A Sense of Community:
Stronger Rural Banks Enhance Stronger Communities[1]

Officers and members of the Rural Bankers Association of the Philippines, my colleagues from the Bangko Sentral, friends, ladies and gentlemen, good afternoon. I join the banking community and our nation in celebrating with you the 57th Charter Anniversary of Rural Banking in the Philippines.

The BSP has regularly engaged our major banking organizations: from the BAP to the Chamber of Thrift Banks and to RBAP and Bangkoop. All share the common trait of having been founded to serve as a venue. Each is a forum for collective discussion and each one is a platform for advocating identified specific industry concerns.

On many occasions, these separate discussions eventually converge because there will always be those specific issues that are peculiar to banks and the banking industry. Capital, corporate governance and credit standards are but some of these common concerns.

But there will also be specific issues which define the unique dialogue between the BSP and each banking organization.

For the RBAP, the issues that we have been talking about include the delivery of banking services to the countryside, competition at the community level, SPRB Plus, concerns over the rapidly growing salary loan market as well as the ability of RBs to engage in the sale or purchase of foreign currencies or securities.

All of these issues reflect BSP's desire to tailor-fit prudential supervision of the numerous small banks that serve our communities.

The size of your balance sheet, measured in pesos and centavos, should not be what rural banking is all about. Instead, you should be defined by your proximity to your respective local markets and the individuals and businesses that make up that community. This is the unique feature of rural banking and the ensuing regulatory framework stems from the type and magnitude of risks that you take in that context.

This sense of community is definitely distinctive of rural banks. It is, in fact, the reason why rural banks are referred to more commonly in other jurisdictions as "community banks". From our perspective though, rural banking is "community banking plus plus". While we should never forget that sense of community, we must also be cognizant that the countryside is clearly the target community.

---

[1] *Remarks delivered by BSP Deputy Governor Nestor A. Espenilla, Jr. at the 57th Charter Anniversary Symposium of the Rural Bankers Association of the Philippines (RBAP) under the theme "Rural Banks: Reliable Partners of Local Communities for Growth".*

This matters because the needs of the countryside in an archipelagic Philippine economy not only differs from the urban centers but also differs from one specific rural locality to another. This differentiation offers both opportunities and challenges … and these are the issues which I would like to focus on in my remarks today

Nurturing Local Growth

It is rather clear that rural bankers are deeply entrenched in their respective communities. If banking and finance are to offer a value proposition, it must be the case that the behavior and strategic focus of each rural bank must correlate closely with the prospects and performance of their chosen local community.

This is not going to be an easy task because the Philippine countryside is a diverse sampling of rich local cultures that run parallel to highly uneven economic conditions. That means that demographic details that may pose as a challenge to some RBs may be opportunities for other RBs. The strategic case that needs to be made then is that rural banking is not only about the needs of a distinct community but also about the nuances between one community and another.

Available data bears out the extent of the diversity. We know that nearly half of national saving is attributable to 90% of families. This tells us three things:

1. Yes, saving is highly uneven among families;

2. Generating saving is not automatic across families and communities throughout the country; and

3. There may be opportunities to be tapped if we fully appreciate the demographics of our communities.

Where would these savings be?

I can tell you that in the aggregate 19% is in Mindanao, 18% in the Visayas, 45% is in Luzon outside NCR and the balance of 18% is in Metro Manila.

I can also tell you that saving appears to be possible for families that earn at least Php60,000 annually. This is not a high income threshold and it re-enforces the fact that saving can and does occur even among those with modest incomes. The same data also shows that families with five or more children save more on average than those with, for example, two children.

All of these data are publicly available and can be broken down by region. With a little more spade work, we can generate even provincial data. Some data can even be more granular.

The point that I am making, ladies and gentlemen, is that rural banks are reliable partners of communities for growth … but this means that rural banks in Region 1 for example are operating differently than those in Region 6 in the Visayas or in Region 13 in Mindanao.

