Proportionality in Practice: Bangko Sentral ng Pilipinas Experience

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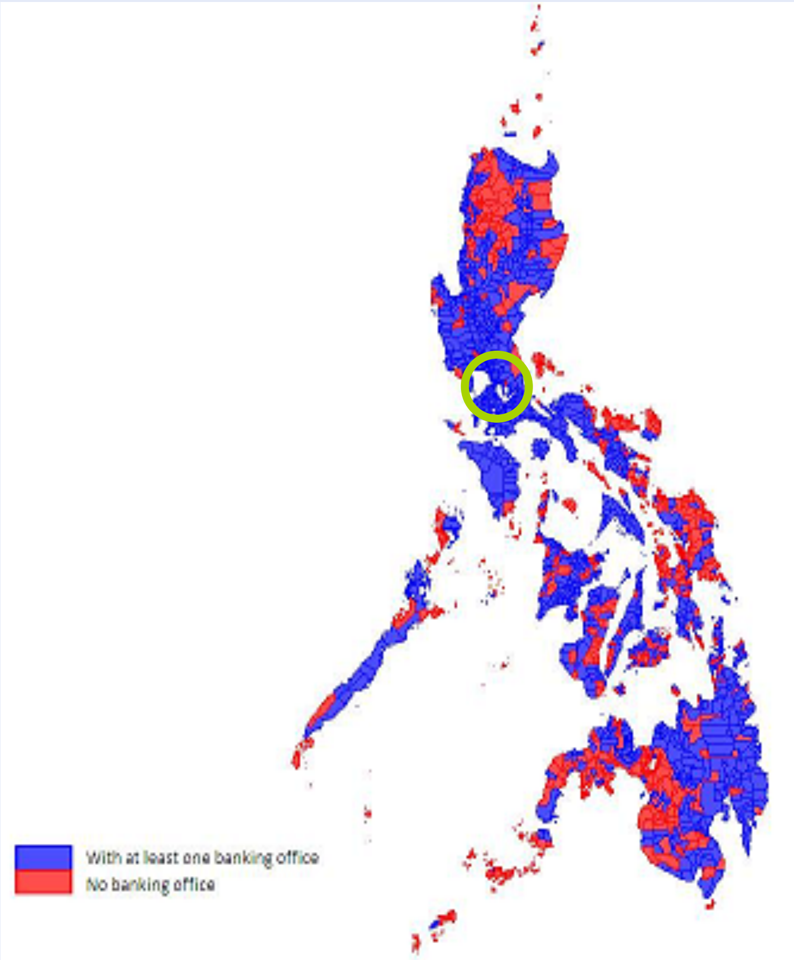
BANGKO SENTRAL NG PILIPINAS

Presentation Outline

- Country Context – Access to Finance Scenario
- Guiding Principles
- Illustrative Cases
  - Expansion of Physical Reach of Banks: Micro-banking offices and Recognizing Appropriately Designed Products
  - **Expansion of Virtual Reach of Financial Services: Framework for E-money and Liberalized Customer On-boarding**
- Other Emerging Issues

Country Context: Access to Finance Scenario



- 609 out of 1634 (37%) municipalities have no banking office (end-December 2011)
- Concentration of banking services are in the high income and urbanized areas
- Only 2 out of 10 households have a deposit account
- Archipelagic barriers pose a large access to finance challenge

- Improving financial quotient
- Increased innovation by market players

Guiding Principles

- Financial inclusion is a worthy policy objective and something that should be pursued alongside the promotion of stability and efficiency in the financial system.
- Financial inclusion and financial stability are mutually reinforcing.
- Financial stability and financial inclusion are not inevitable. Both demand at least the same measure of energy, imagination and serious attention from policy makers.
- Good data should be developed to properly inform policies and determine progress

Guiding Principles

- In addressing financial access issues, market based solutions are feasible and should be encouraged. It is necessary to establish a supportive regulatory environment for the said market based solutions to work.
- These solutions, of course, present real and valid risks but they can be properly managed.
- To fully understand the business models and attendant risks, where they lie and how best they can be managed, a flexible test and learn approach is necessary.
- All financial service providers should be properly and proportionately regulated to uphold consumer protection and financial system integrity.

Policy, Regulation and Supervision Initiatives

Wider Range of Products

- Micro-deposits
- Microinsurance
- Micro-agri Loans
- Microfinance **+** for emerging SMES
- Housing Microfinance

Expanded Physical Network

- Opening of Micro-banking Offices (MBOs)

Expanded Virtual Reach

- E-money Regulatory Framework (bank and non bank)
- E-money Issuers
- E-money Network Service Providers

Lower Barriers to Customer Acquisition

- Updated Anti-Money Laundering Rules

Appropriately Designed Products

- Wide range of products (Circular 694)
  - Microfinance Loans
    - Microenterprise Loans
    - Housing Microfinance Loans
    - Micro-Agri Loans
    - Microfinance Plus
  - Microfinance Savings Deposit Account
  - Microinsurance

