

DIGITALIZATION IN RURAL BANKS: THE BUSTLING ENGINE OF CHANGE¹

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Introduction

Rural Bankers Association of the Philippines (RBAP) President Mr. Roberto Abello; Manila Mayor Francisco “Isko Moreno” Domagoso; BSP Monetary Board Member Bruce Tolentino; officers and members of RBAP; esteemed colleagues from the banking industry; distinguished guests; ladies and gentlemen; good morning!

First of all, congratulations to the men and women of the Rural Bankers Association of the Philippines for successfully organizing this 62nd Charter Anniversary Symposium. It is a pleasure and privilege to be part of this event and again stand witness to another feather in the cap of this organization.

Through the years, the RBAP has successfully risen above the challenges in the industry and displayed faithfulness in its commitment to serve our communities. Indeed, your chosen theme this year, “Rural Banks: Reaching Communities Thru Digital Banking,” echoes your passion to serve and thrive in the digital era amid the daunting challenges ahead.

Shape of things to come

To give you an idea of the shape of the things to come, let me share with you the results of the First Semester 2019 Banking Sector Outlook Survey (BSOS). Based on the latest BSOS, 37.5 percent of respondents from domestic universal and commercial banks (U/KBs) that have plans to use technology expect that 21 percent to 40 percent of their transactions will be conducted through the use of digital channels in the next two years. In addition, 40.0 percent of respondents from foreign banks foresaw that more than 80 percent of their banking transactions will utilize digital means. Meanwhile, 41.7 percent of respondents from rural and cooperative banks (R/CBs) projected that 10 percent to 20 percent of the transaction will utilize the internet, mobile phones or other electronic platforms.² Certainly, competition is shifting into the digital arena fueled by technology.

¹ Keynote Speech delivered by Deputy Governor Chuchi G. Fonacier during the 62nd Charter Anniversary Symposium of the Rural Bankers Association of the Philippines (RBAP) held at the Manila Hotel, One Rizal Park, Manila on 6 November 2019.

² SPRD. “First Semester 2019 The Philippine Banking Sector Outlook Survey (BSOS)”

But rural banks are poised to optimize the benefit of digital technology because they are equipped with an in-depth knowledge of communities that they serve, familiar with the lay of the land, and supported by vast network of more than 3,000 banking offices nationwide.

Allow me then to highlight three realities that will guide the industry as it treads in this digital era. **First**, the industry is coming from a position of relative strength and stability to effectively compete in the digital space. **Second**, rural banks stand to benefit from embracing digital transformation. **Third**, technology is institution-agnostic. All institutions regardless of size may take advantage and exploit its potential

Let me briefly go over each of these factors.

First : A Sound and Stable Rural Banking Industry

Front and center is that the rural banking industry remains sound and stable. The total assets of the industry expanded year-on-year (YoY) by 8.5 percent to reach P258.2 billion as of end-June 2019.³ At the same time, capitalization moved up by 12.2 percent YoY while deposits increased by a robust 7.8 percent YoY. Ladies and gentlemen, you will agree that these are very good baseline figures.

Capital adequacy ratio (CAR), remains well-above the minimum BSP and international standards. In particular, the CAR of rural banks stood at 19.9 percent as of end-June 2019. In terms of profitability, industry figures were also much better. Annualized net income as of end-June 2019 reached P2.7 billion, far better than the reported figures in the same period a year ago.

But you might ask – why reinvent the wheel when the numbers clearly show that we are okay on the way we do things now? Let me quote Alvin Toffler, an American writer, futurist, and businessman to answer this question. He said that, “The illiterate of the 21st century will not be those who cannot read and write, but those who cannot learn, unlearn, and relearn.” Indeed, adaptability or the ability to manage and cope with change in response to an evolving market landscape or new financial circumstances is crucial to thrive in this environment.

On that note, let me talk about the second key factor, or the benefits of going digital.