There is likely to be some differentiation in strategic focus depending on the needs of the local stakeholders. This follows from having to target diverse communities rather than the more similar corporate accounts of any given industry.

Protecting the Financial Consumer

This richness means that the banking relationships with rural banks will tend to be more personal. The task is not merely to service those that are already "bankable". Instead, there is that need to nurture the community so that economic agents mature from consumers to savers and hopefully, from savers to retail investors.

This is where the Financial Consumer Protection framework becomes a critical regulation. Approved by the Monetary Board earlier, we envision an engaged stakeholder operating within an inclusive financial system under an enabled policy environment that protects the interests of financial consumers.

This last sentence is quite a mouthful. What it amounts to is holding BSP-supervised entities to a 5-part standard of conduct. These are:

1. Maintaining client privacy through information security protocols and procedures;

2. Providing all relevant information to a client before consummating a transaction with that client;

3. Defining an objective process and identifying a specific venue for consumer complaints;

4. Determining that the products and services being offered are suitable to the risk and profile of the client; and

5. Nurturing the financial well-being of consumers by promoting financial awareness.

Like other BSP-supervised entities, rural banks will be rated on a scale of 1 to 4, evaluating your adherence to the standards, the commitment of your Board and Senior Management as well as the adequacy of your systems, internal policies, and self-assessment procedures.

I urge our rural banks to treat this not as yet another layer of regulation. The banking relationship fostered by rural banks in a community must translate into nurturing the financial consumer. One simply cannot look after the banking needs of a community without due consideration of its financial consumers.

Stronger RBs Means Stronger Communities

This renewed focus on consumer protection is structured to make the banks an active and an even stronger partner of the financial consumer. It is one facet of the reform agenda that was directly learned from sad global experience highlighted by a mortgage crisis.

There are many other facets of this reform agenda and they ultimately boil down to improving the quality of bank capital to be able to truly absorb losses. Gone are the complex hybrid instruments previously classified as Tier 3 capital and there has been a fundamental restructuring of the framework for determining eligible-capital for banks.

Although Philippine banks were certainly not exposed to the same risks that nearly brought the global financial market to a collapse, the BSP has nonetheless moved forward with several strands of reforms. These reforms are meant to strengthen the balance sheet of banks, enhance governance in banking, better manage potential conflicts of interest and be pre-emptive steps against brewing system-wide risks.

These are “big ideas” and they seem to suggest massive changes. To the contrary, we have endeavored to initiate the reforms by managing the pace of change and calibrating its contents so that we are constructive rather than disruptive.

Change will never be without significant adjustments since that is the nature of change. But while these changes will always be with some cost, we have always made it a point to be transparent with our intention but flexible with the implementation.

We have always collaborated with market stakeholders and you can see that in the recent issuances.

Under Circular 809, we ensured that the provisions of Republic Act 10574 (the Amended Rural Banks Act) could be executed. Where necessary, we convened the stakeholders – including RBAP certainly – so that we could collectively agree on how to move forward without losing sight of the main objectives of this law.

Together with the implementing rules and regulations for Republic Act 10641 (the Amended Foreign Bank Entry Liberalization Law), we believe that the legal foundation for healthy competition has been laid. This new competition should also bring with it the transfer of know-how and expertise.

All these can only mean a wider array of choices for our financial consumers. With that comes a corresponding push among market players to be stronger and be better amidst more competition.

There are those who believe, however, that these two laws in particular will open the system to a form and level of competition that we would not be able to handle. By their thinking, rural banks would be vulnerable by the mere fact that you are a small player in a market that can only get bigger.

We can appreciate that there is some fear but we do believe that the fears are unfounded.

Do we expect a global or regional bank to open shop in the country and marginalize rural banks? But how can that be when the main product of rural banking is the relationship with the community … a relationship that you have been developing from your inception.

