PHILIPPINES

BANKING

SUMMARY

The Philippines has 54 commercial banks, including 14 foreign branches and four bank subsidiaries majority-owned by foreign banks. The top five banks control 35 percent of banking assets. The Philippines has not been spared from the financial crisis affecting most of Asia since July 1997. The peso depreciated 35 percent and interest rates rose, triggering sharp increases in non-performing loans and adversely affecting some of the smaller financial institutions in the country.

Bangko Sentral ng Pilipinas (BSP), the central bank, regulates banking. Overall, it has performed well in managing the economic turmoil stemming from the crisis: as of October 1998, liquidity had been restored to financial markets and the exchange rate, although fragile, had generally stabilized.

As of June 1998, foreign banks controlled about 16 percent (US$9.6 billion) of commercial bank assets, and U.S. banks alone accounted for 5.3 percent (US$3.2 billion). The 1948 prohibition on the entry of new foreign banks remained in effect until May 18, 1994, when a new banking act allowed up to 10 foreign banks to enter by establishing full service branches. Since all ten branch licenses have been issued, additional foreign banks are again restricted from establishing branches in the Philippines. Three U.S. banks have established full-service branches, but only Citibank, N.A., engages in retail banking. Foreign banks can also enter the Philippines by investing in or acquiring up to 60 percent in the voting stock of a *de novo* bank subsidiary or a locally incorporated bank. However, no U.S. bank has yet established such a presence.

Foreign banks operate under additional restrictions not applied to their domestic counterparts. Capital adequacy ratios and legal lending limits are based on the locally incorporated capital of the branch, and net-due-to-head-office borrowings need to be fully converted to pesos to qualify as capital for certain regulatory requirements. These restrictions mitigate much of the benefit in establishing branches. There are also limits on branching, automatic teller machines, remittances of profits, and ownership of land and buildings. Another important limitation in the 1994 legislation is a requirement that Filipino-controlled banks control at least 70 percent of banking system assets.

DESCRIPTION OF THE MARKET

Structure of the Market

The Philippine banking system includes commercial banks, thrifts, and rural banks. As of June 1998, the Philippines had 1,011 banking institutions of all types, with 6,472 branches or offices. Many of these are small, undercapitalized, family-owned institutions, never considered strong, which

have now been weakened further by a surge in non-performing loans stemming from a depreciated peso, poor liquidity, and/or a weak economy, and increased capitalization requirements.

Commercial banks dominate the banking industry and account for over 90 percent of banking system assets. From 1993 to 1997, the commercial banking system has grown rapidly, with assets, deposits, and loans all increasing over 25 percent yearly. There are currently 54 commercial banks operating in the Philippines, compared to 33 in 1993, with total assets of 2.5 trillion pesos (US$59 billion) as of June 1998. Most of the 36 Filipino-controlled commercial banks, or their holding companies, are listed on the Philippine Stock Exchange.

Foreign- and Filipino-owned commercial banks and branches can obtain either a regular commercial bank license or an expanded commercial bank license. The expanded commercial bank license allows foreign banks to become universal banks and engage in a variety of other financial activities, including securities underwriting. In order to obtain an expanded license, the institutions must meet higher capital requirements.

The Philippine government maintains three wholly-owned banks which specialize in agricultural lending, development finance, and loans to small and medium enterprises.

Foreign Banks

Commercial banks in the Philippines include 14 branches of foreign banks and four banking subsidiaries which are majority-owned by foreign banks, with assets totaling 403 billion pesos (US$9.6 billion). A 1994 law allowed the entry of foreign banks into the Philippines for the first time since 1948. In 1995 and 1996, ten new branch licenses were granted to foreign banks (one U.S.), joining four existing foreign branches (two U.S.) whose presence predated the 1948 law. Four new bank subsidiaries which are majority-owned by foreign banks were also established. There are also 29 representative offices (5 U.S.) and 16 offshore banking units (5 U.S.) in the Philippines. ING Bank (Netherlands) is the only foreign institution with an expanded commercial bank license. Several Philippine commercial banks have branches and remittance offices in the United States, specializing in providing banking services to Filipino workers sending remittances back home; only one provides full banking services.

