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PDIC

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Integrated financial supervision: Does it answer the need for reforms?

The Cover

Signifying unity and kinship, the ***bundle*** *represents the convergence of the roles of financial supervisors and their common interests in enhancing governance among financial institutions and promoting stability in the system amid product innovation and growing competition.*

Publisher's Note

RICARDO M. TAN
President & Chief Executive Officer
Philippine Deposit Insurance Corporation

I am honored to present the June 2004 issue of the ***PDIC Forum*** *which discusses the emerging concept of integrated financial supervision and encapsulates deposit data/statistics of the Philippine banking system.*

For this issue, the Managing Director of the Financial Services Authority (FSA) of the United Kingdom (UK), Michael Foot, was interviewed electronically for Straight Talk on his views on integrated financial supervision. Dr. Melanie Milo, Research Fellow from Philippine Institute for Development Studies, provided a digest of her extensive discussion paper on integrated supervision that is now a veritable reference material locally on global financial integration. Chairman Lilia Bautista of the Securities and Exchange Commission presented the local perspective on the Philippine financial system's bid towards consolidated supervision. A reprint of the paper presented by Wonkeun Yang, Sun Eae Chun and Zhigang Xie on "The role of KDIC in the Korean financial restructuring process" graced the pages of the DI World. Articles by PDIC on "Strengthening deposit insurance system through effective bank supervision" and "Analysis of domestic deposits" were highlighted in PDIC Front.

The ***PDIC Forum*** *represents PDIC's contribution in providing an avenue for critical and analytical discussions of topics that seek to strengthen depositor confidence and promote stability of the financial system.*

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Integration of Financial Supervision: The global experience

by Melanie Milo, Ph.D., *Philippine Institute for Development Studies (PIDS)*

Identifying the appropriate level and form of intervention is a serious challenge to government. Regulatory efficiency factors in overall economic performance. Inefficiency results in costs to the community through higher taxes and charges, poor service, uncompetitive pricing, or slower economic growth. In order to control costs and ensure effectiveness, regulation has to be placed within a consistent framework. To do this, it is necessary to establish clearly what needs to be regulated and why, as well as to define the principles for effective and efficient regulation (Wallis *et al* 1997). A corollary to this would be the identification of the appropriate regulatory structure. This is especially true in the financial sector.

Financial systems in both developed and developing countries have typically been subject to substantial public regulation. The basic rationale for this is that both the payments system, and public confidence in financial institutions and instruments on which the financial system is built, bear the qualities of a public good. Hence, the need for some government intervention to achieve market enhancing outcomes (Grimes 1999). But the system of supervision and regulation must be constantly assessed and adjusted to keep pace with a rapidly-changing financial services industry. And in many countries in recent years, including the crisis economies in Asia, that meant moving towards integrated or consolidated financial sector regulation/supervision[1].

This article gives an overview of the consolidated financial sector regulatory approach and discusses some of the policy issues relating to restructuring financial section regulation and supervision.

Consolidated or unified financial sector regulation[2]

A country's financial regulatory structure includes the various agencies in charge of regulating its financial sector and how they are organized. Technically, there are two main types of regulatory structure – according to institutional groups and according to regulatory functions (Carmichael 2002). Under the former, regulatory agencies are in charge of specific categories of financial sector institutions. Under the latter, regulatory agencies are organized according to regulatory functions; that is, according to the underlying functions of regulation in terms of addressing the different sources of

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* *The views expressed here are those of the author and do not represent those of the Philippine Institute for Development Studies or the Philippine Deposit Insurance Corporation.*

[1] *In its strictest sense, banking regulation refers to the framework of laws and rules that govern banks' operations, while banking supervision refers to the monitoring of banks' financial conditions and the enforcement of banking regulation (Spong 1994). This paper follows the practice of viewing regulation and supervision in a more general sense, and uses the terms interchangeably. It should also be noted that both the old General Banking Act of 1948 and the new General Banking Law of 2000 defined supervision as including regulation.*

[2] *This section draws on Milo (2002), which contains an extensive discussion of the approach as well as the issues.*

Table 1. **Sources of market failure and their regulatory implications**

Market Failure	Regulation	Regulatory Institution
Anti-competitive behavior	Merger, antitrust rules, free entry and exit to markets	Consumer protection or conduct of business agencies. In some cases, these are part of other supervisory authorities.
Market misconduct	Information disclosure, business conduct, licensing, governance and fiduciary responsibilities, financial strength	Banking Supervision Authority, Securities Commission, Insurance Regulatory Authority. Could all be under one integrated authority
Asymmetric Information	Prudential regulation: entry requirements, capital requirements, balance sheets restrictions, liquidity requirements, customer support schemes (e.g., deposit insurance)	Banking Supervision Authority, Securities Commission, Insurance Regulatory Authority. Could all be under one authority.
Systemic Instability	Maintenance of suitable macroeconomic environment, lender of last resort facility, direct regulation of the payments system	Ministry of Finance, Central Bank, Banking Supervision Authority (in many cases part of the Central Bank) and Deposit Insurance Agency. In the case of an independent Banking Supervision Authority, these functions are separated.

Source: *Dammert (2000).*

market failure. Table 1 presents the four main sources of market failure in the financial sector – anti-competitive behavior, market misconduct, asymmetric information and systemic instability – as well as the corresponding regulations needed to address them and the regulatory institutions capable of implementing them.

Under a pure institutional type of regulatory structure, a regulator responsible for correcting all four sources of market failure is assigned to each institutional group, which is usually defined by the three traditional financial services sectors – banking, insurance and securities. And under a pure functional type, a separate regulator is responsible for correcting each of the four sources of market failure but for all institutions that experience that particular failure. In practice, regulatory structures around the world typically involve a combination of these two types (Carmichael 2002). In most developing countries, for instance, the central bank takes on the various regulatory functions for the banking sector, while separate agencies do the same for the insurance and securities sectors.

Recently, significant attention has been focused on the structural aspects of financial regulation, particularly the desirability of a unified regulatory agency – that is, an agency that supervises two or more of the traditional financial services sectors. A number of countries have adopted this structure in recent years. In particular, there has been a growing trend worldwide towards restructuring regulatory agencies along functional lines, particularly with respect to prudential regulation. The primary reason has been the trend towards financial services integration, particularly the rise of financial conglomerates such as universal banks.

Financial services integration or financial convergence refers to the production or distribution of a financial service traditionally associated with one of the three major financial sectors by service providers from another sector. Forms of integration include *bancassurance*, universal banking and financial conglomerates. Financial services integration also occurs through the blurring of product lines because of innovation, which in turn has been facilitated by financial deregulation policies and significant advances in information technology and telecommunications (Skipper 2000).

Financial services integration, especially the formation of conglomerates, has challenged the traditional demarcations between financial regulatory agencies and has made industry-specific supervision inadequate. Thus, it is now generally accepted by banking regulators that banking groups or financial conglomerates need to be supervised on both a solo and consolidated basis to take into

account supervisory concerns that may be overlooked at the entity level (Palmer 2002). In fact, consolidated supervision of banking groups is one of the "Core Principles for Effective Bank Supervision" identified by the Basle Committee on Banking Supervision (BCBS 1997).

But it should be noted that there are preconditions for the effective implementation of consolidated supervision of banking groups, which include the legal framework, independence of the supervisory agency and commitment to the process. The components of consolidated supervision are consolidation of accounts, quantitative consolidated supervision (includes prudential requirements such as capital adequacy, large exposures and connected lending) and qualitative consolidated supervision (includes management and organizational structure, group-wide business plans and strategies and consolidated internal controls and risk management) (MacDonald 1998). Thus, it requires a high degree of coordination, cooperation and harmonization, which is very difficult to achieve because of significant differences in the three major financial industries' regulatory frameworks. Both regulatory gaps and/or duplication of regulatory effort are also very likely under this setup. A related supervisory challenge of financial convergence, then, is the need to move to functional rather than industry-specific supervision.

Prudential and market conduct concerns that result from financial services integration include transparency, contagion, regulatory arbitrage, conflicts of interest, double and multiple gearing; fit and proper requirements; and unregulated group entities (Skipper 2000). Countries are therefore seeking more effective ways to supervise financial conglomerates. On the other hand, smaller countries are seeking ways to achieve economies of scale in regulation through better management of regulatory resources (particularly personnel) and infrastructure support (Mwenda and Fleming 2001). Hence, the growing trend and interest in the unified or integrated financial sector regulation/supervision approach both in developed and developing countries.

"Simply changing the structure of regulation cannot guarantee effective supervision, and integrated regulation per se is not a solution to regulatory failure."

Carmichael (2002) discussed the experience of nine countries with integrated regulators - Australia, Canada, Denmark, Japan, Korea, Norway, Singapore, Sweden, and the United Kingdom – that compose an informal grouping called the Integrated Regulators Group[3]. The criterion that was used as a basis for membership when the group was created in 1999 was that the agency be at least responsible for prudential regulation of both banks and insurance companies. While most group members have a wider range of responsibilities than this, the combination of responsibilities for banking and insurance regulation was taken as a working definition of 'integrated regulation'. In particular, Carmichael (2002) noted the one area in which there was a high degree of consensus was in terms of the motivation for establishing the integrated agency, namely: (i) convergence in financial markets and the need for a more consistent approach to regulating financial conglomerates; (ii) the need for greater consistency in the application of policy across different industries; and (iii) the ability to make more efficient use of scarce regulatory resources.

On the other hand, there is a broad range of responsibilities, powers, and organizational and operational structures among the members of the Integrated Regulators Group. What they do have in common is that all major forms of prudential regulation have been brought together under one roof. Some integrated agencies also included part or all of market conduct regulation. Only the Monetary Authority of Singapore combined these two regulatory functions with systemic stability regulation through oversight of the payments system and monetary policy. Finally, competition policy was not incorporated in any of the integrated agencies. Thus, majority of the integrated regulators can be considered as differing versions of the functional approach to regulation because they assign one regulator to each source of market failure, at least in principle. The main variation is that some go beyond the pure functional model by combining two or more of these functional regulators into the integrated agency.

The most extreme case of regulatory approach would be the single regulator supervisory model, wherein there is only one control authority, separated from the central bank, with responsibility over all financial markets and intermediaries, and concerned with all the objectives of regulation. It is interesting to note that this model characterized the early stages of financial system development when

[3] *Iceland joined the group in 2000.*

the central bank was the only regulatory body (Di Giorgio and Di Noia 2001). This explains why the integrated model is being adopted, for instance, by a number of transition economies in Eastern Europe.

More recently, de Luna Martínez and Rose (2003) also conducted a survey of 15 developed and developing countries that have adopted integrated financial supervision, whether partial or full. Their survey included the developed countries covered by Carmichael (2002), except Japan, plus Estonia, Hungary, Iceland, Latvia, Luxembourg, Malta and Mexico. As in the previous survey, the need for more effective and consistent supervision of financial conglomerates and the need to maximize economies of scale and scope were the primary reasons for such a move. The latter rationale was especially true for the small economies included in the survey such as Estonia, Iceland, Latvia, and Malta. The decision to adopt integrated supervision was also made following a major financial crisis in three countries – Mexico, South Korea and Sweden. The latter was also an attempt to minimize gaps in financial regulation and supervision.

The survey also showed that there are important differences with regard to scope of regulatory and supervisory powers, although they all reported that they had power over core supervisory functions such as the conduct of on-site and off-site examinations and the imposition of fines and penalties for non-compliance with existing laws and regulations. In terms of regulatory powers, 12 agencies reported that they can set prudential rules on credit, market and liquidity risks, while 11 had the power to set accounting and disclosure rules. The survey also showed that ministries of finance and central banks continued to play a key role in establishing prudential regulations, including those on entry requirements.

Finally, de Luna Martínez and Rose (2003) reported the various obstacles that the 15 countries faced in the adoption of an integrated supervisory system. These included legal constraints and the need to enact new laws; staffing problems such as the demoralization of staff and the departure of experienced personnel; problems and delays in the integration of IT and other infrastructure systems; lack of mission and clarity during the early years of existence; and budgetary problems.

At least 46 countries had adopted unified or integrated supervision by 2002, with around half creating a single regulator for the entire financial sector and the other half merging two of the main supervisory authorities (Table 2). The number of countries with single supervisors significantly increased from 1996. The additions to this group of countries are Australia, Estonia, Germany, Iceland, Ireland, Japan, Korea, Malta and the UK. More countries are also in the process of either adopting or considering moving towards partial/full unified financial services supervision.

Table 2. **Countries with a single supervisor, semi-integrated supervisory agencies and multiple supervisors in 2002**[a]

Single supervisor for the financial system		Agency supervises 2 types of fin'l intermediaries: Banks & securities firms	Banks & insurers	Securities firms & insurers	Multiple supervisors (at least 1 each for banks, securities firms and insurers)	
1. Austria	12. Japan	23. Dominican Republic	29. Australia	40. Bolivia	47. Argentina	62. Italy
2. Bahrain	13. Latvia	24. Finland	30. Belgium	41. Chile	48. Bahamas	63. Jordan
3. Bermuda	14. Maldives	25. Luxembourg	31. Canada	42. Egypt	49. Barbados	64. Lithuania
4. Cayman Islands	15. Malta	26. Mexico[b]	32. Colombia	43. Mauritius	50. Botswana	65. Netherlands
5. Denmark	16. Nicaragua	27. Switzerland	33. Ecuador	44. Slovakia[b]	51. Brazil	66. New Zealand
6. Estonia	17. Norway	28. Uruguay	34. El Salvador	45. South Africa[b]	52. Bulgaria[b]	67. Panama
7. Germany	18. Singapore		35. Guatemala	46. Ukraine[b]	53. China	68. Philippines
8. Gibraltar	19. South Korea		36. Kazakhstan[b]		54. Cyprus	69. Poland[b]
9. Hungary	20. Sweden		37. Malaysia		55. Egypt	70. Portugal
10. Iceland	21. UAE		38. Peru		56. France	71. Russia
11. Ireland	22. UK		39. Venezuela		57. Greece	72. Slovenia[b]
					58. Hong Kong	73. Sri Lanka
					59. India	74. Spain
					60. Indonesia[b]	75. Thailand
					61. Israel	76. Turkey
						77. USA

Notes: [a]*Sample includes only countries that supervise all the three types of intermediaries (banks, securities firms and insurers).*
[b]*Countries reported to also be considering adopting partial or full integrated supervision.*

Source: *de Luna Martínez and Rose (2003).*

With respect to the applicability of consolidated financial sector supervision to developing countries, the literature cites two key lessons that they can learn from the experience of developed country practitioners (e.g., Abrams and Taylor 2000, Bain and Harper 1999, Briault 1999, Carmichael 2002, de Luna Martínez and Rose 2003, Llewellyn 2001, Mwenda and Fleming 2001, Reddy 2001, Skipper 2000, Taylor and Fleming 1999). One is that simply changing the structure of regulation cannot guarantee effective supervision, and integrated regulation per se is not a solution to regulatory failure. Correcting regulatory failure requires first and foremost better regulation; that is, setting more appropriate prudential and market conduct standards, improving surveillance and strengthening enforcement. Integrated regulation may help facilitate this process, but it cannot cause these changes to occur by itself. Indeed, the countries that adopted the integrated financial sector supervisory approach did so to enhance the supervisory process.

