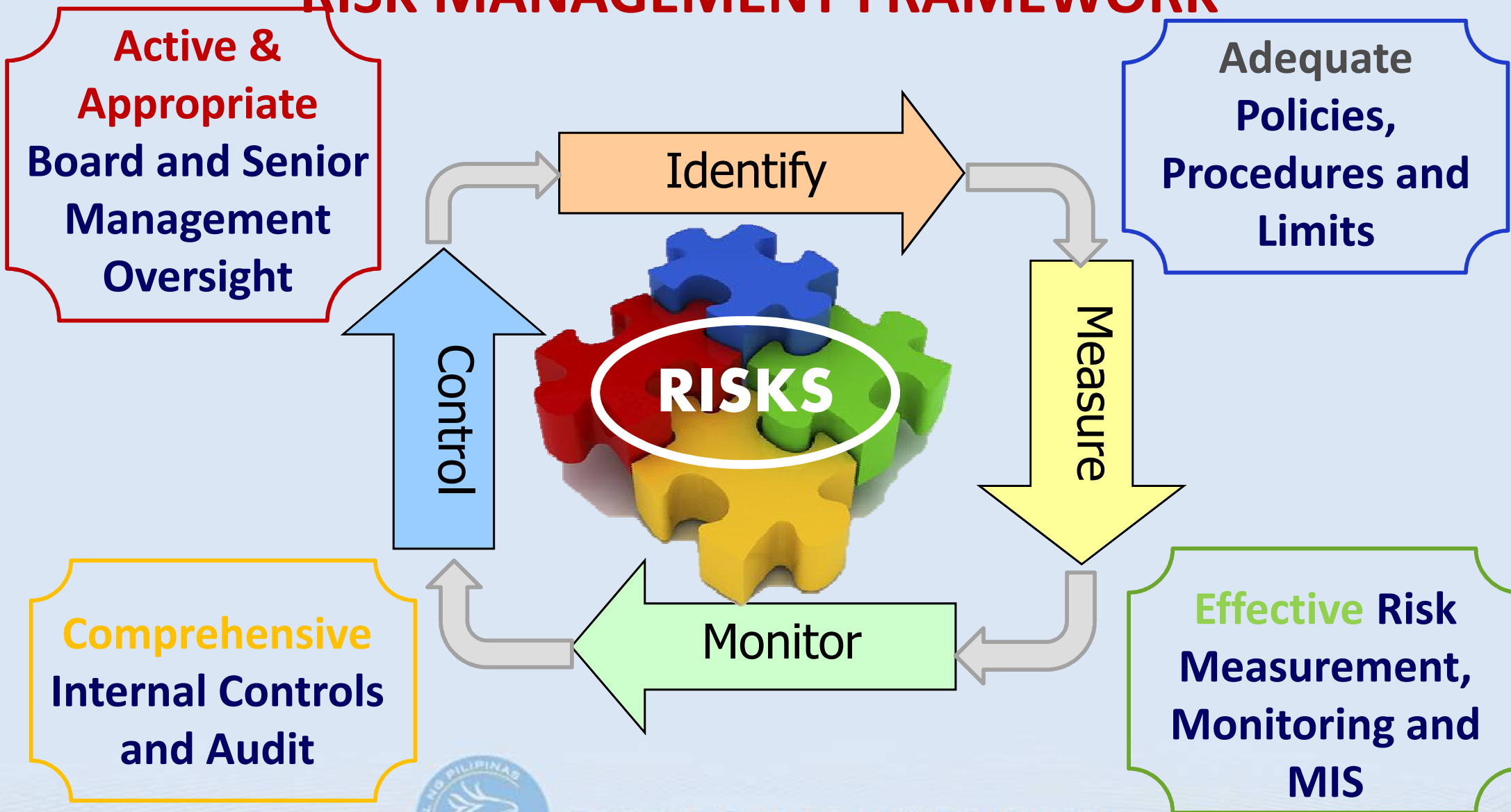
\* *Manual of Regulations for Banks*



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# RISK MANAGEMENT IN THE BANKING SECTOR