Condition of the Industry

The Asian financial crisis has negatively affected banks in the Philippines. Thinner interest spreads due to heightened competition received a setback when the crisis pushed the peso to historic lows in January 1998. Prime bank lending rates, which had dropped to 11-12 percent, rebounded as high as 17 percent in reaction to increased reserve requirements, tighter liquidity, and soaring overnight interest rates. Ordinary business rates were generally much higher.

The level of non-performing loans (NPLs) in the commercial banking sector climbed from less than 3 percent at the end of 1996 to 4.7 percent at the end of 1997. Partly due to a stricter definition of past-due loans, the NPL ratio rose to 9.6 percent in May 1998. The Bankers Association of the Philippines forecasts that NPLs will probably reach 12 to 13 percent of outstanding loans by the end of 1998, a level considered manageable, before the trend reverses. On a brighter note, however, interest rates began to decrease in April 1998, as liquidity eased and the Central Bank reduced reserve requirements.

Thus far, the regional crisis has forced the BSP to place under receivership one small commercial bank due to its nonperforming loan portfolio. The country's smaller institutions, however, have been more affected. So far, six thrifts and 14 rural banks have been closed. These institutions, however, account for only a very small portion of the system's total assets.

Capital Requirements

The Philippines has not yet adopted BIS standards. The Central Bank is seeking legislative authority to adopt the international capital standards in revisions to the General Banking Law, which were recently submitted to Congress. However, Philippine banks are required to maintain a minimum capital to risk assets ratio of 10 percent. This ratio differs from the BIS standards in that it only recognizes Tier 1 capital, assets are only assigned either a zero percent or 100 percent risk weighting, and off-balance sheet items are not included.

Minimum capital requirements are being raised in stages for existing banks. They are now 3.5 billion pesos for an expanded commercial bank and 1.625 billion pesos for a regular commercial bank. The minimum capital required for an expanded commercial bank will rise to 4.5 billion pesos at the end of 1998, 4.95 billion pesos at the end of 1999, and 5.4 billion pesos at the end of 2000. For a regular commercial bank, the minimum requirements are 2.0 billion pesos at the end of 1998, 2.4 billion pesos at the end of 1999, and 2.8 billion pesos at the end of 2000. Capital requirements are 5.4 billion pesos for new expanded commercial banks and 2.8 billion pesos for new regular commercial banks.

Regulatory Structure

Bangko Sentral ng Pilipinas (BSP) is the central monetary authority mandated to provide policy direction in the areas of money, banking, and credit. It also has supervisory authority over the operations of banks. The BSP has complete fiscal and administrative autonomy. A Governor, appointed by the President, administers the BSP and chairs the Monetary Board, which establishes policy. The Bankers Association of the Philippines is the commercial banks' lobby. In coordination with the BSP, it commits members to regulatory-like policies.

The Philippine Deposit Insurance Corporation, patterned after the Federal Deposit Insurance Corporation, was established to provide protection for depositors. It is also the designated receiver for troubled banks. The PDIC insures peso deposits up to 100,000 pesos (US$2500) at all banks, whether foreign- or Philippine-owned. It does not insure dollar deposits at offshore banking units.

The Philippines has a very strict bank secrecy law that shields account information, even from the government. An effort to eliminate bank secrecy as part of a 1998 tax reform bill failed. The World Bank had made lifting bank secrecy a condition for a Banking Sector Reform Loan, but appears to be settling for less than full compliance. The government is considering lifting bank secrecy for DOSRI (directors, officers, shareholders, and related interests). The Philippines has no law on money laundering.

President Estrada has promised to implement additional financial sector reforms, including further hikes in minimum capitalization requirements to foster mergers and consolidation, reductions in reserve requirement, stronger prudential standards, and substantive changes to the country's General Banking Act. Liberalizing restrictions on foreign bank entry, ownership, and branch establishment are possible areas for improvement. Legislation would be required, however, to raise ownership limits.

U.S. PRESENCE IN THE MARKET

As of June 30, 1998, foreign-controlled banks accounted for 16 percent of commercial bank assets, including 5.3 percent held by U.S. banks as of end-June 1998. As of year-end 1993, foreign banks accounted for 8 percent of assets, with U.S. banks holding 6 percent.

