Maayong hapon kanatong tanan!

Our president, Eking Abellana, requested me to talk with you on this topic, since my bank, the Rural Bank of Mati, is one of the 393 rural banks classified as a small rural bank, a category applicable when any of these applies:

1. Those with no more than 3 banking offices - currently at 393 / 450, or 87% of total RB's.
2. Those with capital at P20m and below - currently at 160 RB's or 35% of RB's.
3. Those with total assets of P100M and below – currently at 144 or 32.00% of RB's.

The question is: is it worth maintaining the 393 or 87% small rural banks?

When I was the president of this association 2 years ago, there were 550 rural banks. Today, there are 450. Therefore, we can also ask the question, is it worth maintaining the rural banking industry?

For the past 7 years, the Philippines has enjoyed an unprecedented economic growth, even besting China and India in the latest data (Q1, 2016). The economy has consistently grown more than 6% per year, our debt servicing ratio is going down. We have a stable source of foreign exchange from remittances and the BPO industry. The proactive management of our primary regulator, the BSP, has minimized the negative effects of external shocks, resulting in a stable peso, and record low inflation.

Yet, behind this rosy picture remain the grim reality. The poverty rate is persistently stuck at 26% - 27%. In absolute terms, this means that some 26 million Filipinos still struggle on an income of less than P212/day (A family of 5 needs P212/day to meet basic needs.) In the run-up to the recent elections, one of the most stinging criticisms was that very little of these economic gains have trickled down to the poor. The income gap remains high, the filth and squalor continues unabated. For example, right in the Ermita and Malate tourist belt districts of Manila, are dirty sidewalks with homeless families, in front of both beat up and gleaming facades, a stark reality where, for many, dreams of hope remain as dreams.

Fortunately, there is a proven tool to uplift the poorer sectors, making it easy for them to participate in the economic boom. This tool is financial inclusion. And the best conduit for financial inclusion is the rural banking system. Through simple and easy-to-understand products, the barrier to financial inclusion is kept low. Over time, many rural bank clients "graduate", with their requirements now provided by commercial banks. On the macro-economic aspect, rural banks promote a more stable economy by avoiding too big to fail scenarios, isolating external events, and supporting local enterprise. Indeed, if there is one mission for rural bankers, it could well be a) financial inclusion, and b) financial improvement of its clients.

Recent history has 2 proofs that financial inclusion works:

1. In 1945, the Philippines, grappling from the destruction of World War II, suddenly was expected to solve its problems alone as a newly independent country. For all its contribution and support to the American cause, the country was excluded in the Marshall Plan, an American program to rehabilitate Europe, including erstwhile enemies like Italy, and Japan, on which the U.S. dropped the atomic bombs. The Marshall Plan swiftly put Japan and much of Europe back to their feet. Fortunately, our far-sighted forefathers implemented the rural banking industry, harnessing financially prepared families nationwide to mobilize local savings and provide credit to farmers and entrepreneurs particularly in the provinces.

   To ensure their viability, the Central Bank of the Philippines provided half of the capital on repayment basis and assigned exclusive geographical areas for each rural bank. As a result, by the 60's, with just over 10 years of rural banking, the economy was on its track, and visible signs of progress were seen nationwide.

2. More recently, in the 1990's, in India, the government mandated banks to open 4 branches in unbanked areas for every new branch they want to open. The resulting availability banking services in the unbanked areas significantly reduced poverty nationwide.

Despite these proofs, the capability of rural banks to perform their mission of financial inclusion is becoming more difficult. Three factors are largely responsible:

1. Regulatory Aspect

It is getting more burdensome. Chief among the causes are these two:

A. The standardization of the MORB, circulars, and memoranda across all types of banks. This itself places extra burden on simple rural banks, by the sheer number of pages that must be navigated and understood, many of which are not applicable to its operations. The result is a compromised understanding of the policy in question, which present a higher likelihood of errors.

B. The increasing regulatory burden imposed on small rural banks caused by the alignment of regulations to international standards despite the fact these banks do not engage in international banking.

The result is slow but steady clipping of the ability of rural banks to perform their main function of financial inclusion, one of which is to be as a viable alternative to informal lenders. This objective cannot be discounted, since it is well known that the lower cost of borrowing from rural banks can break the cycle of poverty for those mired in 5-6 debts. In addition, the move of bigger banks encroaching into the market of rural banks has increased personal debt levels. This indebtedness is increasing with the proliferation of credit cards, itself a problem through increasing credit card delinquencies.