Second: Benefits of going digital

- ***Improving Efficiency with Digitalization***

³ Figures inclusive of cooperative banks

Top of the list is that digitization will improve efficiency. Going digital will drive operational costs down. Many of the time-consuming manual processes and significant investments in upgrading hardware and software will be reduced. This will, in turn, prompt banks to rationalize the rates charged for financial products and services. By doing so, rural banks will become more competitive as you will be able to provide more affordable services.

- ***Providing Better Service by Filling the Digital Gaps***

Now that clients have more choices available to them, rural banks can differentiate themselves from their competitors by providing value adding services. SMS and mobile apps to manage the personal accounts of clients without having to visit the bank's branch are services that enhances customer experience. Ultimately, this will draw more clients to the bank, expand its reach, and allow it to effectively and efficiently compete with the big players.

Third : Technology is Institution-Agnostic

This brings me to the third reality, that is, technology is institution-agnostic. Technology is not monopolized by the bigger banks. Use of technology is not all about cost outlays, it is also about partnerships between and among rural banks and fintech players and strategic alliances across the industry even involving the larger banks. Colleagues, alliances between a bank and a fintech company, and between a universal bank and a rural bank are happening as we speak. These strategic alliances are taking bold steps to seize the vast opportunities that lay ahead.

BSP's Strategy on Digitalization / Fintech

Rest assured, that the BSP supports responsible fintech innovations. The BSP will continue to provide an environment that will enable the industry to reap the benefits of digitization. Our regulatory approach is shaped by three core principles, namely: (a) to ensure that regulation is risk-based, proportionate and fair; (b) to maintain active multi-stakeholder collaboration; and (c) to ensure consumer protection.

I would like to emphasize that the BSP believes that technology is a catalyst for more inclusive growth. This is the overarching principle driving our issuances promoting branchless or scaled down touch points.

In 2017, the BSP issued a pair of regulations: Circular 940⁴ on cash agent operations and Circular 987⁵ on the establishment of branch-lite units (BLUs). These policies were crafted with the goal of expanding the network of low-cost touch points to efficiently deliver financial products and services to the public. Cash agents and branch-lite units, with their high visibility and convenient setup and functions, allow small business owners and country folk to save on time, travel, and transaction costs. Currently, there are 1,874 BLUs and over 40,000 cash agents actively operating in the country.⁶

These were complemented by the issuance of pivotal policies for financial inclusion – Circular 992,⁷ which outlines the framework for Basic Deposit Accounts (BDA). By easing financial and documentary requirements, the BDA aims to encourage account ownership among the country’s unbanked and low-income population.

Ladies and gentlemen, I am very optimistic that we are so close to the realization of our shared vision. After 30 years in the making, the Philippine ID System Act (Republic Act No. 11055) was passed last year. And I am happy to share that on 7 October 2019, the BSP has already signed the memorandum of agreement (MOA) with the Philippine Statistics Authority (PSA) to implement the “Philippine Identification System (PhilSys) Act.

The law is beneficial for all Filipinos as it provides “a means of simplifying public and private transaction” through a reliable and nationally-accepted proof of identity, which is a key requirement in opening a bank account. It will be easier for unbanked Filipinos to open bank accounts and avail of financial products and services.

This initiative, together with the passage of the National Payment Systems Act (NPSA, RA 11127)⁸ that grants the BSP with regulatory oversight over the country’s payment systems, will significantly advance the digitalization of the banking system and the BSP’s financial inclusion agenda.

National Retail Payment System

The National Retail Payments System (NRPS)⁹ provides the gateway for more Filipinos to have access to a transaction account to send and receive payments via any electronic device. As of end-July 2019, there were 51 participating BSP Supervised

⁴ Circular No. 940 dated 20 January 2017 - Guidelines on Deposit and Cash Servicing Outside of Bank Premises

⁵ Circular No. 987 dated 28 December 2017 - Rationalization of Prudential Requirements on Banking Offices and Guidelines on the Establishment of Branch-lite Units

⁶ Source: Department of Supervisory Analytics (DSA)

⁷ Circular No. 992 dated 01 February 2018 - Framework for Basic Deposit Accounts

⁸ Republic Act No. 11127 signed 30 October 2018 – An Act Providing for the Regulation and Supervision of Payment Systems

⁹ Circular No. 980 dated 06 November 2017 - Adoption of National Retail Payment System (NRPS) Framework - provides the policy and regulatory framework for the conduct of electronic retail payments under NRPS in the country.