Three U.S. banks, Citibank, Bank of America, and Chemical Bank (now Chase), have established branches in the Philippines. Only Citibank, which was established in the Philippines in 1902, engages in retail banking. Five other U.S. banks maintain representative offices in Manila to facilitate investment and trade financing, but do not engage in commercial banking. Five U.S. banks also operate offshore banking units, and are only authorized to conduct non-peso-banking operations.

Citibank is the largest foreign bank and the seventh largest commercial bank in the Philippines; it has one direct branch with four [sub] branches. The bank believes it has found a particular niche in foreign exchange trading and derivatives. Bank of America and Chase each have one direct branch. Although licensed as full service branches, they currently offer only wholesale banking products. Bank of America had long conducted retail banking through BA Savings Bank, a thrift in which it held a minority interest, but it recently sold its stake to its Philippine partners.

TREATMENT OF U.S. FINANCIAL INSTITUTIONS

Foreign Branches

Before May 18, 1994, when President Ramos signed Republic Act 7721 (An Act Liberalizing the Entry and Scope of Operations of Foreign Banks), the entry and licensing of new, wholly foreign-owned banks was prohibited under the 1948 General Banking Act. The 1994 Act opened a five-year window permitting up to ten new foreign banks to enter the market as full-service branches (retail and wholesale banking). Two U.S. banks (Citibank and Bank of America) operate branches under pre-1948 licenses. All ten foreign branch licenses have already been issued; therefore, additional foreign banks are, in effect, restricted from entering the Philippine banking market in branch form. There are no plans to increase the number of foreign branch licenses, which would require legislation. However, Development Bank of Singapore and a Philippine commercial bank (Bank of Southeast Asia) opted to consolidate and started operating as DBS Bank Philippines, Inc., on September 1, 1998. This has made available one slot for the entry of one more foreign bank via the branching mode to complete the 10 branches allowed by law. A foreign bank cannot have both a subsidiary bank and a branch license.

Under a 1996 banking circular, commercial banks with the equivalent of the prescribed minimum capital can obtain an expanded commercial bank (universal bank) license. However, U.S. banks indicate that the central bank will not allow them to apply for an expanded commercial bank license as a branch because of Glass-Steagall restrictions.

The 1994 banking law also places restrictions on the number and location of branches established by foreign banks. Each foreign bank is permitted to open a total of six offices, but three are required to have BSP Monetary Board approval with regard to location. The four existing foreign branches are also permitted to establish six new sub-branches, in addition to those grandfathered when restrictions were imposed in 1948. Automated Teller Machines (ATMs) are of limited value in bypassing branching restrictions. Current regulations limit the use of off-site ATMs (those not located in a branch) to dispensing cash and handling credit card and utility payments. Foreign banks are, however, able to participate in shared ATM networks on an equal basis with Philippine banks.

Foreign branches must assign 210 million pesos (US$5 million) in capital for the first three branches; additional branches require 35 million pesos (US$875,000) per branch. American bankers do not, however, consider these requirements onerous. For regulatory capital purposes, Net-Due-to-Head-Office (NDTHO) borrowings are limited to a maximum of four times the permanently assigned branch capital. The branches of foreign banks must also remit and convert at least 15 percent of their NDTHO accounts into pesos with adjustments allowed for significant involvement in certain activities, e.g., exports. For computing the limits on foreign exchange holdings, the BSP requires that NDTHO borrowings be 100 percent converted to pesos.

Capital adequacy ratios and single borrower/sector lending limits for foreign branches are based on local capital instead of consolidated global capital, to a large degree eliminating the benefit in establishing branches.

Banks are required by law to lend 25 percent of their loanable funds for agriculture/agribusiness purposes and 10 percent to small and medium enterprises (SMEs). These requirements apply to all banks, but foreign banks are disadvantaged in meeting the requirement by their inability to freely expand their branch networks.

