

## **Rural Banks: Making a Difference in Financial Inclusion<sup>1</sup>**

To the officers and members of the Rural Bankers Association of the Philippines (RBAP) under the leadership of Dr. Armando B. Bonifacio; esteemed colleagues from the banking industry; distinguished guests; ladies and gentlemen; good morning!

Thank you for inviting me to this annual national gathering of the RBAP. It is always a pleasure to see the beauty of Baguio, the city known for its sweet strawberries, Panagbenga Festival and most importantly, for the friendly, warm and accommodating locals.

I have been to Baguio City several times. And every visit is always a rewarding experience. I always find this place fascinating and at the same time, relaxing because of its cool weather, beautiful pine forest and unique local culture.

One of the places I find interesting here in Baguio is the Cemetery of Negativism or the Lost Cemetery. It is a symbolic site for burying negativities — thoughts, emotions, attitude – in short, bad vibes. As you enter the Cemetery you will see a welcome sign which says, “Negativism is man’s greatest self-imposed infliction, his most limiting factor, his heaviest burden. No more for here is buried the world’s negativism for all time. Those who rest here have died not in vain – but for you a stern reminder. As you leave this hill, remember that for the rest of your life. Be More Positive.”

Adopting the thought-provoking reminder of the Cemetery of Negativism... to be more positive... I would like to start my remarks on a positive note.

I am pleased to share with you that Standard & Poor's Global Ratings (S&P) upgraded its rating on the Philippines to 'BBB+', which is two notches higher than the minimum investment grade of 'BBB-' and a step away from an 'A' rating. The upgrade was supported by the country's strong growth trajectory, healthy external position, low public indebtedness, and sustainable public finances. Government agencies are now crafting a roadmap to systematize our pursuit of the 'A' grade from global rating agencies.

Likewise, I am happy to report that last February, S&P upgraded its Banking Industry Country Risk Assessment (BICRA) on the Philippines to group 5 from 6, the second consecutive BICRA upgrade since last year. The BICRA methodology employs an evaluation framework which assigns scores to rated jurisdictions on a scale of 1 to 10, with group 1 corresponding to the lowest-risk banking systems and group 10, the highest-risk. S&P cited the improved institutional framework in the Philippines with the amendments to the BSP charter that enhance the BSP's supervisory powers. The

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<sup>1</sup> Keynote Speech delivered by Deputy Governor Chuchi G. Fonacier during the 66<sup>th</sup> Annual National Convention and General Membership Meeting of the Rural Bankers Association of the Philippines (RBAP) held in Baguio Country Club, Baguio City on 20 May 2019.

starting point for rating banks in the Philippines has consequently gone up to 'bbb' from 'bbb-'. This refers to stand-alone credit profile (SACP) ratings usually applied to hybrid debt.

In addition, the Japan Credit Rating Agency (JCRA) has upgraded their rating outlook on the Philippines from 'Stable' to 'Positive'. The JCRA cited the country's high and sustainable economic growth, resilience to external shocks, accumulation of foreign exchange reserves and the government's sound fiscal position as the primary rationale for the upgrade.

As we reap the economic benefits of these upgrades, the theme you have chosen for this year: "Rural Banks: Bridging the Gap in Financial Inclusion" speaks well of your important role in inclusive growth and in increasing access to financial services, a role which you have been performing even before the term financial inclusion itself gained attention.

For today's keynote, allow me to highlight three realities in the rural banking industry. First, there has been a significant shift in the rural banking landscape since the enactment of Republic Act No. 720 in 1952. Second, rural banks' familiarity and geographical locations make them an ideal conduit for the efficient provision of financial access in the countryside. Lastly, the BSP considers the RBAP as its partner in providing/developing an enabling environment for countryside development.

## **Rural Banks and the Changing Environment**

Let us briefly go back in history. The enactment of Republic Act No. 720 in 1952 provided the legal framework for the establishment and operation of rural banks in the Philippines. The passage of the law paved the way for the key local financial institutions to effectively provide credit to farmers and people of rural communities, thereby promoting and expanding the rural economy in an orderly and effective manner. This was the original *raison d'être* for the establishment of rural banks.

After more than six decades, there have been significant shifts in the landscape of the domestic financial system. There are now many other financial service providers – banks and non-banks, formal and informal – that are already in or are planning to enter the rural banking space. The demands of your market and the conditions in which you operate have also evolved with the advent of financial liberalization, digital transformation and regional growth centers.