The second lesson is that there is no single best form of integrated regulatory agency. Unified financial services supervision has been adopted differently in many countries; its application has varied from country to country and there is no single right way of introducing or implementing unified models of financial services supervision. Factors that accounted for the differences include differences in starting points, differences in industry structures and differences in objectives.

For instance, Abrams and Taylor (2000) maintained that developing regulatory capacity should precede the issue of regulatory structure, and the latter becomes a major concern only if it will help to achieve the former. Particularly in many developing and transition economies where banks and hence banking supervision are central to their financial systems, unification of financial sector supervision must not compromise banking supervisory capacity or independence. However, they also noted that changing the structure of regulation could help in the elimination of gaps in regulatory coverage. In some countries that suffered financial crises, for instance, the presence of a systematically significant unsupervised group of financial institutions was a contributing factor.

The other factor that they identified as crucial in assessing the unified model is that the institutional structure of regulation should mirror the institutional structure of the industry being regulated. Thus, in countries where the financial system includes universal banks or where banks are significant players in the securities markets, then combining banking and securities regulation will be most appropriate. Combining banking and insurance regulation will be most appropriate in countries with strong linkages between banks and insurance companies. Finally, combining the regulation of all three sectors will be most appropriate when distinctions between different financial intermediaries have become blurred or the financial services industry is composed of diversified, multi-activity groups.

Clearly the issue of restructuring financial regulatory institutions is a complex one, and the decision of whether or not to integrate financial services supervision should be taken only after full consideration of the circumstances and capacities of each individual country. If the decision to establish a unified financial regulator is reached, Taylor and Fleming (1999) then cited two critical issues that need to be addressed if an integrated agency is to be successfully established. One, it is important that the transition for the individual specialized agencies to the unified agency is managed effectively. In this context, it is vital to develop an implementation plan that will dictate the path from the fragmented to the integrated model. Two, once the integrated agency is in place, there is a range of administrative and personnel issues that must be addressed, which must be done in the context of a well managed change program.

While there is some support for consolidated financial sector supervision in developing countries, a more contentious issue is whether the unified regulator should be separate from the central bank. The latter, in turn, partly stems from the issue of whether central banks should be (or continue to be) involved in banking supervision.

A more contentious issue is whether the unified regulator should be separate from the central bank.

Banking supervision and the central bank

An earlier survey of the structure of financial regulatory institutions in 123 countries as of 1999 (Llewellyn 1999, in Llewellyn 2001) showed that for 89 countries or over 70 percent of the sample, the central bank is still the one responsible for the supervision of banks. Furthermore, the most common model of banking supervision, which made up around 50 percent of sample, is for the central bank to supervise only banks. Central bank supervision of banks was also far more common in developing countries than in developed countries – 78 percent of the developing countries in the sample compared to 35 percent of

Table 3. **Location of bank supervision function**

Region	Central Bank Only	Central Bank Among Multiple Supervisors	Central Bank Not a Supervisory Authority
Africa	Botswana Burundi Egypt Gambia Ghana Kenya Lesotho Malawi Morocco Namibia Nigeria South Africa Zambia	Rwanda	
Americas	Brazil Guatemala Guyana Jamaica Trinidad and Tobago	Argentina United States	Bolivia Canada Chile Honduras Mexico Panama Peru El Salvador Venezuela
Asia/Pacific	Bangladesh Bhutan Cambodia China India Indonesia Israel Jordan Kuwait Lebanon Malaysia Maldives Nepal New Zealand Philippines Qatar Saudi Arabia Singapore Sri Lanka Tajikistan Tonga Vietnam	Taiwan Thailand	Australia Japan Korea
Europe	Croatia Estonia Greece Ireland Italy Lithuania Macedonia Moldova Netherlands Portugal Romania Russia Slovenia Spain	Belarus Czech Rep Germany Hungary Latvia Poland Turkey	Austria Belgium Demnark Finland France Iceland Liechtenstein Luxembourg Sweden Switzerland United Kingdom
Offshore Financial Centers	Aruba Bahrain Cayman Is. Cyprus Macau Malta Mauritius Oman Western Samoa Seychelles Solomon Islands St. Kitts and Nevis	Vanuatu	Gibraltar Puerto Rico British Virgin Is. Guemsey Turks & Caicos Is.

Source: *Barth et al (2002).*

developed countries. The results of this survey are borne out by other surveys on financial supervisory structures conducted by the World Bank and the Office of the Comptroller of the Currency (OCC) of the US, which are reported in Barth *et al* (2002). Table 3 shows the distribution of developed and developing countries according to the location of bank supervision also as of 1999.

On the issue of whether the central bank should be responsible for bank supervision, Barth *et al* (2002) noted that there are reasonable arguments both for and against this structural issue in the literature. In particular, the main point of contention is its impact on the safety, soundness and systemic stability of the financial system.

As Barth *et al* (2002: p. 9) noted, arguments for central bank supervision of banks point to the informational advantage that it affords the central bank, which facilitates its functions:

> *Because banks are the conduits through which changes in short-term interest rates are transmitted, the central bank needs to have accurate and timely information about the condition and performance of banks as a precondition for effective conduct of monetary policy. In addition, without "hands on" bank supervision responsibility, the central bank may take too little account of conditions in the banking sector when setting monetary policy. Further, the central bank needs to have access to information on the solvency and liquidity of banks in order to exercise its function of lender of last resort. Having such information in a timely manner is especially crucial in times of financial crises, and the best way to ensure access is by assigning on-going banking supervision responsibility to the central bank. Having supervisory power may also aid the central bank in acting quickly and precisely via the banking system in time of crisis*

[Goodhart and Schoenmaker (1993), Goodhart (1995), Haubrich (1996), Briault (1999), Peek, Rosengren, and Tootle (1999), Abrams and Taylor (2000)].

On the other hand, Barth *et al* (2002) note that those who argue against central bank supervision of banks typically cite the resulting conflict of interests between its monetary policy function aimed at price stability and bank supervision function aimed at financial stability. In particular, the central bank "... may pursue a too-loose monetary policy in order to avoid adverse effects on bank earnings and credit quality" (p. 9). The latter, in turn, has to do with reputation risk, in that bank failures could adversely affect public perception of the credibility of the central bank's conduct of monetary policy. Thus, monetary policy would suffer, which runs counter to the generally accepted view that the central bank's fundamental task is to preserve the value of the currency (Fischer 1997). Removing supervision from central banks would then strengthen their anti-inflation credibility because they can focus on the single objective of price stability. On the other hand, given that the main task of the central bank is to preserve the value of the currency, the policy debate has also focused on the assignment of other "optional" tasks (including banking supervision and regulation) to central banks. Finally, those who favor a separate financial supervisory agency also argue that the lender of last resort function combined with the supervisory function can add to the problem of moral hazard (Icard 2002). In this case, a central bank that is conscious of its reputation as a competent supervisor would be biased towards bail-outs and not allowing banks to fail.

Clearly, there are strong conceptual arguments both for and against the central bank's combined functions of banking supervision and monetary policy, which can be supported by the diversity of global experience. The empirical work that has been done on this structural issue is still limited. Barth *et al* (2002) noted several studies that support a narrower focus for the central bank that does not include bank supervision, but the results are far from conclusive. The general consensus in the literature so far is that there is no "one right answer", and that the answer will largely depend on country-specific circumstances and capacities. These include prevailing conditions in the financial system, the political environment, and the preferences of the public (Haubrich 1996). In particular, the effects of monetary policy on banking supervision and vice versa should be explicitly examined before a country decides on whether to retain or remove bank supervisory duties from its central bank.

Another key issue that relates to the central bank's supervisory function is whether it should supervise other financial service sectors as well, such as securities and insurance. Overall, the arguments in the literature reviewed by Barth *et al* (2002) weigh more heavily against it because: (i) it will lead to excessive concentration of power; (ii) the conflict of interests would be more extensive; and (iii) it could unduly extend the financial safety net if the central bank's lender of last resort function is seen as extending across all financial institutions, thereby worsening the moral hazard problem.

Thus, Goodhart (2000) concluded that:

The arguments for separating banking supervision from Central Banks, and placing this within a unified financial supervisory agency, have become increasingly powerful in recent years, more particularly in developed countries with complex financial systems. The blurring of functional boundaries has led to a seamless financial system; so efficiency suggests that a unified financial supervisor should mark that system. Add in perennial concerns about putative conflicts of interest, and a worry whether an (operationally) independent Central Bank with added supervisory functions might become too powerful within a democratic context, and the result is a potent cocktail of reasons for such a change (p. 43).

On the other hand, Goodhart (2000: p. 43) also concluded that "...there are much stronger reasons to believe that the conduct of banking supervision will be better done under the wing of the Central Bank in less developed countries." This he attributed to three main factors: (i) less complex financial structures in developing and transitional countries that tend to rely more on standard commercial banking; (ii) greater susceptibility to systemic disturbances, which tightens the connection between monetary policy and supervision including lender of last resort operations; and (iii) generally better levels of expertise, independence and funding of central banks in developing countries compared to other agencies.

But he also conceded that there are differences even among emerging countries, with some having more developed and complex financial structures than others. For instance, the IMF (2001) also noted that the trend toward consolidation of bank with nonbank financial activities is beginning to gain ground in emerging markets, particularly the universal banking paradigm. Thus, different countries are again likely to come up with different models. The bottom-line is that mechanisms for timely sharing of information between regulators of different institutions, and between prudential supervisory and monetary authorities are put in place,

"Integrating non-banking regulators with bank regulators could weaken the regulatory capacity of the latter if human and financial resources are limited."

regardless of institutional design (Crockett 2001).

Some points to consider for the Philippines

Meister (2001; in Barth *et al* 2002) very rightly emphasized that the "… design of regulatory and supervisory responsibilities is one of the most important matters affecting the future course of financial market policy. There is, however, no universally valid answer to the question of *how* this should be done." Furthermore, he noted that the answer cannot be derived from theory. Unfortunately, there is very little empirical analysis addressing this issue. Needless to say that further research is called for in order to inform the policy debate on financial supervisory framework issues, and before any country undertakes to radically change its financial regulatory structure.

In considering what regulatory structure is appropriate in an integrated financial world, the underlying issue is what regulatory structure minimizes the chances of government failure in ameliorating market imperfections and does so most efficiently (Skipper 2000). With respect to consolidation of financial sector supervision, some consensus is beginning to emerge. However, the literature is generally cautious especially in the application of the approach to developing countries. That is, each country must conduct a full assessment of the pros and cons of adopting a particular model. There is consensus, however, on the key factors that need to be considered in such an assessment. In particular, the literature highlighted two: changing the regulatory structure must be undertaken only if it will maintain and enhance supervisory capacity and the effectiveness of supervision; and the change in the institutional structure of regulation must reflect the change in the market structure.

Making the decision to move towards a consolidated approach is the most critical part, but it marks just the beginning of a complex process. The more difficult part would be how to undertake it, especially with respect to defining the role of the central bank in a consolidated financial supervisory framework. Thus, an explicit institutional analysis, which takes into account the characteristics and capacities of the country's financial system and overall financial sector infrastructure, is needed in order to come up with a definitive plan of action and timeframe.

In fact, the critical role of institutions, institutional capacity and institution building in the financial sector - both with respect to undertaking reforms to resolve the immediate problems brought about by the crisis and longer run reforms to strengthen and develop the financial sector – was one of the key lessons that emerged from the 1997 Asian financial crisis[4]. In particular, the experience of the crisis-economies was fairly consistent: weak institutional frameworks, which included lack of operational skills, qualified staff and financial resources, lack of commitment or political discipline, lack of independence, and political interference in the agencies that were designated or specially created to carry out the reforms, significantly hindered the reform process and vise versa. In terms of institutional strengthening for financial regulation and supervision, the architecture of financial regulation and supervision itself also became an important area of reform in addition to the enhancement of prudential regulation and supervision of banks through the adoption of international standards or "best practices". Looking at their varied experiences will prove instructive.

Overall, Korea's experience has been described as "decisive actions with massive public funds to restructure the financial sector", which led to the rapid resolution of the crisis and enabled banks to begin the road to recovery. In particular, Korea undertook a major restructuring of its financial supervisory framework to supervise the restructuring process and to correct the root causes of the crisis over the longer term. It adopted the single regulator supervisory model and followed a "big bang" approach similar to the UK. It established the Financial Supervisory Commission (FSC) and the Financial Supervisory Service (FSS; the FSC's executive body) in April 1998 and in January 1999, respectively, upon the passage of legislation consolidating the existing financial supervisory authorities in December 1997. This move was motivated by the need to strengthen prudential regulation in order to promote financial stability; the proliferation of supervisory gray areas and regulatory gaps, which allowed financial institutions to engage in regulatory arbitrage; and the significant growth of nonbank sectors, which was not accompanied by sufficient

[4] *An extensive discussion of the various institutional arrangements that the governments of the crisis-affected economies established in the light of the Asian crisis is presented in Milo (2004).*

supervision and prudential regulation (Bain and Harper 1999). The quick pace of the consolidation process was deemed necessary to immediately restore financial stability following the Asian crisis. But it should also be noted that the feasibility of a unified financial regulatory body in Korea (and more so in the UK) was first subjected to in-depth studies and analyses, which then formed the basis for the proposed bill to consolidate all existing financial supervisory authorities.

Coordination among the different financial regulatory agencies, including the PDIC, particularly with respect to prudential regulation must also be strengthened.

In May 1999, Indonesia enacted a new Central Bank Act that conferred upon Bank Indonesia the status and position of an independent state institution. This Act also provided for the separation of the bank supervision function from the Central Bank through the creation of an independent Financial Supervisory Authority (FSA) similar to Korea's FSC/FSS. The FSA was supposed to be established before December 31, 2002 (Bapepam 2000). The target date was later moved to January 2004, and then to mid-2005. That Indonesia was not able to replicate Korea's experience is not surprising considering the significant difference in their initial conditions. The priority of Bank Indonesia (and rightly so) was to develop regulatory capacity by amending and strengthening banking regulation and supervision to comply with international standards, and to restructure troubled financial institutions. Thus, changing the institutional structure of regulation was not the major concern. Doing so in such a short period would have also been premature given Indonesia's very weak institutional framework. Finally, the merits of a financial mega-regulator was also not fully understood and clearly established. Thus, although the draft law on the proposed FSA was submitted to Parliament in May 2003, its progress has been blocked by considerable debate on its contents and timing. A gradual approach will be more prudent and realistic.