## RISK MANAGEMENT FRAMEWORK



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### SOUND Risk Management System

# RISK MANAGEMENT IN THE BANKING SECTOR

## BSP Expectations to mitigate risks:

### Board

- Has **ultimate** responsibility over the bank and its corporate governance
- Establishes overall strategy, acceptable risk levels
- Monitors overall performance to prevent excessive risk exposure
- Provides adequate resources to manage risks appropriately

### Senior Management

- Implements board-approved strategies
- Develops appropriate **policies and procedures** to manage risks
- Manages the day-to-day affairs of the bank

Powers/  
responsibilities and  
duties of directors -  
Subsec X141.3 of the  
MORB





# RISK MANAGEMENT IN THE BANKING SECTOR

## BSP Expectations to mitigate risks:

- ❑ Sound credit risk management practices - Section X178
  - ❖ Credit granting process
  - ❖ Credit grading system
  - ❖ Credit classification and provisioning
- ❑ Liquidity risk management - Section X176
- ❑ IT Risk management system - Section X177
- ❑ Operational risk management - Section X179
- ❑ Compliance system - Section X180
- ❑ Internal control system - Section X185
- ❑ Internal Audit function - Section X186





# POLICIES AND REGULATIONS IN PLACE

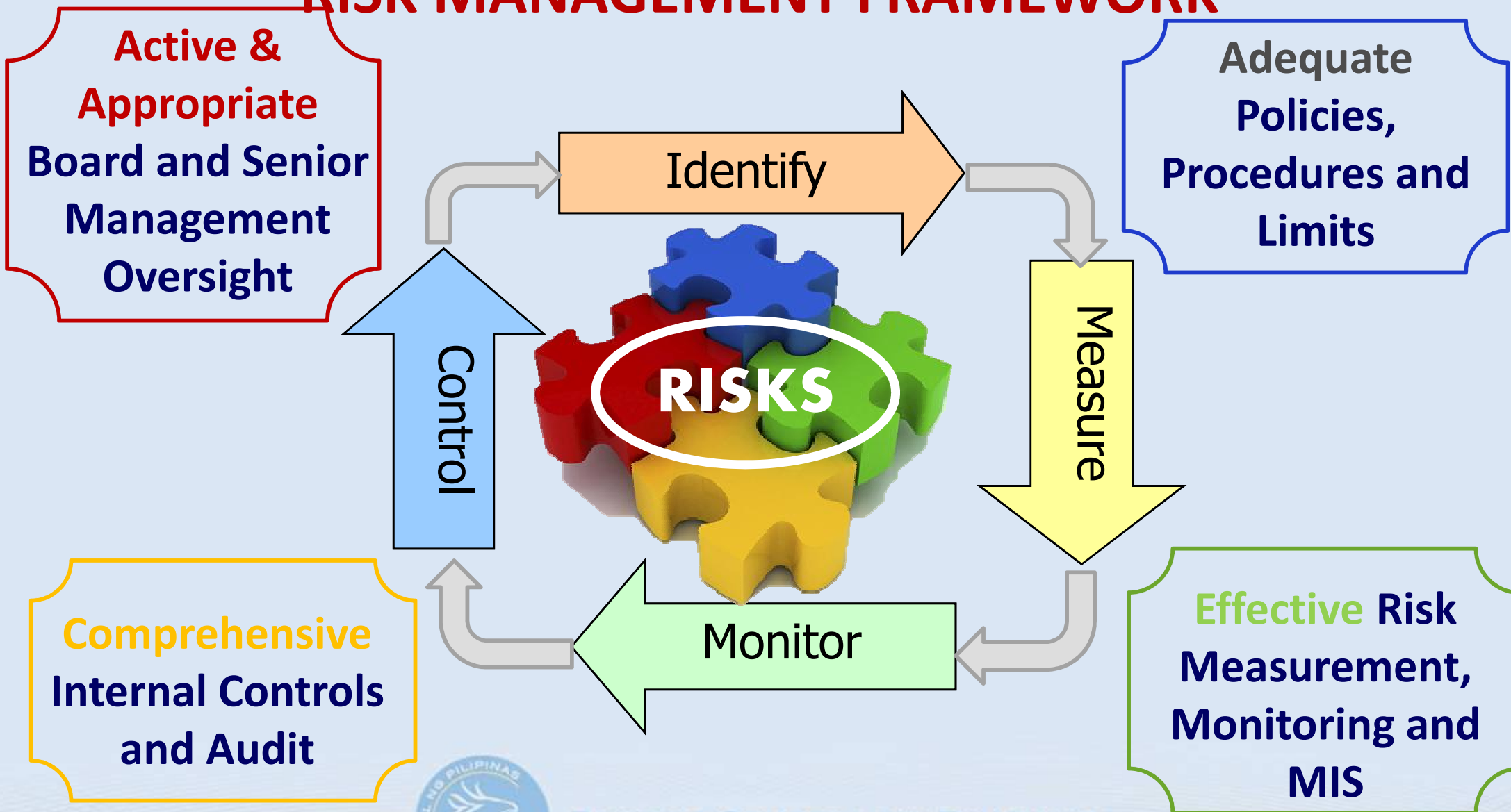
**What** can be adopted by MFIs in terms of risk management?