Change is inevitable. What matters is how we respond to change. Charles Darwin, who is best known for his theory of evolution, is believed to have said and I quote, "It is not the strongest or the most intelligent who will survive but those who can best manage change." Indeed, adaptability or the ability to manage change in response to an evolving market landscape or new financial circumstances is crucial to survival. Without the ability and agility to adapt, we will stagnate or lose our relevance.

In other countries, community banks are also struggling to find their rightful spot in a rapidly evolving financial environment due to tougher competition with other market players. In the Philippines, however, small banks can still thrive in this changing environment and remain relevant due to their geographic advantage, expansive physical network and familiarity with the chosen niche market.

### **Expanded Reach and Immersion in the Countryside**

At present, our statistics on financial inclusion show that around 28 percent of cities and municipalities of the country are still unbanked as of the third quarter 2018. The remote location of rural areas is one of the main factors that limit people's access to formal financial institutions. This means that access to financial products and services in the country remains a huge challenge.

Rural banks are well positioned to respond to this challenge given their geographic advantage and expansive network. As of end-March 2019, there are 445 rural banks<sup>2</sup> with a collective network of 2,934 head offices and other offices. While bigger banks are concentrating in highly urbanized and densely populated regions of the Philippines such as the National Capital Region (NCR), Region IV-A (CALABARZON) and Central Luzon, rural banks are thriving in regions where there is less access to financial services. In Ilocos, Cagayan Valley, MIMAROPA, Bicol, Caraga and Cordillera, there are more rural banks compared with other bank types.

Rural banks are also the frontrunners in the establishment of branch-lite units. As you know, branch-lites were introduced to enable banks to have a presence in areas where it is not economically feasible to establish a full blown branch. Out of 1,909 operating branch-lite units, 54 percent are owned by rural banks.<sup>3</sup> Looking at previously unbanked municipalities which recently gained banking presence, most of them are now enjoying banking services because of branch-lite units.

The numbers that I have presented indicate that rural banks are truly more accessible in the countryside. You have a geographic footprint and market familiarity that other bigger players do not possess. Take advantage of this unique position to further strengthen your foothold so that you will be more resilient against market competitors.

The rural banking industry can also explore untapped opportunities in unbanked municipalities whose level of economic activity is actually high. For instance, 15 percent of unbanked areas in the country are 1st to 2nd class municipalities. These areas will surely benefit from financial intermediation to sustain the local economic growth not to mention boost consumption and productivity.

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<sup>2</sup> The rural banking industry includes cooperative banks.

<sup>3</sup> Source: BSP website.

Overall, economic growth has been spilling over to the countryside. For instance, the 2018 Regional Gross Domestic Product (RGDP) data shows that the economy of fourteen regions grew faster than that of the NCR (4.8 percent), with Bicol Region growing the fastest at 8.9 percent followed by Davao Region and Region IV-B (MIMAROPA) both at 8.6 percent.<sup>4</sup> Such growth in the countryside underpins the opportunities for the rural banking industry to expand its business and help the country achieve more inclusive growth.

Admittedly though, some of you may be already satisfied with the current market that you are serving. If geographical expansion is not part of your game plan, there are various opportunities to improve your products and services in terms of design and delivery.

As leaders of the rural banking industry, what sets you apart from the managers of bigger banks is that you are more relationships-driven. You have an intimate knowledge of the local economy and close ties with the community. These will enable the industry to be more responsive to the needs of customers as well as to market trends.

Technology is changing the way banks do business. Some clients do not have to ever set foot in a bank branch if they have a fully enabled smart phone. The emergence of financial technology companies or “Fintechs” is also dramatically changing the delivery of financial services in payments and even in the underwriting of credit. Technology further offers ways for banks to improve the efficiency of operations and cut costs. While you can use these technologies to your advantage – to improve operational efficiencies and value proposition – I believe that the value of person-to-person contact will never fully go away. For instance, if you call a customer service hotline, is it not that you still prefer to talk to someone rather than hear default and machine-recorded responses from the other end of the line?

The point is, even in the face of digitalization, rural bankers can still build on a position of strength, and the relationship and market familiarity that you have established with the community. It is possible for technology to enhance relationships rather than replace them. If you are able to effectively nurture the confluence between the two, you will be able to not only increase but also cement your customer base.