Thailand also drafted a new Bank of Thailand Act, which was aimed to strengthen central bank independence, and a Financial Institutions Act. The Financial Institutions Act would have given the Bank of Thailand (BOT) the sole responsibility for supervising financial institutions (as opposed to sharing it with the Ministry of Finance under current laws), and paved the way for universal banking in Thailand by also empowering the BOT to supervise financial subsidiaries and conglomerates on a consolidated basis. Specifically, it combined the Commercial Banking Act and the Act on the Undertaking of Finance Business, Securities Business and Credit Foncier Business (BOT 2001). It should be noted that problems in finance companies that became evident in early 1997 were the first indicators of the Thai financial crisis, which in turn triggered the Asian financial crisis. The Act thus aimed to eliminate redundancies and discrepancies between different laws applicable to different types of financial institutions thereby creating a uniform standard of supervision among these institutions. However, this Act *was subsequently revised due to strong opposition on its contents. In particular, the proposal to (partially) unify supervision under the BOT was dropped. Instead, the BOT* collaborated with the MOF to draft the Financial Institutions Businesses Act to bring Thailand's banking supervisory regime up to international standards, including consolidated supervision of financial conglomerates. At the same time, the BOT also proposed to collaborate with other regulators, namely the Ministry of Finance, Ministry of Commerce (for the insurance industry), and Securities and Exchange Commission to enhance coordination and information sharing among regulators in order to standardize supervision of financial conglomerates (BOT 2003). Similar to Indonesia, lack of operational skills and qualified staff, and political interventions severely hampered the agencies that were designated or created to carry out the restructuring and rehabilitation of financial institutions after the crisis.

An umbrella approach, in which separate regulatory authorities are established and coordinated, had been deemed as desirable for Asian developing countries because they typically do not have sufficiently strong prudential regulations or banking sector supervision. In such a situation, integrating nonbanking regulators with bank regulators could weaken the regulatory capacity of the latter if human and financial resources are limited, which could in turn reduce confidence in the overall financial system. Furthermore, independent regulatory regimes that protect central banks from policy intervention are mostly lacking. Thus, integrating the various regulators without ensuring independence may weaken the quality and credibility of the overall regulatory regime.

The most important task now is to create an awareness, understanding and appreciation of the integrated approach among the regulators.

Instead, the priority should be the strengthening of bank regulation, while improving regulatory capacities for nonbanking business (Shirai 2001). Certainly, the cases of Indonesia and Thailand bore these out.

With respect to the other crisis-affected economies, Malaysia already had a fairly satisfactory bank regulatory framework and institutional framework prior to the Asian crisis. Thus, institutional infrastructure building was less emphasized compared to the other crisis-affected economies. It also already had a partially unified financial supervisor. Bank Negara Malaysia, which was established in 1959, took over the supervision of the insurance industry fairly recently in 1988, while securities firms continue to be supervised by a specialist agency. Singapore's pre-crisis regulatory/institutional framework was deemed as very strong, and the Monetary Authority of Singapore (MAS) was actually the first integrated supervisor. But it did so gradually. The MAS, which is a fairly young central bank that began operations only in 1971, also acquired powers to regulate the insurance industry in 1977 and the securities industry in 1984. Both are quite strong and proactive regulators.

In contrast to Indonesia and Thailand, the Philippine banking sector's regulatory framework prior to the crisis was rated fairly well, which resulted from earlier reforms that included significant improvements in prudential regulation and supervision. Also, an independent central bank was already in place - the *Bangko Sentral ng Pilipinas* (BSP), which was established under the New Central Bank Act enacted in 1993. What the Asian crisis did was to expose the need to close regulatory gaps that resulted from the integrated or conglomerated nature of financial institutions but with a fragmented regulatory system in the Philippines. This was demonstrated in the failure of several commercial banks, which was linked to problems in their investment house subsidiaries that were in turn inadequately supervised.

The Philippines has had a long history of universal banking, which was introduced in 1980 and came to dominate the Philippine financial system. And over the years, the country has continued to follow a policy of despecialization by allowing banks to further widen their range of permissible activities and products, including the recent introduction of *bancassurance* in 2002. The Philippines also has a long history of financial innovation as a result of regulatory arbitrage, both by banks and nonbanks. But such evolution in the financial services sector was not accompanied by a similar evolution in financial regulation and supervision until fairly recently. The BSP has undertaken steps toward consolidated supervision of banking groups, as well as initiated efforts to coordinate with other regulatory agencies. But more needs to be done.

The priority is also (and should be) the strengthening of bank regulation, particularly the consolidated supervision of banking groups, and at the same time improving regulatory capacities for nonbanking business. Coordination and cooperation among the different financial regulatory agencies, including the PDIC, particularly with respect to prudential regulation must also be strengthened and institutionalized. Finally, at least one supervisor has to have comprehensive oversight. All these point to the relevance of, and can serve as interim measures to, the consolidated financial sector supervision approach in the case of the Philippines. Preliminary support for the consolidated financial sector supervision approach can be justified based on the primary motivation for the adoption of this approach, which is financial services integration or convergence. This was also the case in Korea, but not in Indonesia or Thailand. That being said, the bigger issue is how to undertake the transition, and that will require careful study and planning.

The most important task now is to create an awareness, understanding and appreciation of the approach among the regulators, the regulated entities and consumers, as well as policymakers and lawmakers. This point is clearly illustrated and emphasized in the case of the UK, which has undertaken the most complex and comprehensive integration of financial regulators to date – its Financial Supervisory Authority (FSA) brought under one roof 10 regulatory bodies. In particular, **the FSA deemed it important to clearly lay out what it can and cannot do - that it is not a panacea for all problems in the financial sector and it does not remove the consumers' responsibility for their own action. Thus, the FSA embarked on a major education campaign to promote public understanding of the financial system and of the FSA (Thorpe 2002).**

Understanding what consolidation means and what it can and cannot do must also be coupled with an assessment of what the country needs and what it can and cannot do. The approach's

relevance and how it should be implemented must be bolstered by more in-depth studies and institutional analyses to take into account the characteristics of the Philippine financial system and the capacity to undertake such a reform. These studies can then inform the policy debate and, if found relevant, facilitate either the amendment of the relevant existing laws or the drafting and passing of a new law. For instance, it took us years to finally pass the New Central Bank Act and General Banking Law, which are relatively less contentious. The experience of Indonesia and Thailand also showed the difficulty of passing a law without sufficient understanding and appreciation of the consolidated approach.

Clearly, the transition from institutional regulation to functional regulation is a complex process. And the choice need not be made in extremes of single and multiple regulators because there are possibilities of hybrids and supplementing arrangements. As Skipper (2000) pointed out, there is something to be said for building on existing structures. Under any system, issues of information exchange and coordination are inevitable. In the final analysis, the regulatory objectives, coverage, skills, operational effectiveness and credibility are important considerations, and structures remain just one element of financial regulation (Reddy 2001).

Finally, the need for sustained capacity building for financial regulators and supervisors, regardless of the structure, must be emphasized. Building sustainable institutions take time. Thus, financial reform must be seen as a continuing process; it does not end at discrete changes in financial policies (including changes in the regulatory structure), which could lead to inertia. Financial regulation and supervision then becomes a major point for reform only when problems have already arisen. Because the financial services sector is very dynamic, the system of supervision and regulation must be constantly assessed and adjusted, not just to keep pace with but also to anticipate changing needs. That is the only way for even a financial super-regulator to remain effective and efficient.

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Our guest writer, Melanie Milo, Ph.D., is a research fellow of the Philippine Institute for Development Studies (PIDS). Working at the PIDS as a research fellow in the last four years and as research associate from 1995 to 2000, she has authored numerous policy and discussion papers on financial supervision and integration, financial sector development and reform, international macroeconomics, and development economics for the Institute and delivered some of these papers for various local and international conferences. Her discussion paper on Financial Services Integration and Consolidated Supervision: Some Issues to Consider for the Philippines written in 2002 has been the take-off point for this article.

Milo has been conferred a Ph. D. in Economics from the Australian National University in Canberra in 2000. Prior to this, she earned her degree in Masters in Economics of Development and Diploma in Economics of Development from the same university. She was a cum laude graduate of the University of the Philippines Diliman with a degree in Bachelor of Arts in Economics in 1987.

Moving towards a unified financial regulation in the Philippines

by Lilia R. Bautista, *Chairman, Securities and Exchange Commission*

The integration of financial supervision and regulation has been slowly gaining prominence in the discourses on macroeconomic fundamentals as a viable alternative in achieving long-term and continued stability in global financial systems.

In the Philippines, our Constitution provides for the creation of an independent central monetary authority with primary responsibility over monetary, banking and credit policy; supervision over the banking sector and regulatory powers, as may be provided by law, over the operations of finance companies and other institutions. This would inevitably dictate the shape of the Philippine unified regulator if we do decide to move towards that goal.

Rationale and scope of unified financial regulation

Experience in other countries

Unified financial sector regulation refers to the establishment of a single supervisor for the entire financial sector or centralizing in one agency the powers to supervise at least two of the main financial intermediaries (such as banking with insurance, banking with securities or securities with insurance). As of the end of 2002, 46 countries had adopted unified regulation, including UK, Sweden, Norway, Singapore and South Korea, among others. With the numbers increasing faster in recent years, Estonia, Germany, Ireland and Malta are the recent additions to the group of unified regulators.

Unified regulation is not a recent development. Closer to home, the Monetary Authority of Singapore combined banking supervision with insurance and the securities industries in 1971 and 1984, respectively. Canada and the Scandinavian countries followed shortly. It was the unification in UK in 1997, which was given extensive media coverage when it integrated 9 previously separate regulators at once, that captured worldwide interest in the idea. However, the approach to and the resulting structures are far from uniform. A survey of unified regulators conducted by the World Bank (Martinez and Rose, 2003) showed that 29% had a single supervisor for the whole financial system while 30% have a single supervisor for 2 out of 3 types of financial intermediaries. The resulting structures have been a mix of institutional and functional decisions with the exception of Australia that chose to adopt a purely functional structure.

Under Australia's structure, prudential regulation of all institutions (deposit taking, insurance and pension) is conducted by the Australian Prudential Regulation Authority (APRA); systemic stability thru its influence over monetary conditions and through oversight of payment system is supervised by the Reserve Bank of Australia; disclosure and market conduct by the Australian Securities and Investment Commission (ASIC) and competition behavior by the Australian Competition and Consumer Commission (ACCC). Systemic stability, competition regulation, conduct of business and prudential regulation were placed in four (4) institutions.

Rationale for unified financial regulation

Notwithstanding the differences in scope and resulting institutional structure, there appears to be commonality in the reasons for the move to unified regulation. In the same survey conducted by the World Bank (Martinez and Rose, 2003), the reason advanced by 93% of the respondents was the "*need to better supervise a financial system moving towards universal banking*". This was closely followed by the need to "*maximize economies of scale and*

Unified regulation promotes regulatory efficiency by avoiding duplication in support infrastructure, competitive neutrality and the avoidance of turf wars or the removal of doubts over jurisdictional questions that could weaken regulatory effectiveness.

scope" cited by 80% of the respondents, *"need to solve problems resulting from poor communication and a lack of cooperation among existing supervisory agencies (27%), need to minimize gaps in the regulation and supervision of financial intermediaries by establishing a single authority accountable for the supervision of all financial institutions (20%), need for operational restructuring of regulatory agencies (20%), need to overcome other weaknesses in the overall quality of financial regulation and supervision (13%).*

The rise of financial conglomerates raises difficult problems for regulatory effectiveness with multiple regulators. In particular, there is the danger that because of a fragmented supervision, an over-all risk assessment of the institution as a group may not be undertaken. Fragmented supervision also created regulatory gaps that can be exploited by the regulated entities and lead to failures similar to what happened in the case of the Urban Investment Corporation.

In addition to the ability to regulate financial conglomerates better, unified regulation also promotes regulatory efficiency by avoiding duplication in support infrastructure; competitive neutrality that is hampered by the existence of too many regulators charging different costs on the entities that they regulate; and the avoidance of turf wars or simply the removal of doubts over jurisdictional questions that could weaken regulatory effectiveness.

Constraints of unified regulation

The broad agreement on the benefits of unified regulation has not completely removed the arguments against it, however. Some of the dangers being cited are the risk that the change process can go off- track, diseconomies of scale typical of monopolistic organizations, which the unified regulator will be; the limited synergies - in particular those of skills, focus, and culture - of the unified agencies; and the moral hazard problem that is likely to be caused by the perception created in the public mind that all creditors of the entities that the unified regulator supervises will receive equal protection. Correspondingly, a number of alternatives to unified regulation have been advanced either as a transition measure to or in place of unified regulation itself. Two of these, the creation of an oversight board and the unification of support services while having their own merits, unfortunately, do not solve the problems arising from multiple regulation particularly the regulatory gaps, and the differences in rules and regulations. The third, which is the sharing of facilities with the Central Bank but with the supervisory agency separate from the latter as practiced in Finland, may not be consistent with our Constitution.

There are two cautionary notes on unified regulation. First, unified regulation, by itself, cannot guarantee effective supervision. Second, unified regulation does not end with the creation of a unified regulatory structure. A unified regulatory structure cannot solve the weakness of regulation arising from its inability to address market failures. These market failures, which gave rise to the need for regulation in the first place are anti-competitive behavior, market misconduct, asymmetric information, and one that is unique to the financial system; systemic inability where the sudden loss of confidence in some institutions can cause otherwise unrelated and sound institutions to fail. The risk was demonstrated during the Asian Financial Crisis when 'contagion' along with 'moral hazard' became the buzzword in the international financial community. Correcting market failures requires better regulation, which means setting more appropriate prudential and market conduct standards, improving surveillance and strengthening enforcement. For this reason, the Securities and Exchange Commission continues to focus on strengthening its regulatory capability while exploring the possibility of unified regulation with other regulators. Subsequent to the enactment of the Securities Regulation Code in 2000, SEC trained its staff in market surveillance monitoring and enforcement, created new core operating departments including those for market regulation, corporation finance, enforcement, compliance and inspection. Now with ADB assistance, SEC is looking at ways to establish risk-based capital

standards, the futures market and unified regulation.

Unified regulation does not end with creation of a unified regulatory structure. In order to achieve its objectives, unified regulation must be accompanied by the development of unified regulatory and supervisory framework for the financial sector, to the extent possible and as allowed by the international standards. Otherwise, the unified agency might simply become a simple umbrella with the previously separate agencies carrying on with their business as before, albeit, in one roof. Towards this end, International Standard bodies continue with their work in identifying areas where the harmonization of regulatory and supervisory practices across different types of financial intermediaries should be achieved. These cover on-site supervision, off-site monitoring and analysis, consolidated supervision, components of capital, minimum capital requirements, licensing requirements, accounting standards. However, it is not expected that all rules can be harmonized due in large part to the different regulatory challenges faced in each sector that necessitate different regulatory responses. For instance, only modest harmonization in capital requirements between banks and insurance companies can be expected. Practically all banks follow the Basel Capital Accord. On the other hand, insurance companies are required to maintain different types of reserves that vary by country depending on the type of risks that they may face such as the "future risk reserve" and "catastrophe reserve" in Japan or the 'policy holder dividends' and 'policy reserves' in Korea.