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# RISK MANAGEMENT IN THE BANKING SECTOR

## RISK MANAGEMENT FRAMEWORK



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### SOUND Risk Management System

# POLICIES AND REGULATIONS IN PLACE

**What** can be adopted by MFIs in terms of risk management?

- Oversight of the Board/Corporate Governance
- ✓ Clearly defined roles and responsibilities
- ✓ Strategic direction
- ✓ Prudent and appropriate limits – approving authority; maximum loan size; loan types (diversification)
- ✓ Adequate policies, processes and procedures
- ✓ Self-assessment function – internal audit



# POLICIES AND REGULATIONS IN PLACE

**What** can be adopted by MFIs in terms of risk management?

- Credit risk
  - ✓ Well-designed credit granting criteria (i.e., credit evaluation and scoring process, loan underwriting)
  - ✓ Appropriate credit administration and monitoring procedures (i.e., loan disbursement, monitoring, collection, effective MIS & reporting)
  - ✓ Effective credit control and review process (i.e., adequacy of provisioning, credit work out, analysis of trends and identification of problems)



# POLICIES AND REGULATIONS IN PLACE

**What** can be adopted by MFIs in terms of risk management?

- Operational risk
  - ✓ Clear delineation of functions
  - ✓ Effective internal control systems
  - ✓ Accurate, reliable and timely recording of transactions



# HOW CAN THESE BE ACHIEVED?

- **COMMITMENT** from the board and management to:
  - Provide adequate guidance and clear direction
  - Devote sufficient resources to credit risk management
- **CHANGES** - Enhance credit granting criteria/employ measurement tools
- **COLLABORATION AND COOPERATION** by and among the board, management and staff towards effective and sound credit risk management practices
- **COMMUNICATION** – ensuring clear and proper dissemination of policies, processes and procedures
- **CONTROL SYSTEM – MIS**; effective loan review/audit function





**Thank You!**



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**“Risk comes from not knowing what you`re doing.”**

*- Warren Buffett*

**“Risk is like fire:  
If controlled it will help you;  
if uncontrolled it will rise up  
and destroy you.”**

*- Theodore Roosevelt*



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# KEY TAKEAWAYS ON MICROFINANCE

- # Financial access issues are better addressed through **market based solutions**, thus, should be encouraged.
- # For these to work, an **enabling and supportive regulatory environment** should be established.
- # These solutions present real and **valid risks but** these concerns **can be managed**.
- # Financial service providers must be **proportionately regulated** to allow them serve the financially-excluded at the same time address concerns of safety and soundness.