Subsidiary Banks

The 1994 law permits foreign banks to enter the Philippine banking market by investing in up to 60 percent of the voting stock of a *de novo* banking subsidiary or a new bank or by acquiring up to 60 percent of the voting stock of an existing locally-incorporated bank. Regulators have stated that they are studying the possibility of allowing up to 100 percent ownership in the case of distressed banks as part of the measures in response to the Asian Crisis. Prior to liberalization, foreign banks were restricted to 30 percent of total voting shares of a domestic commercial bank, with an additional 10 percent subject to the approval of the President of the Philippines. A foreign bank acquiring control of an existing bank or establishing a new banking subsidiary must list 10 percent of the shares on the local exchange. Philippine law prohibits foreign-owned banks and branches from collectively controlling more than 30 percent of the banking system's assets.

A foreign bank seeking to enter the Philippine banking market in *de novo* form has to be widely owned and publicly listed unless more than 50 percent of its equity is held by its home government. The bank is considered widely owned if there are at least 50 shareholders, with no individual owning more than 15 percent of the bank's stock. In addition, a bank had to be among the top 150 banks worldwide (by net worth) or among the top five banks in its home country. These were the criteria by which the ten branch licenses were awarded to the leading banks from the Philippines' main trading partners and neighbors. One U.S. bank (Chemical, now Chase) received a new license to establish a branch. So far, no U.S. bank has been interested in acquiring control of an existing Philippine bank or establishing a new bank subsidiary.

Restrictions

All three U.S. banks and most foreign commercial banks operating in the Philippines are enjoined from making direct, local-profit remittances to their head offices more than once a year. One U.S. bank has been unable to make direct remittances since 1989 under a BSP regulation prohibiting remittances by a foreign bank engaged in litigation with the Philippine Deposit Insurance Corporation (PDIC) or with outstanding PDIC assessments. At issue is the PDIC determination that head office borrowings are equivalent to deposits and that local foreign-owned branches should pay PDIC premiums on such borrowings. The banks contend such transactions are borrowing and not

subject to PDIC premiums. The Supreme Court ruled in Citibank's favor in August 1998, but the government has the right to seek reconsideration by the full court.

Constitutionally-mandated restrictions which affect all foreigners, including banks, prohibit direct ownership of land and buildings by foreigners, although they may acquire up to 40 percent ownership in condominium projects. Other laws limit ownership in financial institutions and prohibit ownership in certain industries, such as mass media and retail trade.

In its schedule of commitments under GATS, the Philippines bound foreign ownership levels that were generally below those allowed under current laws. In banking, the bound limit is 51 percent. Although the GATS commitments were disappointing, the new administration has publicly floated the idea of allowing 100 percent foreign ownership of troubled banks. This, however, would require legislative action.

U.S. and other foreign financial service providers operating in the Philippines participate fully in the processes leading to changes in laws and regulations pertaining to such services. Their opinions are solicited, and on some occasions they have been asked to testify before the Philippine Congress. U.S. bankers were consulted in the shaping of the 1994 liberalization law.

Assets and Liabilities of the Philippine Financial System
Year-end 1993 and Year-end 1997
(US$ millions)

	December 31, 1993			December 31, 1997		
	Assets	Liabilities	Net Worth	Assets	Liabilities	Net Worth
Total Financial System	47,310	40,560	6,750	75,762	65,318	10,444
Banking System	42,339	37,431	4,908	70,446	62,163	8,283
Commercial Banks	*38,329*	*33,939*	*4,390*	*63,944*	*56,726*	*7,218*
Thrift Banks	*3,086*	*2,730*	*356*	*5,084*	*4,235*	*849*
Rural Banks	*924*	*762*	*162*	*1,417*	*1,201*	*215*
Nonbanks	4,971	3,129	1,842	5,316	3,155	2,161

Peso values converted to US$ at exchange rates of 23.978 P/US$ (12/31/93) and 40.116 P/US$ (12/31/97).
Source: Bangko Sentral ng Pilipinas

Distribution of Assets Held by Commercial Banks
Percentage of the Total
Year-end 1993 and Year-end 1997

	December 31, 1993	December 31, 1997
100% Filipino-Owned Banks	67.8%	55.0%
Majority Filipino-Owned Banks	23.9%	30.2%
Majority Foreign-Owned Banks	n/a	1.1%
Foreign Branch Banks	8.3%	13.6%
of which: U.S. Branch Banks	*6.0%*	*6.9%*

n/a - no majority foreign-owned banks existed in 1993
Source: Bangko Sentral ng Pilipinas