A memorandum of agreement was signed between the BSP and PDIC to establish an information exchange framework to facilitate sharing of relevant data and enhance the effectiveness of examination and monitoring systems.

The prospects for unified financial regulation in the Philippines

The idea of unifying our regulatory agencies has gained recognition in the Philippines. At the very least, it is being discussed by those who would be directly affected by it; the Bangko Sentral ng Pilipinas (BSP), the Insurance Commission (IC), the SEC and to some extent, the Philippine Deposit Insurance Corporation (PDIC). The overriding concern among these regulators is the mismatch between the existing regulatory structure and the structure of the financial industry that each supervises. Thus, these various regulators are faced with financial conglomerates whose separate supervision leaves too many gaps, regulatory overlaps and in one case, the failure of a financial institution under our overlapping supervision.

As of April 2004, the SEC has regulatory powers over 1,835 registered firms, comprising of the following:

1.	Pre-Need companies	39
	Licensed general agents of pre-need companies	6
2.	Transfer Agents	28
3.	Dealers in government securities	64
4.	Investment Houses	
	• with quasi-banking license	6
	• without quasi activities banking license	30
	• underwriting of securities	9
5.	Broker – Dealer	115
6.	Investment companies	29
7.	Issuers of securities	234
8.	Issuers of registered securities (Unlisted)	114
	Public Company	
9.	PSE	1
10.	Philippine Central Depository	1
11.	Securities Clearing Corporation	1
12.	Securities Investor Protection Fund	1
13.	Fixed Income Exchange	1
14.	Finance Companies	620
TOTAL		**1,835**

The IC supervises 104 non life insurance companies, 42 life insurance companies and 42 brokers.

The BSP supervises 7,494 banks (universal and commercial banks, rural and thrift banks) and 11,000 non-bank financial institutions (with and without banking or quasi-banking functions). In some cases we have overlapping jurisdiction over some companies. Surely, something needs to be done!

Financial conglomerates

Universal banks have been around us for more than twenty years. They were introduced as early as the 1980s as part of our financial liberalization program in order to promote greater efficiency in our financial system. The promotion of

universal banks continued over the years through such policies as the widening of the banks' permissible activities and products, relaxation of the line of business restrictions, cross-selling and lately, bancassurance. Another key feature of the Philippine financial system is the dominance of domestic universal banks, which accounted for 64% of total banking assets and 53% of the total assets of the financial system by March 2002. Therefore, the regulation of the financial system has to be equally 'home grown' unlike the case of one dominated by the multinational corporations whose conduct, at the very least, are subject to the disciplines imposed by the regulators in their home countries.

Key issues for unification of Philippine regulatory institutions

The constitution provides:

> *"Sec. 20. The Congress shall establish an independent Central Monetary Authority ,….xxx. The authority shall provide policy direction in the areas of money, banking, and credit. It shall have supervision over the operations of banks and exercise such regulatory powers as may be provided by law over the operations of finance companies and other institutions performing similar functions."*

At present, the regulation of banks in the Philippines is lodged with the Central Bank (BSP). Traditionally, as in other jurisdictions, supervision of banks is done by the Central Bank. As previously stated, the international trend is to carve out the regulation of banks and set up an institution which will regulate banks with or without all or any of the following: insurance, securities and pension. Singapore, however, is one of the few exception, which decided instead to absorb within its Central Bank the regulation not only of banks but securities and insurance as well. In cases where the monetary policy is separate from single regulator, there must be coordination between the Central Bank and the regulator. In case of the Financial Services Authority (FSA) of UK, there is a Memorandum of Understanding (MoU) between the Bank of England and the FSA.

Without any constitutional amendment, if the Philippines will adopt the Singapore model, there would be a need for legislation to incorporate securities and insurance within the Central Bank. This would make the Central Bank a very powerful body but there would be economies of scale and there would be no regulatory arbitrage.

We can also explore the possibility that the Monetary Board be insulated from the day to day problems of regulation by specifically providing that there would be three (3) Deputy Governors to handle the three areas of banks, insurance and securities whose decisions are final and can only be appealed to the courts. This would enable the Monetary Board to concentrate on monetary policies and set direction over regulatory policies. It need not be bothered by the audit of banks, brokers, listed companies and insurance companies. The three regulators must be part of the Monetary Board so that it can be guided in its policy roles.

Needless to say, there could be a constitutional challenge to such a set up on the meaning of "supervision" which is lodged in the central monetary authority as a whole. Carefully crafting the legislation would seem to be necessary to delineate the regulatory aspect and the oversight function of the Monetary Board.

Constitutional amendment

The other alternative to clearly delineate regulatory function and policy making is to amend the Constitution to carve out the regulation of banks from the Central Monetary Authority and amend the Central Bank Act, the Securities Regulation Code and Insurance Act by legislation to come up with a single regulator.

Transitory measure

While the above policy issues are being debated upon, coordination with these agencies is a must. SEC and BSP have already signed two (2) Memoranda of Understanding and is in the process of crafting another one on joint audit and reporting. A formal coordinating machinery is presently been studied by a BSP consultant.

In the same manner, a Memorandum of Agreement (MOA) was also signed between the BSP and PDIC to establish an information exchange framework to facilitate sharing of relevant data to enhance the effectiveness of their examination and monitoring systems. This was particularly significant since the General Banking Act of 2000 has revoked PDIC's examination powers.

Under the agreement, a shared computerized database containing all the essential bank data shall be created and electronically accessible to both institutions as presently practiced in more developed countries. The framework shall be implemented in two stages with the first stage finalized in November 2002. The second phase, which is still on the planning stage, shall involve sharing of more sensitive information on distressed banks, and will engage the formation of joint committees that would study ways in enforcing corrective measures and failure resolution schemes.

Indeed, the road towards integrated financial supervision for the Philippine financial system is fraught with challenges. Issues an concerns involved should be critically analyzed while merits should be carefully explored to

ensure that this particular reform would achieve a financial regulatory system attuned to best practices in the supervision of financial services in the global market today.

About the Author

Ms. Bautista has been Chairman of the Securities and Exchange Commission(SEC) since March 2000. Prior to this, she rose from Assistant Secretary to Acting Secretary of the Department of Trade and Industry before she was appointed Senior Undersecretary and Special Trade Negotiator of DTI in 1999. She was also Ambassador Extraordinary and Plenipotentiary, Chief of Mission and Permanent Representative of the Philippines to the United Nations Office, World Trade Organization, World Health Organization, International Labor Organization and other international organizations in Geneva, Switzerland from 1992-1999.

As a former Acting Secretary of DTI, she was also the Chairman (Ex-Officio) of the Board of Investments, National Development Company, Garments and Textile Export Board, Philippine International Trading Corp., Export Processing Zone Authority, Center For International Trade Expositions and Missions, Inc., Small and Medium Development Council, and Export and Investment Development Council. She also served as Ex-Officio Member of the Monetary Board - Central Bank of the Philippines.

She started her government service as Legal Officer of the Office of the President. Then, she moved on as Hearing Officer of the Juvenile and Domestic Relations Court of Manila and later, as Chief Legal Officer and Assistant Director of the Board of Investments Legal Office.

Prior to joining government service, she worked as Legal Editor of Corporation Trust Company and Prentice Hall in New York.

Chairman Bautista completed her formal education with the degrees in Master of Laws from the University of Michigan (Dewitt Fellow), Masters in Business Administration and Bachelor of Laws from University of the Philippines. She took special courses in corporate finance and reorganization in New York University and in investment negotiation in Georgetown University.

FSA-UK Managing Director shares his views on integrated supervision and deposit protection

The first stage of reform of financial services regulation in the United Kingdom took a leap on 20 May 1997 with the creation of Securities and Investments Board (SIB). This provided the platform for a single financial regulator, the subsequent ***Financial Services Authority (FSA)***. The FSA properly came into being in June 1998, when responsibility for banking supervision was transferred to the **FSA** from the Bank of England.

Recognizing FSA's wide range of experiences on financial services integration, PDIC Forum delved into the details of its creation, supervisory framework and corporate objectives with Michael Foot, Esq., Managing Director for Deposit Takers and Markets Directorate.

Forum: What circumstances triggered changes in the UK's financial regulatory framework that led to the creation of the FSA? Which agencies were involved? Which agency took the lead, and why was this agency chosen as lead?

Michael Foot: In 1997, a new Government came into power and almost immediately did two connected things. First, it made the central bank (the Bank of England) independently responsible for monetary policy. Shortly afterwards, it announced the creation of a completely new financial regulatory agency, the FSA. This was tasked to bring together 8 existing regimes, including the banking supervision division of the Bank of England, into one new body.

Michael Foot, Esq., Managing Director, Deposit Takers and Markets Directorate, FSA, UK

I think there were 3 reasons: (a) financial services in the UK were becoming increasingly highly integrated. For example, banks had developed or bought insurance and securities operations and vice versa. Regulators for the separate sectors made increasingly little economic sense; (b) there were prospectively large economies of scale to exploit. Before the FSA, none of the regulators was of sufficient scale to reap these; and since the FSA was given its own powers, its basic fees have not risen faster than inflation despite significant upward salary pressures; (c) the Government felt, as a matter of principle, that each agency should have just one function, to aid accountability. If the Bank of England was to be responsible for monetary policy another agency needed to be responsible for supervision.

Forum: Was the birth of the FSA a pure government initiative or was it a result of a long-drawn policy discussion?

MF: The new Government's decision to create a single regulator (in 1997) was not preceded by an extensive public discussion. When the Chancellor announced his intention (to form the FSA), an interim report was published in May 1997, followed by a longer and more detailed report three months later which set out the transition, a more specific timetable for the new legislation arrangements

and further details of how the FSA would work.

Forum: Were there explicit information sharing arrangements between authorities regulating related financial institutions that called to periodic dialogues among them to share market intelligence and discuss concerns of mutual interests? What were the parameters of these sharing arrangements? Would an efficient information sharing arrangement among regulatory authorities be as effective as an FSA?

MF: One of the keys to the subsequent successful co-operation between the FSA, the Bank of England and the Ministry of Finance (HM Treasury) was the fact that a substantial Memorandum of Understanding was agreed among these 3 parties and made public before the actual creation of the FSA. This set out the sphere of responsibility of each organisation, how they were to work together and what information they should share. After 6 years, there is absolutely no pressure from any of the 3 organisations to change it.

Some of this co-operation would, of course, have been possible had the separate regulators remained in being. But the fact is that having all the regulatory information in one building (and integrating all the regulatory staff into one organisation) has helped to ensure that regulatory information is quickly and effectively shared.

Forum: What were the primary criticisms to an integrated financial supervision for UK and how were these responded to?

MF: When the FSA was announced, the idea was widely welcomed but some concerns were expressed, particularly that the new body would be too powerful. It was argued that, in enforcing its rules, the FSA would be the "prosecutor, judge, jury and executioner." To meet this concern, the Government went to great lengths to ensure very full accountability of the new body and, in particular, that there was a complex 2-stage enforcement process. The second stage of this means that any accused firm or individual can go to a separate legal entity, which is completely independent of the FSA and have its case heard afresh.

The FSA has also, during its life, gone to great lengths to consult openly about all aspects of its non-enforcement operations too. This means that interested stakeholders (the practitioners who pay for the FSA, consumer groups and others) have the chance to comment on proposed policies and rules in detail in advance.

Forum: What did you mean by "two-stage enforcement process on ensuring accountability"? Who is the "separate legal entity"? What is the nature of this entity and who runs it?

MF: The first decision-making body is the Regulatory Decisions Committee (RDC) consisting of practitioners and public interest members independent of the FSA. If the firm or individual facing action is still dissatisfied at the end of this first-stage procedure, it or he can present the case to the second stage, which is the Financial Services & Markets Tribunal. This is run by the Lord Chancellor's office and it will consider the case completely afresh under normal legal process. Relatively few cases get this far.

Forum: What were the legalities involved in forming a unified supervisor (i.e., amendments of existing legislation, drafting of entirely new legislation, etc.)?

MF: New legislation was required to get the FSA started and it was done in two stages. A very simple Bill was quickly put through Parliament which created the FSA and allowed it to take over banking supervision and the functions of one of the other existing regulators (the Securities & Investment Board). All the other regulators agreed that their staff too should join the new organisation. But it was apparent that the FSA could only get the necessary powers in its own name to do what the Government wanted it to do after the drafting of a major new piece of legislation replacing/amending many existing statutes.

This actually took another 3 and a half years to come into effect. In the meantime, a very British, co-operative, solution was adopted in

which the pre-existing regulators seconded their staff to the FSA, who ran the organisations from a single building and with a single structure but in the name of and according to the laws governing the existing regulators. I doubt if there is any other country in the world where such a transitional arrangement could have been achieved.

Forum: What were the essential resource requirements in setting up the FSA? What mechanisms were instituted for the initiative to effectively gain support from the policymakers and the financial community?

MF: The early transition years of the FSA coincided with a very strong labour market for many financial sector staff, which put something of a strain on the FSA's ability to recruit and retain staff with the right skill sets. Fortunately, we were not constrained by Government/public sector pay scales and most of the financial services industry was content to see us pay more provided we exercised tight control over costs in aggregate and provided that our regulatory services were run efficiently.

We also launched major public relations initiatives to get consumers to understand that there were some immediate benefits for them. For example, we brought together 8 previously separate complaints systems into 1, and merged 5 separate compensation schemes into 1. We also began some experiments on how we supervised the larger firms, to give them some of the early benefits of a single regulator. I doubt if there are many now who would want to go back to the "old ways".

Forum: What are the main responsibilities of FSA in promoting soundness of financial institutions and stability of the financial system? What are the measures available to FSA to effectively carry out these responsibilities? In case of violations of FSA regulations, what are the enforcement measures available?

MF: The FSA has 4 statutory objectives: to promote market confidence, to improve public awareness of financial issues, to protect consumers and to fight financial crime. Each year, in our *Plan & Budget*, we set out our priorities for the next year, in the context of a longer 3 year planning horizon. We have a very full range of regulatory tools – proactive and reactive – to work with and where necessary we do not hesitate to turn to enforcement action. For companies, this can lead to closure or, less drastically, significant fines and a requirement to compensate consumers who have been mis-sold retail products. For individuals, fines can also be levied and in more serious cases the individual can be barred from some/all financial services for years or even for life. All of this, as I said earlier, is subject to very considerable legal protection; to take away someone's professional livelihood is something one could never do lightly.

Forum: What were the major difficulties and challenges encountered by FSA when it started operations such as market reaction, response from institutions being regulated?

MF: Six years after it first started and two and a half years since it gained its full powers, I think the existence of the FSA is accepted and generally welcomed. Different groups and types of firms have different agendas in their dealings with us. For example, the larger firms have typically found the creation of a single regulator makes it much easier for them to do business with us, as we are essentially a "one-stop shop". Some smaller firms, in contrast, probably regret the passing of what they may have regarded as a regulatory regime more sympathetic to their aspirations. I think overseas regulators also welcome the one-stop shop that is the FSA and certainly, in an era when much new financial legislation comes out of the UK's membership of the European Union, it is very helpful to have the scale to represent British interests in EU, to help prepare this legislation.