# ABOUT BSP: ROLE and MANDATE

- ✓ **Regulates and supervises** financial institutions
  - Philippine Banking System is three tiered:

## Universal and Commercial Banks

- largest type of bank in terms of resources and scope of banking activities (**generally provide wholesale loans to MF institutions**)

## Thrift Banks

- savings and mortgage banks, private development banks targeting SME sector, consumer loans (**some have MF operations**)

## Rural and Cooperative Banks

- relatively smaller banks in rural communities, serving needs of local economies (**some have MF operations**)



# BSP Microfinance Regulatory Issuances

## ☐ Guidelines on MF Operations

- Definition of MF
- Characteristics of a typical MF client



- low income, employment in informal sector, low wage bracket, no physical collateral, closely interlinked household/business activities
- landless, manual laborers, marginal farmers, rural artisans, self-employed, small entrepreneurs, etc.
- With annual family income below the national annual average of P206 thousand



# BSP Microfinance Regulatory Issuances

## ❑ Guidelines on MF Operations

- MF loans - small loans granted to the basic sectors, on the basis of the borrower's cash flows, and other loans granted to the poor and low-income households to enable them raise their income levels and improve their living standards



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# BSP Microfinance Regulatory Issuances

## ☐ Types of MF Loans

**Microenterprise Loans**

**Up to P150,000 (USD3,000)**

**Microenterprise Loan Plus**

- Track record of at least two MF loan cycles in the P50K – P150K range
- From P150,001 to P300,000

**Micro-Agri Loans**

- Farming activities, agri-business & agri-related fixed assets
- Up to P150,000

**Housing MF Loans**

- Home improvements, constructions, house/lot acquisition
- Up to P300,000

# BSP Microfinance Regulatory Issuances

## Features of MF Loans

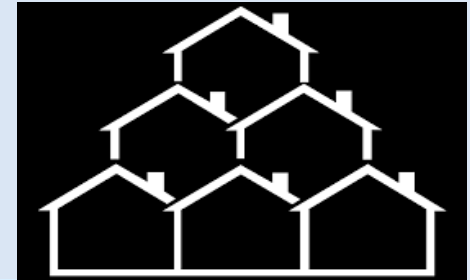
- ✓ Amortization considers projected cash flows of borrowers
- ✓ Typically unsecured
- ✓ Relatively short period; up to 15 years for Housing MF loans term; and 5 years for Home improvements/ repairs
- ✓ Monthly or more frequent amortizations
- ✓ Interest rates are at market rates
- ✓ Frequent amortization, with option for lump sum payment of up to 40% of loan amount, for micro-agri loans



# BSP Microfinance Regulatory Issuances

## ❑ Additional Requirements for Housing MF Loans and Micro-Agri Loans

- At least 2-year track record in MF program
- Well defined housing MF product manual
- Compliance with prudential requirements:
  - ✓ CAMELS and Management ratings of at least “3”
  - ✓ CAR not lower than 12%
  - ✓ No major supervisory concerns to warrant PCA
  - ✓ No arrearages on MF borrowings
- Notarized Certificate of Compliance



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# BSP Microfinance Regulatory Issuances

## ☐ Guidelines on MF Operations

### Micro-deposits

*savings accounts that cater to the needs of the low-income clients*

#### • **General features**

- Maintaining balance not exceeding P100
- Not subject to dormancy charges
- Average daily savings account balance does not exceed P40,000



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# BSP Microfinance Regulatory Issuances

## ☐ Guidelines on MF Operations

### Micro-Insurance

*- providing specific insurance, insurance-like and other similar products and services that meet the needs of the low-income sector for risk protection and relief against distress, misfortune and other contingent events*