Nothing will stop any new bank from extending credit to the countryside. However, if underwriting standards are to be maintained, wouldn't these new banks need time to build the expertise to know the local market and the underlying cash flow of retail borrowers or business clients?

This does not and should not mean that existing banks have vested rights over the market. Since banking is a public franchise, there is an understood responsibility to be continuously capable in delivering useful banking services. That is, being able to effectively manage credit, market, liquidity and operational risks using funds sourced largely from the public.

One clear way to handle this is having a stronger capacity to absorb risks. This is precisely why we put together the reforms on minimum bank capital that is now issued under circular 854. Market conditions always evolve and volatilities cannot be pre-determined. The one aspect which we can directly control is the amount that bank owners put in as risk capital.

More capital is necessary not only because markets are more complex and more volatile today than in the past. The additional capital is needed because the minimum scale needed to operate a bank has realistically increased as well. The use of information and communication technology, maintaining client information, connecting to the BSP, generating then submitting required reports and, to the extent relevant, the clearing of checks and other payments all require technology.

Folders and filing cabinets may not be totally obsolete but the cost of using these simply cannot compete with today's very low cost of a terabyte of digital data that is increasingly accessible through shared services.

While we are cognizant of that reality, I trust that RBAP likewise appreciates that we took into account much of your comments and suggestions. The capital threshold is nuanced by network size and by location, consistent with the very point I raised earlier about the diversity embedded across the Philippine countryside. And to be constructive and not disruptive, we also allowed you a 5-year period within which to build up capital subject to an acceptable plan.

Capital, however, is like a war chest. Battles are not won necessarily by whoever has the most fire power but by those who are best able to deploy such resources. Hannibal, during the 2nd Punic War, was outnumbered by the Roman army but still prevailed. And in 490 BC, 10,000 citizens from Athens defeated the trained and more numerous Persian army in the Battle of Marathon.

Many other examples can be cited but the point has been made. And for banking, it is clear to everyone here that the biggest balance sheet battle is fought on credit risk terms.

For this reason, the Credit Risk guidelines now institutionalized under Circular 855 are meant to focus on the cash flow of borrowers as the underlying measure of capacity to pay. It cannot be about specific documents since these are a mere input to the judgment that a credit officer must eventually exercise.

I have said this in a forum only days ago but let me say it again here: Having identified documents does not guarantee that credit will be granted just as the absence of the same identified documents does not curtail the extension of credit.

Having said that, the new regulation again introduces a calibrated approach by providing documentary exemptions for startups, micro/small enterprises or those whose outstanding loan balance does not exceed Php3 million. We want it clear, however, that these exemptions do not relieve the bank of the responsibility of having sufficient basis for their credit decisions.

Many other significant details in circular 855 should be understood and I urge each of you to take time to fully appreciate how the various facets of circular 855 come together. In the end though, it is about having a viable credit underwriting system that provides for a rating system whose results are continuously back-tested, embeds guidelines on provisioning and, puts in place clear standards for related party transactions.

The Future of Rural Banking

Ladies and gentlemen, our market and that beyond our shores are evolving rapidly. We cannot afford to ride the coattails of 3rd party press releases that extol our resilience from the global weaknesses. While we have achieved much to get to this point, the challenge is to continuously make the hard assessments of what else can we do, why we are pursuing the prospective changes and when should those reforms be in place.

All the changes that I have mentioned today were meant to make the Philippine banking system stronger. This strength is measured by being responsive today to the needs of our stakeholders and by taking responsible actions to put us in a better position in the future.

Rural Banks need to be cognizant that your stakeholders are evolving because the communities where you operate are likewise evolving. Strategic decisions are before you and each of you needs to address those unique issues as you best see fit but within the emerging governance and prudential standards for Philippine banking.

This is thus a period of change, not in response to glaring weaknesses but because it is a continuing partnership for economic growth.

Thank you very much for your attention and good morning.