Forum: How does the FSA supervise deposit-taking financial institutions given the diverse nature of business and ownership structures?

MF: Our prudential supervision of deposit-taking firms has in some senses changed relatively little since the Bank of England had responsibility for it in 1998. We are, however, much better able now to reflect the reality that, for retail-facing groups – banks or insurance companies – the biggest single risk to their capital position is

What is the Financial Services Compensation Scheme?

The Financial Services Compensation Scheme (FSCS) acts as the fund of last resort for customers of authorised finance sector firms. The Scheme's primary aim is to provide protection for private individuals and small businesses. FSCS can pay compensation if an authorised firm is unable, or likely to be unable, to pay claims against it, usually because it has gone out of business or is insolvent. Firms are authorised to trade in financial services in the UK by the regulator, the Financial Services Authority (FSA).

FSCS is an independent organisation, funded by authorised firms, and covers investments, deposits and insurance. The existence of FSCS promotes financial stability by lessening the risk of a single failure triggering a wider loss of confidence in that sector, or the market generally.

FSCS was created under the Financial Services and Markets Act 2000 (FSMA), and became operational on 1 December 2001. At that time it replaced five existing compensation schemes1 and the assets and liabilities of the preexisting schemes were transferred to FSCS. FSCS also assumed responsibility for any outstanding claims.

Deposit protection

FSCS provides protection for customers of deposit-taking firms, being banks, building societies and credit unions. The Scheme is triggered when an authorised deposit-taking firm goes out of business. This would happen, for example, if it is subject to an insolvency action, such as liquidation or administration, or when the FSA concludes that the firm is unable to repay its depositors or is likely to be unable to do so.

Compensation limits

The maximum levels of compensation for bank deposits payable under FSCS' rules are: £31,700 (100% of first £2,000 and 90% of the next £33,000), for the total of a claimant's deposits with that firm. Deposits in all currencies are covered.

How we are funded

FSCS is funded by levies on the financial services industry and operates on a 'pay-as-you-go' basis. Levies are raised to cover the projected costs of the Scheme in a financial year, a process that is normally undertaken once every financial year. Further levies can be raised if compensation payments exceed those anticipated or if there is a major new default in that financial year. Under its rules, a limit to the amount FSCS can levy in any one financial year for accepting deposits is 0.3% of protected deposits (cumulative).

* *FSCS covers **banking, insurance and investments.***

reputational damage from mis-selling products to consumers. Such mis-selling can lead to very substantial compensation payments being necessary. One helpful factor has been that the UK has for a long time required banks and (to use an American term) mutual thrifts to have considerably more capital than required by the relevant international (usually Basel) standard.

Forum: How are depositors in UK protected from bank failures?

MF: These high capital standards plus our encouragement of good management and business practices have produced a UK banking sector that is very strong in terms of both capital and liquidity. The last significant banking failures that led to any call on the deposit protection scheme came in 1991-92 during a major recession. Even then, the total "hit" to deposit protection was only about US$150 million and all of that has subsequently been paid back to the scheme, by virtue of successful liquidation of the banks concerned.

Forum: Please elaborate on how the deposit protection scheme was implemented during those recession years and how it was funded? How were the depositors reimbursed and who took charge of liquidating the banks?

MF: The pre-1998 banking deposit protection scheme under the Deposit Protecion Board (DPB) was initially funded through small upfront payment by each bank. Any additional funds required was raised by way of a levy on each authorized bank. The DPB calculated the amount of money to which each depositor was entitled and paid the money out. It also took responsibility for reclaiming funds as the liquidator of each bank did his work, and returning the money to the banks who had contributed to the levy. The DPB though did not take any responsibility for the liquidation itself.

Forum: What is the Financial Services Compensation Scheme, and how does it work?

MF: The Financial Services Compensation Scheme (FSCS) is a 100% owned subsidiary of the FSA. The FSA has control over the appointment of senior staff and its budget but in operational terms it is genuinely independent. Its creation brought together separate sectoral schemes for banking, insurance, and investments and the basis on which compensation is provided still reflects some of that history.

In general, the philosophy of

compensation in the UK is that the small, less well-informed consumers most needed protection but that moral hazard needs to be avoided. By that I mean that there should not be 100% compensation to, for example, a depositor who puts savings into a bank paying very high interest rates, because the fact of those high interest rates should clearly indicate that risk is greater than normal.

Forum: Under what condition/s was the Financial Services Compensation Scheme (FSCS) created? How was it organized and funded? What is its relationship to the FSA?

MF: So far as the banks were concerned, the creation of the FSCS did not create any significant changes, other than that it operated under the umbrella of the single scheme. As to its relationship with the FSA, it is a subsidiary of the FSA and the FSA is responsible for appointments to the FSCS Board on terms which secure their independence in the operation of its functions. We at FSA also approve its budget and jurisdictional rules.

Forum: How does the amount covered by your deposit protection scheme compare to the average deposit in banks in the UK?

MF: During the last "big" bank failure which the DPB was involved in 1991, over 80% of all deposit insurance claimants had deposits of less than £20,000. That sum would now be equal to over £30,000 in present day prices. Of course, by value, these deposits of less than £20,000 accounted for less than 10% of all the BCCI claimants' deposits. The theory is very much that deposit protection is primarily for the smaller retail depositor.

Until December 2001, the compensation for bank deposits was 90% of the first £20,000.

From 1 December 2001 onwards, it has been 100% of the first £2,000 and then 90% of the next £33,000. Throughout the period, the amounts for bank deposit compensation have been different from those for personal investment or insurance compensation.

The basic theory behind the figures for banks is:

a) that the depositor must take some interest in the soundness of the bank he/she puts money into. Consequently, except where stated in (b) below, 100% compensation would not be appropriate because it would incentivise depositors to chase high interest rates being offered without any downside if the bank fails. 90% minimum compensation was established in 1995 by EU Directive. Before that, the UK figure had been 75% of the first £20,000
b) however, 100% compensation does seem fairer for a depositor in some circumstances. If the bank fails the day after a depositor's salary cheque has gone into his/her account, it can hardly be said that the depositor has been chasing high interest rates. The 100% band of £2,000 could be taken as a rough measure of the average national monthly salary. A Family Resources Survey in 1996/1997 also showed that over 50% of all families had less than £1,500 of savings (excluding life assurance or funded pension arrangements), which meant that a figure of £2,000 would fully protect many people.

Forum: What are the benefits gained from an integrated financial supervision framework? Has integration attained its desired results?

MF: Building a successful single regulator from so many components was never going to be an easy or quick task and the Government has, from time to time, also added to the list of regulatory tasks for the FSA. For example, we are going to become responsible in the next year for regulating insurance and residential mortgage brokering, in the process perhaps tripling the number of firms we authorise.

We have managed to produce a number of significant improvements in regulatory techniques. We have taken advantage of numerous economies of scale. We are well on the way to longer-term aims such as providing a more user-friendly service to practitioners and other key stakeholders. But I am under no illusion that it will take some years more before we can say that the process of integration is complete. Nevertheless, as I have mentioned already, very few would wish to go back to what we previously had.

Forum: What are the remaining hurdles for FSA, if any?

MF: Looking forward, perhaps the biggest single hurdle we still have to surmount is to get better public understanding of what regulators can and can't do. We tried to make clear from the outset that we couldn't and shouldn't promise a no-failure regime. But, while politicians and the media applaud that in theory, the closure of any financial firm – if it is followed by some loss or inconvenience to consumers – tends to lead to criticism of the regulator. We expect to be criticised when this is justified and very happy to have spotlights shone into the way we work and what we have done in particular cases. (For example, there have been 3 separate formal enquiries into the closure to new business of one significant life assurance company.) But, we still have to get across to people the simple truth that the existence of the regulator does not take away all risk.

Forum: What important lessons could be drawn from the UK experience by countries considering integrated financial supervision?

MF: We have never said that the UK model was one that other countries should follow. And we recognise that there are features of the UK (such as the fact that most of the financial service sector is concentrated in London) that has helped the creation of the FSA. But I think the main lessons I would draw are: (a) that it requires a committed senior executive who have a clear vision of what they are trying to achieve and the ability to get support for that from their staff and from key outside stakeholders; (b) that it mustn't involve a "take-over" by one of the existing regulators of the others but the creation of a genuinely new organisation; (c) there are no "quick fixes" and that it will take years to get all the potential benefits from the new organisation.

Forum: For countries like the Philippines, whose financial system is regulated by separate authorities each responsible for a specific type of institution, what critical areas must be looked into before adopting an integrated approach to financial regulation?

MF: It is a fact that the regulators of different kinds of financial service company tend to speak different "languages". This is particularly clear if you contrast banking regulators and insurance regulators. When they come together in one organisation, this can cause major confusion. In our case, it led to the creation of what is effectively a new language – we call it ARROW, which stands for **A**dvanced **R**isk **R**ecognition **O**perating Frame**w**ork. This has given us a common way of identifying risks wherever they arise in the financial sector, of prioritising them, allocating resources and monitoring the resulting risk mitigation processes.

It would have helped our own integration if we had known more about each of the individual regulator's methods of regulation before we came together. That – and mutual trust – are keynotes for successful integration!

(Mr. Michael Foot graciously agreed to be interviewed electronically for this issue through the kind assistance of Mr. Nigel Bromage, former official of the Bank of England. - Ed's Note)

Mr. Michael Foot is Managing Director, Deposit Takers and Markets Directorate at the Financial Services Authority (FSA), United Kingdom. He was appointed on 1 June 1998.

Before the creation of the FSA, Mr. Foot worked at the Bank of England. He joined the Bank of England in 1969 as an economist. He worked in the gilt-edged market (1981-83), the domestic money market (1983-85) and as Alternate Director for the UK at the IMF in Washington (1985-87). He was Head of Foreign Exchange Division (1988-90), and Head of European Division (1990-93). Mr. Foot was appointed Head of Banking Supervision Division in 1993, and became Deputy Director, Supervision & Surveillance in July 1994. Mr. Foot was appointed Executive Director effective 1 March 1996.

Mr. Foot was educated at Latymer Upper School, London, at Pembroke College, Cambridge (MA Economics), and at Yale University, USA (MA). He is a Fellow of the Chartered Institute of Bankers. He has written a number of articles on monetary policy and monetary history. He was awarded the Companion of the British Empire (C.B.E.) for services to financial regulation in the 2003 New Year's Honours List.

Mr. Foot, who was born in 1946, is married with one son and two daughters. For recreation he enjoys choral singing and tennis.

Strengthening deposit insurance system through effective bank supervision

Banking remains one of the most supervised industries in the world due to its critical role in the economy. Banking institutions provide primary sources of credit for businesses to finance economic activities especially in developing countries. Banks also act as agents in the payment and settlement system, facilitating financial transactions. The ineffectiveness of banks in these roles can seriously disrupt flow of funds and result in losses, thus impeding economic growth. Hence, bank regulation is critical to check bank's fidelity to their fiduciary obligations, thereby maintaining the stability and soundness in the banking system.

Effective bank supervision thereby increases public confidence in banks, reduces the incentives of depositors to withdraw funds and minimizes the likehood of bank failures.

The liberalization of financial markets and advancements in technology have changed banking services and practices, leading to increased risk of failure. Liberalization has reduced barriers to competition, driving banks to continually develop products and services more responsive to client needs, and to enhance and keep up with best practices of industry leaders. However, the same market forces may also lead to undesirable results as competition drives banks into innovating and developing new products with unclear attendant risks. A growing concern in conglomerates is that of ownership structure of financial institutions becoming more inter-related. The connection of securities and insurance firms to performance of related banks is also manifested in the blurring distinction of their respective product lines. There is now a rise of hybrids and/or convergence of products that used to be associated with a particular type of financial institution (e.g. mortgages for banking, annuities for insurance and mutual funds for securities).

The risks are compounded by technological advancements that transmit effects of adverse shocks at potentially greater speed. These risks require close supervision to safeguard against institutional failures arising from risks taken by bank officers/owners or market failures where many or large financial institutions fail, either through mismanagement, fraud, poor business judgment or severe economic stress.

Regulation is necessary for the banking industry because of the fiduciary nature of the business, as depositors entrust their funds to banks. Since these depositors may not have the capacity to monitor banks to ensure safety of their funds, they rely largely on the supervisors to perform this function on their behalf, and take corrective action when warranted. Effective bank supervision thereby increases public confidence in banks, reduces the incentives of depositors to withdraw funds and minimizes the likelihood of bank failures.

Framework for bank supervision

The Bangko Sentral ng Pilipinas (BSP) supervises Philippine banks with the aim of promoting and maintaining a stable and efficient banking and financial system that is globally competitive, dynamic and responsive to the demands of a developing economy. The BSP is authorized to supervise and exercise regulatory powers over the operations not only of banks but also of finance companies and non-bank financial institutions performing

PDIC supports the formation of a multilateral coordinating framework for cross-sector consolidated risk-based supervision of all financial institutions that will enhance the analysis of bank performance and condition.

quasi-banking functions[1]. This authority is extended to subsidiaries and affiliates of banks and quasi-banks, including non-allied enterprises controlled by banks.

The Monetary Board (MB) exercises the powers and functions of the BSP. The MB issues rules and regulations it considers necessary for the effective discharge of responsibilities of the BSP. In relation to bank supervision, it decides on the courses of action to be taken on banks which ranges from instituting corrective and disciplinary measures to closure and liquidation.

Cognizant of the integration of products and services of securities and insurance firms with banks, BSP has been working closely with the supervisors of these institutions for the strength of the entire financial system. The Securities and Exchange Commission (SEC) is the main government agency mandated to formulate policies on issues concerning the securities market. It also supervises the securities market comprised of the stock exchange, clearing agencies, brokers, investment houses, financing companies and mutual funds. On the other hand, the Insurance Commission (IC) supervises all insurance companies that are not owned by government. Similar to the powers of the BSP and the SEC, it formulates policies for the insurance industry.

Requirements of deposit insurance system

As a financial safety net player, it is the interest of Philippine Deposit Insurance Corporation (PDIC) to protect depositors from the consequences associated with bank failures and to sustain public confidence in the banking system by providing a formal mechanism to resolve bank failures. It is essential for PDIC to monitor the condition of its member banks to be able to assess and manage risks posed to the Deposit Insurance Fund (DIF). The deposit insurance scheme is often misconstrued as the best defense against bank failures. In reality, good corporate governance validated by effective bank supervision keeps bank failures away.

PDIC relies heavily on the BSP's effectiveness as supervisor of member banks. The reports received from banks are sourced mainly from BSP, enhanced by information derived from BSP reports of examination. In absence of authority to either assess the bank's condition on-site or require information from the bank and its affiliates and subsidiaries, PDIC uses information from BSP in its off-site analyses. BSP assesses bank performance and condition through on-site inspection of bank's books and its risk management procedures, guarding against unsafe and unsound practices. The PDIC uses all these available information on individual bank condition from the BSP[2] and other available sources to assess the risk posed to the DIF. When risks are significant, PDIC coordinates with BSP in trying to resolve the problem.