Finally, to be better positioned to serve your clients, always keep in mind that only sound and well-managed institutions can take advantage of new opportunities and have scope for more innovations. On this note, I am happy to share that the rural and cooperative banking sector remains sound and stable. The total asset of rural and cooperative banks (R/CBs) expanded by 6.6 percent and reached P250.3 billion as of end-December 2018. At the same time, capitalization<sup>5</sup> moved up by 10.4 percent while

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<sup>4</sup> Source: Philippine Statistics Authority (PSA) website

<sup>5</sup> Source: BSP website.

deposits increased by a robust 5.7 percent. Ladies and gentlemen, you will agree that these are good numbers.

Capital adequacy ratio (CAR), as a measure of risk-based capital, remains well above the minimum BSP and international standards. The CAR of rural and cooperative banks (R/CBs) was at 19.6 percent as of end-December 2018. In terms of profitability, industry figures were also better. Net income for 2018 reached P4.0 billion, higher by 3.9 percent than in 2017.

The BSP does not expect the promotion of financial inclusion to be done at the expense of the safety and soundness of bank operations. We emphasize the importance of strengthening banks' overall corporate governance and risk management practices, institutional capacity, and service delivery standards to support the growing demand and evolving banking needs of customers.

At this point, let me acknowledge the valuable inputs by the industry which led to the recalibration of the minimum liquidity framework, allowing us to achieve the optimal effect of our policy reform. Meanwhile, to improve the quality and capacity of their regulatory capital, the risk-based capital adequacy framework of stand-alone TBs, RBs and Coop banks – referred to as the Basel 1.5 framework – shall be aligned with certain elements of the Basel III requirements. These include the adoption of new minimum capital ratios, such as the 6 percent Common Equity Tier 1 (CET1) ratio and 7.5 percent Tier 1 ratio, in addition to the existing 10 percent minimum capital adequacy ratio (CAR).

### **Enabling Regulatory Environment**

On the part of the BSP, we remain committed in providing an enabling regulatory environment that will support rural banks in overcoming emerging challenges and provide various opportunities to be more responsive to the evolving needs of rural banking clients.

Last February 2019, Republic Act (RA) No. 11211<sup>6</sup>, which amends the BSP Charter, was signed into law. The new BSP charter recognizes the strategic role of the BSP in promoting financial inclusion. Under the amended BSP charter, we, as bank regulators, shall continue to promote broad and convenient access to high quality financial services through our supervisory and financial sector reform policies.

Towards this end, the BSP continues to advance its financial inclusion agenda with digital innovations as a catalyst and strategic enabler. Accordingly, the BSP has been gearing up for the development of a digital finance ecosystem that facilitates the

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<sup>6</sup> Republic Act No. 11211 dated 14 February 2019.

diversity of players catering to the various needs of the public, particularly the low-income and unserved segment. Such an ecosystem is built on three pillars.

The first pillar provides democratized access to a transaction account wherein every person is able to open an account and use digital financial services. In this regard, the BSP issued Circular Nos. 992<sup>7</sup>, 950<sup>8</sup> and 1022<sup>9</sup>. Circular No. 992 introduced the framework for basic deposit accounts (BDA) which meet the need of the unbanked for a low-cost, no-frills account, i.e., the BDA has low opening amount which is capped at P100; it has no maintaining balance, no dormancy charges, and can be opened using simplified identification requirements. Meanwhile, Circular Nos. 950 and 1022 allowed covered institutions to implement reduced Know-Your-Customer (KYC) rules for certain low-risk accounts and use technology to comply with face-to-face contact requirements while updating rules for validating client identity by accepting the national ID (PhilSys<sup>10</sup>).

The second pillar delivers an expansive network of low-cost touch points to onboard new clients and facilitates the digitizing and disbursing of cash and other financial transactions. In support of the second pillar, the issuance of Circular No. 940<sup>11</sup> enabled banks to serve clients through ubiquitous retail outlets as cash agents which can accept and disburse cash on behalf of the bank; while the issuance of Circular No. 987<sup>12</sup> permitted the establishment of branch-lite units, which I earlier mentioned.

The third pillar offers an efficient retail payment system that facilitates delivery of digital financial services. Circular No. 980<sup>13</sup> ushered the adoption of the National Retail Payment System (NRPS) framework which promotes interoperability to allow digital transactions to be sent from an account to any account held in a bank or an e-money issuer. Circular No. 1000<sup>14</sup> provided the guidelines on the settlement of instant retail payments; ensured the availability of fund transfer schemes in all electronic channels; and promoted transparency and reasonableness of fees.