Sample Approach to Microfinance

Definition of Microfinance	Clearly define microfinance as a provision of a range of financial services to low income clients/ entrepreneurial poor – credit, savings, insurance, fund transfers. Microfinance loans have specific characteristics (i.e. cash flow based, frequent amortization, etc.)
Capital Requirements/ Adequacy, Licensing Requirements	Banks comply with same standards and requirements for capital adequacy and licensing
Credit Risk	Require banks to have clear underwriting standards and practices for cash-flow based lending.
Risk Management / Problem Assets/ Provisioning	Require high frequency monitoring of portfolio-at risk and corresponding provisioning requirements reflecting peculiar risks of microfinance.
Governance	Specify necessary experience and track record in microfinance in the board and management. Impose clear and comprehensive governance standards.
Supervisory Approach	Create a MicroSME Finance Specialist Group Develop Manual of Examination Procedures

Point of Balance – Proportionality Principles

- Each product feature has embedded risk management principles
- Internal controls are considered
- Reporting is required

- 185 community based banks providing microfinance reaching over a million clients
- Significant take up for the other products (i.e. microinsurance, etc.)

Expanded Physical Network

- Establishment of Micro-banking Offices (MBOs) (Circular 694) or “scaled down branches”
  - Addresses obstacles in establishing bank office
  - Relatively low cost (less infrastructure requirement, no theoretical capital assigned, etc.)
  - Can be viable in light of complete range of product offerings

Point of Balance – Application of Proportionality

- Bank capacity needs to be demonstrated
- Adequate business plan and strategy is required
- Bank will determine what products and services they will offer and required measures will be commensurate to the risks
- Reconciliation with a branch at the end of the day
- Daily cash limit is instituted

- **459 MBOs approved as of August 2012**
- **Over 100 MBOs in the pipleline**
- **Over 60 municipalities are served by MBOs alone**

Expanding Virtual Reach through Electronic Money

- BSP's initial approach to market based products was to proceed with flexibility yet with caution
- Fully understand operating/ business models and identify all risks and necessary risk management
- Closely monitor development and related issues that may arise
- Use existing regulations as necessary and eventually adopt a regulatory approach based on the experience/ lessons learned
- Established a clear delineation between deposit-taking transactions and receipt of funds for fund transfer purposes and consequently regulated proportionately

Expanded Virtual Reach

- Electronic Money Regulatory Framework – E-Money and E-money Issuers (Circular 649) and Electronic Money Network Service Providers (Circular 704)
  - Defines electronic money
  - Allows the establishment of e-money issuers (whether bank or non-bank)
  - Provides the platform for an efficient retail payments platform
  - Fosters the establishment of a ubiquitous agent network
  - Allow the linkage of banks with e-money issuers

Sample Approach to E-money

	CHANGING RISKS	POTENTIAL BENEFITS	BSP APPROACH
CUSTOMER/ USER	• Limited information or misinformation •Lack of trust and capacity •Different customer experiences	• Potential of reaching the currently unserved	•Require consumer protection in the e-money regulations •Financial Education
ISSUER	•Entrants of new players, non-traditional providers (i.e. telcos)	• Greater innovation •Wider reach •Higher efficiency	• Creation of a regulatory framework •Proportionate requirements for non bank providers (i.e. risk management, capital, liquidity, etc.) •Ringfencing e-money operations •Transaction limits •Clear delineation between e-money and deposits
AGENTS	• AML issues •Agent Fraud •Business case challenges	• Wider reach •Serving unserved areas •Broader ecosystem	• Regulation through the entity maintaining the agent networks

Point of Balance – Proportionality Principles

- E-money clearly distinct from deposits
- For non bank e-money issuers, there are requirements for capital, liquidity management, governance structure, technology risk management, consumer protection, etc.
- Transaction limits are instituted
- EMIs are responsible for the behavior of agent networks (which can be subject to spot checking)

Lower Barriers to Customer Acquisition

- Circular 706, Updated Anti-Money Laundering Rules and Regulations
  - Provides scope for banks to have a risk-based and tiered system of classifying customers
  - Establishes a framework for applying reduced, average and enhanced due diligence based on the type of customer as well as for customer acceptance, retention and identification process and record keeping
  - Allows outsourcing or reliance on third party for face to face/KYC
  - Liberalized list of acceptable IDs

Point of Balance – Proportionality Principles

- Ensuring that banks have a risk assessment framework
- Simplified KYC only for those that have been identified as low risk clients
- Outsourcing and reliance on third party are to institutions that are still duly authorized
- Awareness of possible risks

Strengthening of Internal Capacity and Inter-regulator Coordination

- Creation of high-level Inclusive Finance Steering Committee
- Four working groups
- Creation of Inclusive Finance Advocacy Staff, Specialist Examination Groups (Micro, SME and Core IT)
- Identification of cross-cutting issues for inter-regulator coordination

THANK YOU.

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