Given all these available information, all member banks are risk-rated by PDIC. Based on these ratings, PDIC determines the adequacy of the DIF. In some cases, problem banks that pose significant and imminent risk to the DIF become subject of BSP-PDIC resolution teams.

Although bank failures are inevitable, these are minimized through prompt corrective actions taken by the bank supervisor at the first signs of problems within the bank. With the timely information gathered from both on-site examination and off-site monitoring, BSP is alerted to changes in the performance and condition of banks allowing them to plan for appropriate intervention.

Mechanism for bank failure resolution

In cases of illiquidity, BSP provides several windows to banks for emergency assistance. But if the problem is more serious like capital inadequacy, BSP's primary response would be to require the bank owners to sign a memorandum of understanding (MOU) to commit to a capital build-up plan within a

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[1] *A company engaged in the borrowing of funds through the issuance, endorsement or assignment with recourse or acceptance of deposit substitutes for purpose of re-lending or purchasing of receivables and other obligations.*

[2] *While PDIC works more closely with the BSP relative to the other agencies by virtue of its institutional focus, information and regulatory action from both SEC and IC can help improve the quality of BSP's analyses of bank's condition by its own regulation of non-bank financial institutions or certain transactions that are nevertheless bank-related. In the case of SEC, it defines the rules regarding issuance of securities by all corporations, including banks. In particular, the SEC keeps a record of securities issued, and information pertaining to such securities that are made available for public inspection. It may also audit the financial statements, assets and other information of a firm applying for registration of its securities whenever it deems that the same is necessary to insure full disclosure and therefore protect the interest of the investors and the public in general.*

specific period of time. The success of instituting a capital restoration plan is driven by the capability of the supervisor to closely monitor and enforce MOU as agreed upon.

In cases of violations of banking regulations, BSP sanctions erring banks with measures that include fines, restrictions of banking activities, or withdrawal of access to BSP's credit facilities and even imprisonment for the responsible bank officers. BSP may also issue cease-and-desist orders in case of unsafe-and-unsound banking practices.

Upon determination that a distressed bank is vital to the community or essential in maintaining financial stability, PDIC can help in the rehabilitation of a distressed bank upon favorable evaluation of a proposal. In such case, financial assistance (FA), which may come in the form of loan, deposit placement, purchase of assets, or assumption of liabilities, may be extended to the distressed bank or its acquirer provided that bank's owners should equitably partake in the cost of rehabilitation. The FA contains various conditions which may include infusion of fresh capital, share divestment, commitment to performance targets, rectification of errors, change of management team, assignment of PDIC consultants and if necessary, nomination of members of the board. When opting to rehabilitate a bank, PDIC works closely with BSP to determine the extent and mode of FA. The amount of assistance granted to the bank is related to the extent of the financial problem, but the cost to PDIC of such assistance cannot be more than the cost of closing the bank.

As a final measure when rehabilitation is unlikely and depositors' interest are seriously jeopardized, the MB may order closure of a bank automatically placing it under receivership of the PDIC.

Based on findings on bank condition, MB may order closure of a distressed bank. The grounds for closure include (a) inability to pay liabilities as they become due in the ordinary course of business, (b) has insufficient realizable assets to meet liabilities, (c) cannot continue in business without involving probable losses to depositors or creditors, or (d) has willfully violated a cease and desist order that has become final. When a bank is ordered closed, PDIC takes over and commences payment of insured deposit claims as soon as records are verified and consolidated. The capability of PDIC to service claims of insured depositors depends largely on the quality of the bank's records for processing and reconciliation. In many cases in the past, records of closed banks were found inaccurate and inadequate seriously delaying claims settlement.

As receiver, PDIC will likewise determine within 90 days whether the institution may be rehabilitated to resume business with safety to its depositors, creditors and the general public or whether it should be liquidated.

PDIC makes a determination that the bank should be liquidated when there is no apparent viable plan for rehabilitation. After notice of MB's concurrence to such determination, PDIC files a petition for assistance in the liquidation of the affairs of the bank with the proper regional trial court (RTC). PDIC seeks the approval of the court in the distribution of the assets to the creditors/claimants of the closed bank.

Directions in enhancing bank supervision

To fill in information gaps that can be gathered from existing sources, PDIC entered into a memorandum of agreement (MOA) with the BSP to share more recent financial and non-financial data of banks, examination reports, periodic output reports and early warning indicators. Both also agree to share information that would indicate performance weaknesses of individual banks, as measured by specified indicators, as soon as such information is available. Discussions are also underway for the draft of a second MOA that involves provisions on additional information coverage and formation of specific joint committees for problem banks requiring special supervisory attention.

PDIC supports the formation of a multilateral coordinating framework for cross-sector consolidated risk-based supervision of all financial institutions that will enhance the analysis of bank performance and condition. The BSP, SEC, IC and PDIC will comprise the Financial Sector Forum (FSF), a body that would operate on the basis of consensus and moral suasion among member agencies. The FSF will facilitate information exchange among agencies subject to provisions of existing charters and laws, and coordination of regulatory activities and policies to address gaps in the supervisory oversight process. As envisioned, the FSF's activities will be principally the identification and resolution of systemic issues, harmonization of cross-sector supervision methodology, regulatory policy coordination, reporting, information exchange and dissemination, and consumer protection and education. The MOA is set for execution by the member agencies in July 2004.

PDIC has also proposed the restoration of its authority to examine member banks, for the purpose of validating findings on problem banks as basis for formulating necessary corrective actions. Such authority will enable PDIC to minimize the disruptive effects of bank failures and effectively manage its risk exposure. This proposal is one of the

amendments in the PDIC charter recently ratified by both Houses of Congress.

Conclusion

Recognizing the emerging synergies among banks and other financial institutions, Philippine bank supervision is evolving to improve the nature and speed of its response to address the twin necessities of strengthening banks and promoting financial stability. PDIC is constantly improving its effectiveness despite hindrances to management of insurance risks for the greater protection of depositors. As PDIC's authority and resources are limited by existing laws, the deposit insurance system is enhanced through heightened cooperation and coordination with the supervisors of financial institutions.

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Analysis of domestic deposits

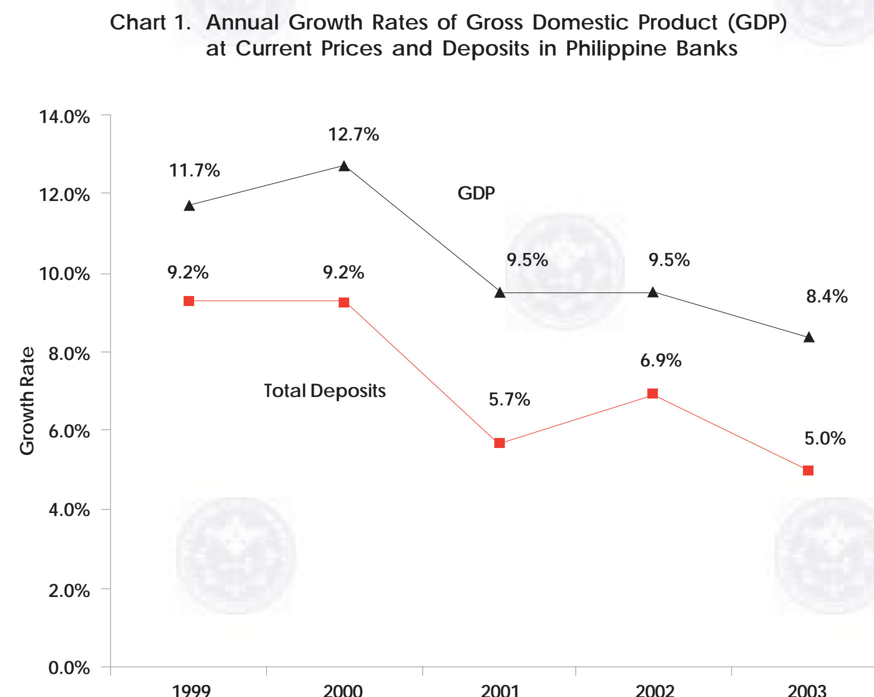
Overview

Deposits in the Philippine banking industry continued to grow although at a slower pace as the economy exhibited a tapered growth in nominal terms in 2003. Total domestic deposits reached P2.46 trillion as of December 2003 up by 5.0% or P116.1 billion from P2.34 trillion in December 2002.

Growth in deposits was evident in all major groups of accounts according to size of deposit balances (see Table 3 in page 33). This showed a favorable trend from a developmental perspective indicating increasing savings across all income groups. However, the bulk of volume change in deposit amount came from accounts with large balances, or from the big depositors i.e., institutional/ corporate and affluent individuals. Such denoted sustained preference of big depositors to maintain their levels of liquidity.

Across bank types, deposit expansion was widespread as consolidated deposits of commercial, thrift and rural banks, all posted growth. Deposit growth was highest in thrift banks at 14.0%; a significant improvement compared to the 7.7% growth posted in 2002. The favorable deposit trend among thrift banks could be attributed to the growth of small and medium sized industries, which enjoyed substantial support from the government during the year. Meanwhile, deposit growth in rural banks at 13.7% was likely boosted by the improved rural incomes as the agriculture sector performed well in 2003. Among commercial banks, deposits went up by 4.0%, with a large portion of the increment traced to higher dollar deposits of residents and non-residents.

Chart 1. Annual Growth Rates of Gross Domestic Product (GDP) at Current Prices and Deposits in Philippine Banks



Commercial banks

Commercial banks continued to dominate the banking industry in terms of resources and banking units. As of December 2003, domestic deposits in commercial banks reached P2.20 trillion up by 4.0% from P2.11 trillion in 2002. Expanded commercial banks and specialized government banks recorded lower growth compared to previous year's. Non-expanded commercial banks bounced back from a contraction of

15.5% in 2002 to a growth of 11.6% in 2003. On the other hand, consolidated deposits in foreign banks continued to drop by 1.4% in 2003.

Around two-thirds of the increment in deposits in commercial banks was attributed to growth in foreign currency deposits (FCDs), which grew by 4.0% in dollar terms, or 8.6% in peso terms. This largely sprang from higher revaluation of foreign currency deposits as the peso-dollar exchange rate adjusted from P53.3:$1 in 2002 to P55.5:$1 in 2003. Foreign currency deposits also increased in terms of volume stemming largely from higher OFW remittances.

Among peso deposits, time deposits led the growth as it surged by 37.1% compared to the 12.4% in 2002. The increase was accompanied by an expansion of 3.9% in number of deposit accounts. On the other hand, savings deposits contracted in terms of

Table 1. Distribution and Deposit Growth by Commercial Bank Type

Bank Type	Amount in Billion Pesos			Percentage Share to Total			Growth Rate	
	2001	2002	2003	2001	2002	2003	2001-2002	2002-2003
Commercial Banks (KBs)	1,980.6	2,112.0	2,196.5	100%	100%	100%	6.6%	4.0%
Expanded KBs	1,307.5	1,444.6	1,506.0	66.0%	68.4%	68.6%	10.5%	4.2%
Non-Expanded KBs	185.6	156.8	175.0	9.4%	7.4%	8.0%	-15.5%	11.6%
Foreign Banks	300.3	296.6	292.6	15.2%	14.0%	13.3%	-1.2%	-1.4%
Specialized Gov't Banks	187.3	214.1	222.9	9.5%	10.1%	10.1%	14.3%	4.1%

Table 2. Contribution of Foreign Currency Deposits (FCDs) to Increase in Total Deposits in Commercial Banks

Amounts in Million Pesos	2001	2002	2003
Levels			
Total Deposits (in PHP)	1,980,642	2,112,040	2,196,455
FCDs (in PHP)	656,825	665,096	722,201
FCDs (in USD)	12,707	12,489	12,992
Increment			
Total Deposits (in PHP)	91,358	131,398	84,415
FCDs (in PHP)	(17,170)	8,271	57,105
Due to revaluation [a/]	22,976	19,874	29,125
Due to change in level [b/]	(40,146)	(11,603)	27,980
Shares to Total Deposit Increment			
FCDs (in PHP)	-18.8%	6.3%	67.6%
Due to revaluation [a/]	25.1%	15.1%	34.5%
Due to change in level [b/]	-43.9%	-8.8%	33.1%

[a/] *Computed as [Previous year's deposits in USD x (current year's exchange rate - previous year's exchange rate)]*
[b/] *Computed as [Current year's exchange rate x (current year's deposits in USD - previous year's deposits in USD)]*

Table 3. Distribution and Deposit Growth in Commercial Banks by Account Type

Deposit Types	Amount in Billion Pesos			Share to Total			Growth Rate	
	2001	2002	2003	2001	2002	2003	2001-2002	2002-2003
Total	1,980.6	2,112.0	2,196.5	100%	100%	100%	6.6%	4.0%
Demand	207.1	262.7	284.0	10.5%	12.4%	12.9%	26.9%	8.1%
Savings	1,033.8	1,091.0	1,062.5	52.2%	51.7%	48.4%	5.5%	-2.6%
Time	82.9	93.2	127.7	4.2%	4.4%	5.8%	12.4%	37.1%
Foreign Currency Deposits	656.8	665.1	722.2	33.2%	31.5%	32.9%	1.3%	8.6%

amount and number of accounts, which hinted at the probability that some savings accounts were consolidated with or converted to time deposits to earn relatively higher interest. The number of demand deposit accounts also declined by 1.8% but increased in terms of amount by 8.1%.

Thrift banks

From 2002 to 2003, thrift banks registered the highest deposit growth among bank types at 14.0% or an increase from P172.8 billion to P197.0 billion. Deposits in Private Development Banks (PDBs) and Savings and Loan Associations (SLAs) reverted to positive growth, while Savings and Mortgage Banks (SMBs) and Micro-Finance Banks both sustained increasing deposit levels.

Time deposits led the growth among deposit types at 36.9%, which was partly driven by a corresponding increase in number of time deposit accounts specifically those with balances over P200,000. Despite reduction in number of deposit accounts, savings deposits still comprised the bulk of total deposits and recorded the most notable improvement in deposit growth in terms of amount at 10.0% in 2003 from 1.3% in the past year. The reduction in number of savings accounts was traced to accounts with relatively small balances, which was similar to the trend in commercial banks, and might have been consolidated with or converted to time deposits to earn higher interest. Growth of demand deposits decelerated at 22.6% compared to the 37.4% posted in 2002. Foreign currency deposits also registered a 20.0% growth during the year.

Rural banks

Deposit in rural banks increased by 13.7% as total amounts climbed from P54.7 billion in 2002 to P62.2 billion in 2003. The favorable performance of the agriculture sector appeared to have lifted consolidated deposits in rural banks. However, deposit growth was not broad-based. Growth in deposits was mostly limited to the biggest rural banks with asset sizes greater than P160 million and those ranging from P40 to P80 million. The closure of 10 rural banks in 2003 contributed to the decline in deposits in rural bank groups with assets less than P40 million and between P80 million to P160 million.