Financial Institutions (BSFIs) in the Philippine Electronic Funds Transfer System and Operations Network (PESONet) automated clearing house (ACH). Meanwhile, there were already 43 BSFIs participating in the InstaPay ACH, wherein 28 are sender/receiver and 15 are receiver only.¹⁰

The exponential growth in the value and volume of payment transactions under the NRPS are encouraging and inspiring as we all continue to work towards our goal of achieving Vision 20/20 or to increase the share of digital payment transactions to 20 percent by 2020. We will soon see the results of our efforts as we receive feedback from the recently concluded study of the Better than Cash Alliance on the use of digital payments in the country.

On a related note, I would like to share that in line with the thrust of ensuring the efficiency of payment systems, the BSP Monetary Board has recently approved a policy requiring the adoption of a National Quick Response (QR) Code Standard for payments. The QR technology has emerged as the most convenient and cost efficient means of moving funds from one account to another. A QR code contains most if not all of the critical information such as account name and account number which are required to be specified in a payment instruction. As such, the use of this code minimizes encoding errors.

The BSP is also working on ensuring that “bills and government payment service” forms part of the electronic payment and financial services offered by banks and non-bank electronic –money issuers (EMIs). With this e-service, consumers will be able to save much time and effort in settling their recurring and periodic bills, as well as payment to government, which includes fees for licenses and permits.

Further, to make it easier for BSFIs to get onboard the NRPS and harness the benefits of using digital platforms, the BSP issued Circular 1033¹¹ in February of this year. Circular 1033 streamlines the licensing requirements of our supervised financial institutions intending to offer electronic payment and financial services (EFPS).

Regulatory reform agenda

Alongside the rapid technological developments happening in the industry, the BSP is gearing up for a new phase of regulatory and supervisory reform. At this point, let me share the highlights of three of our key reform priorities.

The **first** pertains to the use of technology to streamline supervisory requirements. We will be digitizing the submission of reports such as the bio-data of

¹⁰ Source: Department of Supervisory Analytics (DSA)

¹¹ Circular No. 1033 dated 22 February 2019 - Amendments to Regulations on Electronic Banking Services and Other Electronic Operations

officers and members of the board of directors of banks, reports on crimes and losses, and the annual reports and audited financial statements. We are looking at issuing the submission guidelines for these reports before the end of the year. This initiative is part of our Suptech roadmap for report rationalization. The first phase of the report rationalization initiative involved the discontinuation of submission of 21 prudential reports as provided under Circular No. 1057

Second, we will be embedding sustainability principles in our regulatory framework and supervisory tools. This includes raising awareness on the impact of climate change on the bank as it affects your operations and your clients. We will look at the resilience of a bank in times of calamities and how it considers environment, social, and governance principles in its strategies and risk management systems.

Finally, we are currently implementing a parallel run of the new Supervisory Assessment Framework or SAFr, which will eventually replace the CAMELS rating system. SAFr will use a 4 point rating scale instead of 5. It features an assessment that is business model centric that will shape our supervisory intervention and influence the frequency of examination. We will discuss this further in our future meetings with the industry.

Concluding Thoughts

All said, the BSP remains strongly committed in pursuing our financial sector reform agenda through the adoption of proportionate banking regulations and supervisory framework that supports the development of an efficient digital financial ecosystem. We encourage rural banks to fully harness the opportunities from innovative digital technologies in order to maintain industry competitiveness and further expand customer reach to various segments of the economy, particularly the unserved or underserved areas in the country.

We count on our strong partnership with the RBAP towards our shared objective of achieving a sound, dynamic and inclusive banking system for all Filipinos.

And before I end this keynote, let me indulge and leave you with another quote from Alvin Toffler for you to ponder on. He said and I quote, "You've got to think about big things while you're doing small things, so that all the small things go in the right direction."

I wish RBAP more success in all its endeavors. Mabuhay po kayo!