The foundational elements of the digital finance ecosystem are complimented by regulatory initiatives designed to foster innovation. The BSP has been implementing the 'test and learn' approach wherein new solutions are allowed to operate in a live but contained environment without the immediate burden of regulatory compliance. This way, we come to a better understanding of the risks to inform the proportionate regulatory response.

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<sup>7</sup> Circular No. 992 dated 1 February 2018.

<sup>8</sup> Circular No. 950 dated 15 March 2017.

<sup>9</sup> Circular No. 1022 dated 26 November 2018.

<sup>10</sup> Philippine Identification System Act (RA No. 11055)

<sup>11</sup> Circular No. 940 dated 20 January 2017.

<sup>12</sup> Circular No. 987 dated 28 December 2017.

<sup>13</sup> Circular No. 980 dated 6 November 2017.

<sup>14</sup> Circular No. 1000 dated 23 April 2018 together with Memorandum to All BSFIs Nos. 2018-013 dated 28 March 2018, 2018-026 dated 4 September 2018, 2019-001 dated 3 January 2019.

Meanwhile, our initiatives on digital and financial literacy as well as consumer protection are aimed at deepening the public's knowledge of, and trust in digital financial services to ensure that we can fully optimize the welfare-enhancing benefits promised by these digital innovations.

We, at the BSP, believe that a financially-literate citizenry can be more effective in productively contributing to economic growth. To achieve this, the BSP has ongoing Financial Learning Seminars all over the country to help educate the general public. We also develop and manage content for PisoLit on Facebook, as well as create primers, advisories and information materials for sharing with partners and the general public.

The BSP likewise remains committed in its role as proponent and driver of the National Strategy for Financial Inclusion (NSFI). It chairs and serves as Secretariat to the Financial Inclusion Steering Committee (FISC), the interagency body providing strategic direction, guidance, and oversight in respect of the implementation of the NSFI. The FISC in its 6th meeting on 13 June 2018 adopted the two focus areas of digital finance and agriculture and MSME financing.

The opportunities offered by our regulatory environment for inclusive finance has led to global recognition. The Philippines is ranked by the Economist Intelligence Unit (EIU) as the first in Asia and third in the world with the most conducive environment for financial inclusion. With the different elements in place, the BSP aims to see financial inclusion as measured by account ownership double by 2020 from its level of 22.6 percent when the BSP Financial Inclusion Survey of 2017 was conducted.<sup>15</sup> The challenge to rural banks is how to maximize these opportunities within the framework of the regulations that we have so far put together.

## **Concluding Thoughts**

Ladies and gentlemen of the rural banking sector, in an environment that is rapidly evolving, adaptability is the key. Adapting to change does not necessarily mean changing your core and losing your relevance. In fact, as the push for financial inclusion continues to intensify, the role of rural banks today is even greater than it was then. You remain to be a key channel for delivering financial services to the countryside, especially the unserved and underserved markets. Embrace this mission and the role which you were given more than six decades ago and nurture it by evolving and adapting to the demands of the times.

Indeed, the RBAP's role as the unifying voice among rural banks makes you a key partner of the BSP in achieving development in the rural areas. For this reason, the BSP will continue to collaborate and partner with the RBAP to make sure that our

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<sup>15</sup> 34.5 percent using World Bank Global Findex Data.

reform initiatives will result to a robust and resilient rural banking sector and a strong economy that fosters inclusive growth.

Rest assured that we at the BSP will continue to create a conducive regulatory environment for digital innovation and financial inclusion to flourish while, at the same time, ensure the effective management of risks. This balanced approach is anchored on the core principles of risk-based, proportionate and fair regulation; active multi-stakeholder collaboration; and consumer protection and financial education.

Before I finally end my talk, I just want to pay homage to our former captain, the late Governor Nestor A. Espenilla, Jr. who was the foremost champion of financial inclusion. Looking at today's program, I could not help but get a bittersweet feeling upon seeing that RBAP will give him a Posthumous Award. I am also reminded of the words of Sir Isaac Newton, "If we have seen further it is by standing on the shoulders of a giant." Governor Espenilla will remain forever in our hearts!

I wish everyone a fruitful convention. Congratulations RBAP! Thank you and Mabuhay!