Deposit growth in rural banks was boosted by positive trends in all account types both in terms of accounts and amounts. Time

Table 4. Distribution and Deposit Growth by Thrift Bank Type

Bank Type	Amount in Billion Pesos			Share to Total			Growth Rate	
	2001	2002	2003	2001	2002	2003	2001-2002	2002-2003
Thrift Banks	160.5	172.8	197.0	100%	100%	100%	7.7%	14.0%
Savings & Mortgage Banks	118.8	136.1	151.7	74.0%	78.8%	77.0%	14.6%	11.5%
Private Development Banks	33.5	28.7	36.4	20.9%	16.6%	18.5%	-14.4%	27.1%
Savings & Loan Associations	8.2	8.0	8.8	5.1%	4.6%	4.5%	-2.3%	10.1%
Micro-Finance Oriented Banks [a/]	0.0	0.0	0.0	0.01%	0.02%	0.02%	164.8%	44.5%

[a/] *Deposit amounts are less than one hundred million pesos (P100M)*

Table 5. Distribution and Deposit Growth in Thrift Banks by Account Type

Deposit Types	Amount in Billion Pesos			Share to Total			Growth Rate	
	2001	2002	2003	2001	2002	2003	2001-2002	2002-2003
Total	160.5	172.8	197.0	100%	100%	100%	7.7%	14.0%
Demand	8.9	12.2	15.0	5.5%	7.1%	7.6%	37.4%	22.6%
Savings	126.6	128.3	141.1	78.9%	74.2%	71.7%	1.3%	10.0%
Time	8.6	12.4	17.0	5.4%	7.2%	8.6%	44.0%	36.9%
Foreign Currency Deposits	16.4	19.9	23.8	10.2%	11.5%	12.1%	21.4%	20.0%

Table 6. Distribution and Deposit Growth in Rural Bank Group

Classification Per Asset Size in Million Pesos	Amount in Billion Pesos			Share to Total			Growth Rate	
	2001	2002	2003	2001	2002	2003	2001-2002	2002-2003
Rural Banks	46.9	54.7	62.2	100%	100%	100%	16.6%	13.7%
< P20	1.2	1.0	0.8	2.6%	1.9%	1.3%	-15.5%	-19.8%
> P20 to P40	2.5	2.7	2.5	5.4%	4.9%	4.1%	4.6%	-4.6%
> P40 to P80	6.5	6.3	6.9	13.9%	11.6%	11.1%	-3.0%	9.1%
> P80 to P160	9.9	11.7	11.1	21.1%	21.3%	17.8%	17.7%	-5.0%
> P160	26.8	33.0	40.9	57.1%	60.4%	65.7%	23.1%	23.7%

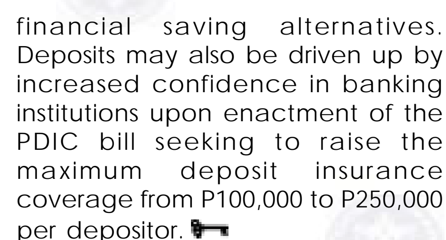
Table 7. Distribution and Deposit Growth in Rural Banks by Account Type

Deposit Types	Amount in Billion Pesos			Share to Total			Growth Rate	
	2001	2002	2003	2001	2002	2003	2001-2002	2002-2003
Total	47.1	54.7	62.2	100%	100%	100%	16.3%	13.7%
Demand	0.8	1.0	1.3	1.7%	1.9%	2.2%	27.9%	29.9%
Savings	29.2	36.4	42.4	62.0%	66.5%	68.2%	24.7%	16.6%
Time	17.1	17.3	18.4	36.2%	31.6%	29.6%	1.4%	6.5%

deposits rose by 6.5% compared to the growth of 1.4% recorded in the previous year specifically among accounts with larger balances. Savings deposits grew across all deposit ranges, both in terms of accounts and amounts, hence recorded a 16.6% growth. Demand deposits registered the highest growth rate in terms of amount and accounts among other deposit types at 29.9% and 14.6%, respectively, which may have arisen from a lower base.

Prospects

Based on PDIC estimates, deposits in member banks are expected to grow by 7% in 2004[1] given prevailing economic trends and policies, and barring global shocks. As banks aim to expand their deposit base, competition for funds shall continue exerting pressure to raise interest rates[2] on deposits with expectations of higher inflation rate[3] thereby keeping deposits attractive relative to other financial saving alternatives. Deposits may also be driven up by increased confidence in banking institutions upon enactment of the PDIC bill seeking to raise the maximum deposit insurance coverage from P100,000 to P250,000 per depositor.



* *Written by **Christopher G. Suguitan**, Supervising Research Specialist and **Mary Ann M. Santillan**, Research Specialist, Research Department.*

[1] *Forecast based on historical trend of deposits.*
[2] *Government forecasts the 91-day T-bill rate in 2004 to range between 7.5% to 8.5% which is higher compared to the actual rate recorded in 2003 at 6.0%, while interest rates on lending and deposits are also expected to rise.*
[3] *Based on official forecast, inflation rate is expected to hover from 4.0% to 5.0% in 2004. This is higher compared to the actual inflation rate recorded in 2003 at 3.1%.*

Industry Scan

Overview

In our pursuit to provide followers of banking - from apprentices to seasoned analysts - with banking and deposit information derived from the performance of our mandates, to the extent that same can be legitimately disclosed to the public, we present in the following pages our bank statistics as of December 31, 2003. The statistics offer an overview of the current banking industry profile and performance from which conclusions may be drawn. This can also serve as springboard for further research.

This issue contains selected balance sheet and income statement accounts and key performance ratios for the Philippine Banking System, further broken down into Commercial, Thrift and Rural Banks. Current data summarized in bar graphs showing various capital, asset quality, earnings and liquidity indicators are also included.

Aside from the financial data, statistics on bank deposits, particularly as to size of domestic deposit accounts are also provided. The same are disaggregated into type of deposit (e.g., demand, savings, time and foreign currency deposits), amount (clusters ranging from below P15,000 to over P200,000) and geographic distribution among the country's 17 regions. The tables and figures presented are as follows:

A. Tables

1. Statistics of the Philippine Banking System (PBS)
   A. Commercial Banks (KB)
      a.1 Expanded KBs (EKB)
      a.2 Non-Expanded KBs (NEKB)
      a.3 Foreign Banks
      a.4 Specialized Government Banks (SGB)
   B. Thrift Banks (TB)
      b.1 Savings & Mortgage Banks (SMB)
      b.2 Private Development Banks (PDB)
      b.3 Savings & Loan Association (SLA)
      b.4 Micro Finance Oriented Banks (MFO)
   C. Rural Banks (RB)
      c.1 Cooperative Banks
      c.2 Regular & MFOs
2. Rural Bank Statistics by Region
3. Domestic Deposit by Size of Accounts
   A. Philippine Banking System
   B. Commercial Banks
   C. Thrift Banks
   D. Rural Banks
4. Regional Distribution of Domestic Deposits
   A. Philippine Banking System
   B. Commercial Banks
   C. Thrift Banks
   D. Rural Banks
5. Percentage Share of Domestic Deposits Per Region

B. Figures

1. Selected Financial Ratios of the Philippine Banking System
2. Growth in Domestic Deposit Amounts in line graph for PBS, KBs, TBs and RBs from Dec-end 1995 to Dec-end 2003
3. Growth in Domestic Deposit Accounts in line graph for PBS, KBs, TBs and RBs from Dec-end 1995 to Dec-end 2003
4. Year-on-Year Deposit Movement with Selected Variables Related to its Growth from Dec-end 1998 to Dec-end 2003
   A. Philippine Banking System
   B. Commercial Banks
   C. Thrift Banks
   D. Rural Banks

C. Glossary of Terms

Caveat

The material provided herewith presents data obtained from financial reports submitted periodically by banks in compliance with existing regulations of the Philippine Deposit Insurance Corporation (PDIC). Submitted reports which are subjected to an internal process of system validating financial disclosures, are the responsibility of banks' Board and management.

In cases of non-submission of a report by a bank for the current period, the bank's most recent available report of the same type is used in the generation of industry statistics (please see notes on unsubmitted reports on page 51.) As a result of this methodology, there may be discrepancies when comparing the same account entry against different statistics generated by the PDIC sourced from different types of reports. Certain discrepancies with statistics of other regulatory agencies mainly attributed to timing differences in data generation and frequency in accessing data sources may as well arise. Other details and/or explanation provided in the material should also be noted as these may contain important information on how the figures were derived or whether there were any procedural refinements applied to the data.

For further queries and information, please contact the Officer-in-Charge of the Bank Performance Monitoring Department at telephone numbers (632) 841-4206, 841-4208 and 841-4000 locals 4211 to 4213, by fax at (632) 812-4116 and 813-3815, by e-mail at bpmc@pdic.gov.ph or write to PDIC 2228 Chino Roces Ave., Makati City 1231, Philippines. Other relevant banking industry data may also be accessed on-line at www.pdic.gov.ph lodged under Bank Statistics.

Table 1

Statistics of the Philippine Banking System (PBS)

As of December 31, 2003 *(Amounts in Million Pesos)*

Accounts	COMMERCIAL BANKS (KB)					THRIFT BANKS (TB)					RURAL BANKS (RB)			GRAND TOTAL
	EKB	Non - EKB	Foreign	SGB	Total	SMB	PDB	SLA	MFO	Total	Coops	Regular & MFO	Total	
STATEMENT OF CONDITION														
Quick Assets	648,237	87,342	189,649	167,818	1,093,046	50,151	11,552	4,632	65	66,401	1,030	21,273	22,303	1,181,750
Gross Loans	1,129,834	123,408	293,746	219,243	1,766,231	122,694	31,225	5,266	151	159,335	4,180	51,854	56,034	1,981,601
Interest Earning Assets	1,544,512	180,982	462,858	352,760	2,541,112	155,298	35,492	8,564	187	199,541	4,438	62,025	66,463	2,807,116
Risk Assets	1,725,344	204,602	399,590	265,563	2,595,098	162,206	47,875	10,419	175	220,675	5,136	74,142	79,278	2,895,052
Risk Weighted Assets	1,184,763	152,664	294,219	209,220	1,840,865	126,834	41,696	10,059	169	178,758	5,136	74,142	79,278	2,098,901
Non-Performing Loans	193,167	23,296	15,892	32,848	265,203	13,525	5,672	884	16	20,097	499	6,146	6,646	291,946
ROPOA	145,783	24,074	2,116	21,152	193,125	15,539	8,206	2,327	0	26,072	244	7,153	7,396	226,593
Non-Performing Assets	342,324	47,416	18,158	54,067	461,965	29,370	13,962	3,290	16	46,639	743	13,299	14,042	522,646
Total Restructured Loans	92,183	9,439	5,152	27,529	134,303	1,941	1,870	91	-	3,902	124	658	782	138,988
Current Restructured Loans	52,482	6,421	3,081	17,864	79,848	1,601	1,454	49	-	3,104	111	495	606	83,557
Non-Performing Restructured Loans	39,700	3,019	2,072	9,664	54,455	340	416	43	-	799	14	163	176	55,430
Gross Problematic Asset	398,702	54,809	21,300	72,540	547,350	31,353	17,472	3,441	16	52,282	856	13,809	14,665	614,297
Loan Loss Provision	94,756	12,899	16,009	23,642	147,307	5,489	2,517	351	12	8,369	225	2,515	2,739	158,416
Total Allowance	105,114	13,912	16,454	25,817	161,297	6,297	2,781	389	12	9,479	229	2,708	2,937	173,713
TOTAL ASSETS	2,129,852	259,362	494,839	415,524	3,299,577	200,464	59,017	14,568	260	274,310	5,661	84,093	89,754	3,663,641
Total Deposits	1,519,217	175,020	292,571	223,026	2,209,834	151,690	36,415	8,813	48	196,965	3,280	58,950	62,230	2,469,029
Total Borrowings	168,939	35,801	23,374	123,246	351,360	8,357	12,087	1,985	59	22,488	1,121	7,009	8,129	381,978
TOTAL LIABILITIES	1,853,774	225,754	419,311	374,563	2,873,401	169,090	52,250	11,395	114	232,848	4,719	70,691	75,410	3,181,659
Capital for Capital to Risk Asset Ratio	200,194	26,972	71,082	37,768	336,017	26,115	4,547	3,057	140	33,858	912	13,086	13,998	383,873
Qualifying Capital	173,726	27,446	73,221	39,131	313,524	27,995	4,328	2,752	142	35,216	912	13,086	13,998	362,739
Capital for NPL, NPA & GPA to Capital Ratio	308,927	41,119	87,787	63,751	501,585	33,018	7,404	3,457	153	44,032	1,159	15,827	16,986	562,602
BOOKED CAPITAL	276,079	33,608	75,528	40,962	426,176	31,374	6,768	3,173	147	41,462	943	13,402	14,345	481,982
INCOME AND EXPENSES														
Interest Income	100,780	15,219	31,349	26,578	173,926	15,744	3,806	992	70	20,613	692	9,399	10,090	204,629
Interest Expense	57,267	8,414	13,446	8,418	87,546	6,760	2,695	527	4	9,986	356	3,827	4,183	101,715
Net Interest Income	43,512	6,805	17,903	18,160	86,380	8,984	1,111	466	66	10,627	336	5,571	5,907	102,914
Other Operating Income	43,580	4,382	11,845	5,017	64,824	2,723	778	247	25	3,772	299	2,441	2,739	71,336
Other Operating Expense	59,994	7,719	16,793	15,058	99,563	10,170	2,406	795	77	13,447	504	6,654	7,158	120,169
Provisions for Loan Losses	12,371	1,508	3,452	4,538	21,869	1,438	69	23	11	1,541	16	164	180	23,590
Net Operating Income	14,728	1,960	9,503	3,581	29,772	98	-585	-105	3	-589	114	1,194	1,308	30,491
Non-Operating Income	16,288	188	987	485	17,948	352	340	65	0	757	16	398	414	19,119
Net Income Before Tax	31,016	2,148	10,490	4,066	47,720	450	-246	-40	3	168	130	1,593	1,722	49,610
Net Income After Tax	24,687	1,940	8,152	3,872	38,652	203	-326	-73	2	-194	129	1,351	1,480	39,938
RATIOS (In Percentage)														
Capital to Risk Assets	11.6	13.2	17.8	14.2	12.9	16.1	9.5	29.3	80.3	15.3	17.8	17.6	17.7	13.3
Risk-Based Capital Adequacy Ratio	14.7	18.0	24.9	18.7	17.0	22.1	10.4	27.4	83.9	19.7	17.8	17.6	17.7	17.3
Non-Performing Loans to Capital	62.5	56.7	18.1	51.5	52.9	41.0	76.6	25.6	10.7	45.6	43.1	38.8	39.1	51.9
Non-Performing Assets to Capital	110.8	115.3	20.7	84.8	92.1	89.0	188.6	95.2	10.8	105.9	64.1	84.0	82.7	92.9
Gross Problematic Assets to Capital	129.1	133.3	24.3	113.8	109.1	95.0	236.0	99.5	10.8	118.7	73.8	87.3	86.3	109.2
Non-Performing Loans to Gross Loans	17.1	18.9	5.4	15.0	15.0	11.0	18.2	16.8	10.8	12.6	11.9	11.9	11.9	14.7
Non-Performing Assets to Total Assets+Total Allow.	15.3	17.4	3.6	12.3	13.3	14.2	22.6	22.0	6.0	16.4	12.6	15.3	15.1	13.6
Loan Loss Provision to Non-Performing Loans	49.1	55.4	100.7	72.0	55.5	40.6	44.4	39.7	74.9	41.6	45.0	40.9	41.2	54.3
Gross Loans to Total Assets+Total Allow.	50.6	45.2	57.5	49.7	51.0	59.3	50.5	35.2	55.4	56.1	71.0	59.7	60.5	51.6
Quick Assets to Total Assets	30.4	33.7	38.3	40.4	33.1	25.0	19.6	31.8	25.1	24.2	18.2	25.3	24.8	32.3
Return on Equity	9.1	5.9	11.0	9.6	9.3	0.6	-4.7	-2.3	1.2	-0.5	14.5	10.5	10.8	8.4
Return on Assets	1.2	0.8	1.7	0.9	1.2	0.1	-0.6	-0.5	0.8	-0.1	2.3	1.7	1.7	1.1
Net Interest Margin	2.9	4.0	3.9	5.2	3.5	6.0	3.4	5.5	40.4	5.5	7.9	9.6	9.5	3.8
Operating Expense to Operating Income	83.1	82.5	68.1	84.6	80.3	99.2	131.0	114.7	96.6	104.1	82.1	85.1	84.9	82.5
Operating Expense excl. Provisions to Operating Income	68.9	69.0	56.4	65.0	65.8	86.9	127.4	111.6	84.6	93.4	79.5	83.0	82.8	69.0
Non-Operating Income to Net Income Before Tax	52.5	8.8	9.4	11.9	37.6	78.1	-138.2	-165.2	5.9	450.2	12.1	25.0	24.0	38.5
Quick Assets to Total Deposits	42.7	49.9	64.8	75.2	49.5	33.1	31.7	52.6	136.2	33.7	31.4	36.1	35.8	47.9
Gross Loans to Total Deposits	74.4	70.5	100.4	98.3	79.9	80.9	85.7	59.8	315.3	80.9	127.4	88.0	90.0	80.3
No. of PDIC Member Banks	12	8	19	3	42	31	29	30	2	92	44	719	763	897