#### • **General features\***

- Premiums: up to 7.5% of daily minimum wage
- Guaranteed benefits: up to 1,000 times the daily minimum wage





# BSP MF Regulatory Issuances

- Guidelines on MF Operations
- Incentives for MF**
- Rules for Safe and Sound Operations
- Rules Implementing Other Laws





# BSP Microfinance Regulatory Issuances

## ☐ Incentives for MF

- Allows qualified MF-oriented banks and MF-oriented branches of regular banks to establish branches anywhere in the Philippines (low licensing fee)
- Establishment of Micro-Banking Office (MBO) that primarily caters to the banking needs of MF clients

***Non-Transactional activities***

***Transactional activities***



# BSP Microfinance Regulatory Issuances

## Incentives for MF

### ***Non-Transactional activities***

- Market loans, deposits and other bank products & services
- Accept loan applications and conduct preliminary credit evaluation
- Host on-site automated teller machines (ATMs)
- Perform customer care services
- Perform customer identification process, receive account opening documents and facilitate account activation



# BSP Microfinance Regulatory Issuances

## Incentives for MF

### ***Transactional activities***

- Approve, open and accept micro-deposits, and service withdrawals
- Disburse loan proceeds and collect loan amortizations of micro-loans
- Present, market & sale microinsurance
- Receive/pay-out funds in remittance transactions
- Act as a cash/money in & out for e-money transactions



# BSP Microfinance Regulatory Issuances

## Incentives for MF

### ***Transactional activities, cont'd.***

- Collect premiums/pay out benefits from/to members of social security institutions
- Pay out benefits under government-sponsored conditional cash transfer schemes
- Accept utilities payments
- Purchase foreign currencies up to the maximum equivalent of US\$300 for credit to micro-deposit accounts



# BSP Microfinance Regulatory Issuances

## □ Incentives for MF - Results

- Microfinance in the Philippine Banking System (as of end-March 2017)

	Number of Banks	Amount (in million PhP)	Number of Borrowers
<b>MF-Oriented Banks</b>	<b>10</b>	<b>6,970.7</b>	<b>1,009,933</b>
Thrift Bank	1	6.3	366
Rural Bank	9	6,964.4	1,009,567
<b>MF-Engaged Banks</b>	<b>157</b>	<b>6,255.3</b>	<b>676,021</b>
Universal Bank	1	0.5	27
Commercial Bank	1	119.0	7,020
Thrift Bank	24	3,480.2	318,260
Rural Bank	120	2,516.5	320,932
Cooperative Bank	11	139.1	29,782
<b>Total</b>	<b>167</b>	<b>13,226.0</b>	<b>1,685,954</b>



# BSP Microfinance Regulatory Issuances

## Incentives for MF

- 75% credit risk weight in calculating CAR, provided:
  - › Highly diversified portfolio, i.e., at least 500 borrowers distributed over a number of industries
  - › All borrowers included in the count must not have any non-performing loans
- Loan value up to 90% appraised of real estate mortgage (REM)
- MF borrowers are exempt from submitting income tax returns and audited financial statements



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# BSP Microfinance Regulatory Issuances

## ☐ Incentives for MF

- Presentation, marketing & sale of micro-insurance (MI) products
  - need prior BSP approval subject to the submission of the ff docs, among others:
    - Bank's license as MI agent or broker from IC
    - Agreement between the bank & insurance co.
    - Approval of IC of the MI product



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# BSP MF Regulatory Issuances

- Guidelines on MF Operations
- Incentives for MF
- Rules for Safe and Sound Operations**
- Rules Implementing Other Laws



# BSP Microfinance Regulatory Issuances

## Rules for safe and sound operations

- Sound credit granting process based on cash flow or ability and willingness of the client to repay the obligation
- Adequate credit policies and procedures, effective loan review function
- Governance arrangements and contractual agreements between a bank with MF operations and its related MF NGO
  - Prohibits bank officers from holding officership positions in related NGOs/foundations