B. Marketing Aspect

On the marketing aspect, it is also getting more difficult because the interest to preserve rural banking services has vastly declined since the 1990's. There is no Overall Banking Framework policy that should define, and more importantly, harness the unique comparative advantage of each banking group. What we have today is a free-for-all scenario, with foreign banks, Qualified ASEAN banks, universal banks, commercial banks, thrift banks, government banks, and rural banks, all feverishly competing against each other. We find this kind of deregulation most ruinous to rural banks, because it is in the nature of any enterprise to go for lower hanging fruits, the ones found in the areas served by rural banks. Today, we find a foreign bank like Maybank in retail banking, and even our primary government development bank, DBP, in the salary loan business. DBP was created to fund long-gestation projects beyond the capability of commercial banks, projects like airports, ports, bridges and such. Another government bank, Landbank, was created to ensure the country's self sufficiency in food. Finding that banking purely on agriculture was not viable, the bank was granted a commercial bank license. Today, Landbank is like any other commercial bank, except that it also into salary lending to government employees, ostensibly as part of the closing of the loop in government receipts and disbursements.

C. Operations Aspect

Finally, on the operations aspect, rural banking is more complicated, with increasingly more resources devoted to non-revenue generation (compliance, reports, manuals, security), leaving less for revenue-generating basic rural banking services, such as deposit creation, lending, and collection.

All of these combine to create a decreasingly less conducive atmosphere, making rural banking, as opposed to other alternatives now available in the provinces like resort operations, less and less of an enjoyable pursuit.

If this status quo continues, these avenues are available for small rural banks:

1. Capital build-up

2. SPRB

3. CPRB

4. Privately-arranged sale or merger.

What can we do?

We harness RBAP, our association that has earned respect in the industry since it reunited to be a single organization 8 years ago. Each of us rural banks must clean our house. As part of our self-improvement campaign, RBAP must take a more active role in developing basic standards to lift RBs nationwide. By doing so, RBAP is better able to promote and protect the RB brand. May I propose these ideas to the incoming board of RBAP:

1. RBAP works with BSP to develop 3-year baseline standards initially based on existing lowest performance parameters. This ensures that ALL existing RB's are included in this improvement program. Every RB is given 3 years to surpass the standards. Every 3 years, the standards are tightened, again based on (updated) lowest performance parameters. These standards are:

A. funded loan loss provision to total loans

B. NPL to total loans

C. deposit volatility

D. operating cost to total revenues

E. net income to total revenues

At the very least, this program will help ensure that no rural bank is left behind.

2. Encourage the BSP to come up with an Overall Banking Framework for the country in order to:

A. Harness the best comparative advantage of each banking group.

B. Avoid ruinous competition. This is important especially since many foreign banks and Qualified ASEAN banks are so huge that one of them is easily bigger than the entire Philippine banking system.

C. Use the framework to force banks to open branches in unbanked areas. In India, when they allowed a bank to branch anywhere so long as they open 4 branches in an unbanked area, rural development prospered. In the Philippines, there is no such rule, so today, despite the proliferation of banks, there are still 591 towns and cities that are unbanked. While free-market advocates might complain about this move, we believe that the overall good of the country must override such considerations.

3. Encourage RBAP to review with BSP the requirement for a 100% and immediate funding of additional loan loss provision, regardless of the negative effect this will have on the bank in question. This requirement is particularly onerous, especially since such provision is for potential and not actual losses on loan operations. In fact, the pressure this wreaks on the bank is a leading cause of bank closures. There is a

staggered arrangement but it is not available to well-capitalized rural banks.

Per BSP data, as of September 2015, the funded loan loss provision-to-NPL ratio of the rural banking industry is 67%. Why then can't rural banks fund at least 5% more instead of 100%?

Why should it immediately be 100%, which becomes stagnant funds, even if such a move, instead of strengthening, will actually threaten the very existence of the bank?

4. Make RBAP be proactive in its legislative agenda with Congress in order to ensure the passage of legislation supportive to the agenda of the rural banking industry.

Finally, we, rural bankers must walk the talk. As members of the communities where we operate in, let us source our purchases locally, with preference to our clients, to the extent possible. For many local businesses, an order for uniforms, for example, can be the biggest single order of a local tailor.

We also need to periodically review our strategy. A rural bank can no longer all things to all people. Instead, it must narrow its focus of operations, so that it can afford to fund its chosen strategy. The smaller the bank, the narrower must be its focus.

In practical terms, a rural bank can target the people in their community, both residents and those who have already moved elsewhere. The connection to the community's diaspora is a captive market which can be served through actual and virtual branches. In addition, the extended family and generational market of these local families are also captive markets.

Since many communities already have banks other than the resident rural bank, it is also important that the local rural bank differentiate its services as one of long-term relationship for the long-term improvement of the customer's financial standing.

In closing, let us go back to our opening salvo on ensuring that economic gains must be felt by all. We are here to help the poor get out of poverty. Let us have products with very low barriers to entry in order to effect financial inclusion. Let us constantly tweak our products and services so that these poor can concentrate on productive efforts, with the rural bank taking care of the nitty-gritty of their finances. So, fellow rural banks, our mission may be less glamorous, but definitely more important if we want a country with less poverty, a narrowing income gap, and a higher level of human development.

More power to the rural bankers!