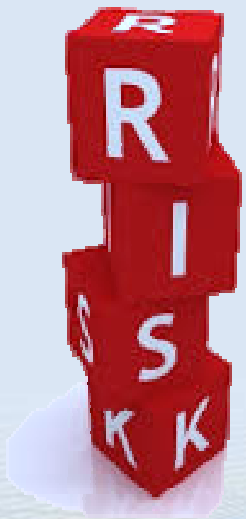
# BSP Microfinance Regulatory Issuances

## Rules for safe and sound operations

### ➤ Measurement of Portfolio-at-risk (PAR) and Loan Loss Provisioning

- ✓ PAR - outstanding principal amount of all loans that have at least one missed payment for one or more days
- ✓ Loan-loss provisioning

	Loan Loss Provision
Current	1 %
PAR 1-30 days	2 %
PAR 31-60 days/ R1	25 %
PAR 61-90 days	50 %
PAR over 90 days/ R2	100 %



# BSP Microfinance Regulatory Issuances

## ❑ Rules for safe and sound operations

- Guidelines governing issuance of electronic money (e-money) and operations of electronic money issuers (EMIs) in the Philippines
  - Defines e-money
  - Ensures that bank/non-bank EMIs have the necessary capacity (e.g. capital requirements, IT systems and security features and internal controls)
  - Ensures compliance with anti-money-laundering rules (e.g. KYC, recording, reporting suspicious transactions, transaction caps)
  - Ensures consumer protection
- Related regulations on e-money network service providers and technology risk management



# BSP Microfinance Regulatory Issuances

## ☐ Rules for safe and sound operations

- Submission of MF reports: submit the
  - Report on MF Products - monthly
  - Income Statement - quarterly
- Past due/PAR MF loans are considered non-performing loans





# BSP Microfinance Regulatory Issuances

## ❑ Rules for safe and sound operations

- Guidelines on the recognition and de-recognition of credible and competent MFI rating agencies (MIRA)
  - Ensures that MIRAs
    - ✓ Demonstrate commitment to comply with relevant rules and regulations
    - ✓ Possess technical capability, experience and organizational resources to provide objective and transparent ratings
    - ✓ Use a rating framework that reflects all material facets of MF operations, its attendant risks and operational challenges.
  - BSP recognition valid for three years and may be renewed



# BSP Microfinance Regulatory Issuances

## Rules for safe and sound operations

- Guidelines governing the rediscounting facility to refinance the loan portfolio of MF-oriented banks

### ***In addition to standard requirements:***

- One year track record in MF
- 500 active borrowers
- Officers and staff have at least 1 year experience in micro-lending & completed a MF training course
- Past due ratio not more than 5%
- Repayment rate not less than 95%



# BSP Microfinance Regulatory Issuances

## ❑ Rules for safe and sound operations

### ➤ Guidelines implementing the Truth in Lending Act

- Enhances loan transaction transparency, as mandated in the Truth in Lending Act
- Requires banks to only charge interest based on the outstanding balance of a loan
- Defines effective interest rate and requires that this will be the only rate used in all loan documents and marketing materials
- Requires a uniform disclosure of loan terms
- Requires banks to post in conspicuous places the revised format of disclosure statement.



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## BSP Microfinance Regulatory Issuances

- Guidelines on MF Operations
- Incentives for MF
- Rules for Safe and Sound Operations
- Rules Implementing Other Laws



# BSP Microfinance Regulatory Issuances



## Rules Implementing Other Laws

### ➤ R. A. No. 9501 – Magna Carta for MSMEs

#### ✓ Based on Total Assets:

Micro - up to P3,000,000

Small - P3,000,001 up to P15,000,000

Medium - P15,000,001 up to P100,000,000

### ➤ MSME credit allocation (% of loan portfolio)

– 8% for micro- and small enterprises

– 2% for medium enterprises

### ➤ Compliance period of 10-yrs or up to 16 June 2018