Source: Consolidated Statement of Condition and Consolidated Statement of Income & Expenses.

Note: SGB refers to Specialized Gov't Banks (Land Bank of the Philippines, Development Bank of the Philippines and Al-Amanah Islamic Investment Bank which are considered Commercial Banks.)

Zero (0) means value is less than five hundred thousand (500T)

Table 2

Rural Bank Statistics by Region

As of December 31, 2003 (Amounts in Million Pesos)

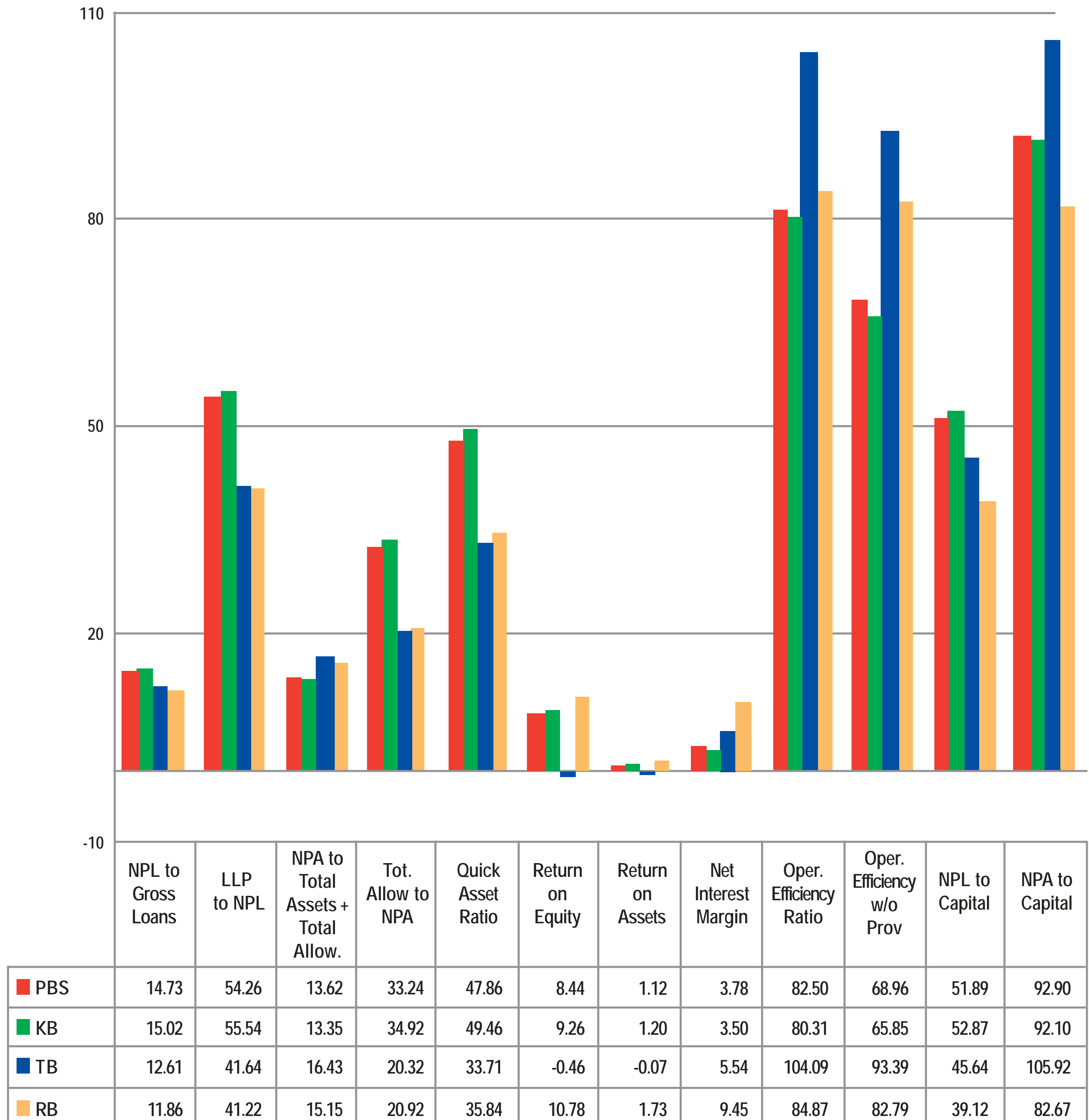
Accounts	Regions																	GRAND TOTAL
	NCR	1	2	3	4-A	4-B	5	6	7	8	9	10	11	12	CAR	ARMM	CARAGA	
STATEMENT OF CONDITION																		
Quick Assets	1,640	1,598	911	3,579	6,193	659	564	840	1,764	439	266	1,232	1,213	409	508	18	471	22,303
Gross Loans	4,895	4,760	2,917	9,493	11,735	1,294	3,318	2,914	3,038	890	967	3,058	2,033	1,456	968	89	2,209	56,034
Interest Earning Assets	5,919	5,195	3,135	11,283	14,914	1,575	3,361	2,977	4,081	1,139	1,101	3,619	2,885	1,618	1,269	96	2,296	66,463
Risk Assets	6,830	6,342	4,034	13,590	18,859	1,851	3,985	3,507	4,796	1,174	1,168	4,143	3,096	1,859	1,333	99	2,612	79,278
Non-Performing Loans	159	762	501	1,030	1,743	187	295	428	410	89	59	373	94	166	128	3	215	6,646
ROPOA	567	510	409	1,327	2,937	112	246	154	335	22	32	281	129	129	102	1	105	7,396
Non-Performing Assets	726	1,272	911	2,356	4,681	299	541	582	745	112	91	654	224	295	230	4	320	14,042
Total Restructured Loans	155	44	48	113	69	4	99	33	20	43	2	49	59	12	6	-	27	782
Current Restructured Loans	119	37	37	82	42	3	95	22	7	42	0	37	45	12	6	-	21	606
Non-Performing Restructured Loans	36	7	11	31	26	1	4	11	13	1	1	13	14	1	0	-	6	176
Gross Problematic Asset	845	1,309	948	2,440	4,729	303	638	608	752	153	92	691	269	308	235	4	341	14,665
Loan Loss Provision	120	225	166	352	586	78	146	204	212	75	40	226	87	69	56	6	90	2,739
Total Allowance	126	241	180	374	624	81	152	214	234	78	43	257	96	77	59	6	95	2,937
TOTAL ASSETS	7,756	7,097	4,435	15,197	21,688	2,084	4,295	3,935	5,540	1,359	1,284	4,659	3,697	2,075	1,595	110	2,947	89,754
Total Deposits	5,918	5,329	2,516	10,302	16,504	1,433	2,916	2,751	4,216	867	657	2,050	2,623	1,256	1,134	46	1,711	62,230
Total Borrowings	339	458	862	1,717	1,043	146	618	370	228	168	241	842	214	254	81	21	529	8,129
TOTAL LIABILITIES	6,904	6,209	3,754	12,753	18,405	1,681	3,732	3,368	4,709	1,106	1,004	3,189	3,154	1,664	1,287	75	2,415	75,410
Capital for Capital to Risk Asset Ratio	819	881	680	2,408	3,176	401	552	547	809	249	279	1,415	522	401	307	35	518	13,998
Capital for NPL, NPA & GPA to Capital Ratio	947	1,126	861	2,792	3,807	482	709	769	1,049	329	323	1,672	619	481	366	40	615	16,986
BOOKED CAPITAL	852	889	682	2,444	3,283	403	563	567	831	253	280	1,470	542	412	307	35	532	14,345
INCOME AND EXPENSES																		
Interest Income	871	675	529	1,558	2,099	245	504	470	629	163	164	690	481	286	166	17	542	10,090
Interest Expense	459	320	242	671	969	103	287	194	277	54	48	169	100	72	45	3	170	4,183
Net Interest Income	412	355	287	888	1,130	142	217	276	353	109	116	522	381	214	120	15	371	5,907
Other Operating Income	170	209	200	439	560	59	98	137	141	37	45	164	146	88	57	8	183	2,739
Other Operating Expense	559	519	407	1,070	1,490	160	287	366	448	113	125	487	349	228	128	11	413	7,158
Provision for Loan Losses	11	4	10	22	30	4	14	11	6	3	2	17	16	4	4	3	19	180
Net Operating Income	13	40	70	235	170	37	14	36	39	30	35	181	162	70	45	9	123	1,308
Non-Operating Income	74	19	21	74	133	5	6	6	24	1	1	20	11	13	1	-	5	414
Net Income Before Tax	87	59	91	309	303	42	19	42	63	31	36	201	173	83	45	9	128	1,722
Net Income After Tax	66	54	74	290	271	40	18	37	46	27	32	159	135	62	42	9	120	1,480
RATIOS (In Percentage)																		
Capital to Risk Assets	12.0	13.9	16.9	17.7	16.8	21.7	13.8	15.6	16.9	21.2	23.9	34.1	16.8	21.6	23.0	35.1	19.8	17.7
Non-Performing Loans to Capital	16.8	67.7	58.3	36.9	45.8	38.9	41.6	55.7	39.1	27.2	18.4	22.3	15.3	34.6	35.0	8.2	34.9	39.1
Non-Performing Assets to Capital	76.6	113.0	105.8	84.4	123.0	62.0	76.3	75.7	71.0	34.0	28.3	39.1	36.1	61.4	62.8	9.5	52.0	82.7
Gross Problematic Assets to Capital	89.2	116.2	110.1	87.4	124.2	62.7	90.1	79.1	71.7	46.7	28.4	41.4	43.4	64.2	64.4	9.5	55.3	86.3
Non-Performing Loans to Gross Loans	3.3	16.0	17.2	10.8	14.9	14.5	8.9	14.7	13.5	10.1	6.1	12.2	4.6	11.4	13.2	3.7	9.7	11.9
Non-Performing Assets to Total Assets+Total Allow.	9.2	17.3	19.7	15.1	21.0	13.8	12.2	14.0	12.9	7.8	6.9	13.3	5.9	13.7	13.9	3.3	10.5	15.1
Loan Loss Provision to Non-Performing Loans	75.1	29.6	33.2	34.2	33.6	41.7	49.6	47.7	51.7	83.5	68.0	60.7	92.4	41.5	43.3	169.9	42.0	41.2
Gross Loans to Total Assets+Total Allowance	62.1	64.9	63.2	61.0	52.6	59.8	74.6	70.2	52.6	62.0	72.9	62.2	53.6	67.7	58.5	76.5	72.6	60.5
Quick Assets to Total Assets	21.1	22.5	20.5	23.6	28.6	31.6	13.1	21.3	31.8	32.3	20.7	26.5	32.8	19.7	31.8	15.9	16.0	24.8
Return on Equity	7.9	6.3	11.2	12.4	8.7	10.3	3.3	6.8	5.8	10.9	12.0	11.1	25.1	16.0	14.2	28.1	25.7	10.8
Return on Assets	1.0	0.8	1.7	2.0	1.2	2.0	0.4	1.0	0.9	2.2	2.7	3.5	3.9	3.3	2.8	9.4	4.4	1.7
Net Interest Margin	8.0	7.2	9.6	8.4	7.7	9.4	7.0	9.9	9.8	10.5	11.6	14.6	14.2	14.9	10.2	18.8	17.5	9.5
Operating Expense to Operating Income	97.8	92.9	85.6	82.3	89.9	81.5	95.7	91.3	92.1	79.6	78.5	73.5	69.3	76.8	74.7	60.8	77.8	84.9
Operating Expense excl. Provisions to Operating Income	95.9	92.1	83.5	80.6	88.2	79.6	91.2	88.6	90.8	77.3	77.5	71.0	66.3	75.3	72.5	47.5	74.4	82.8
Non-Operating Income to Net Income Before Tax	85.2	31.9	22.8	23.9	43.8	11.9	29.4	14.8	38.3	3.0	4.0	9.8	6.6	16.1	1.3	0.00	4.2	24.0
Quick Assets to Total Deposits	27.7	30.0	36.2	34.7	37.5	45.9	19.3	30.5	41.8	50.6	40.5	60.1	46.2	32.6	44.8	38.1	27.6	35.8
Gross Loans to Total Deposits	82.7	89.3	115.9	92.1	71.1	90.3	113.8	105.9	72.1	102.6	147.3	149.1	77.5	116.0	85.4	192.0	129.1	90.0
No. of PDIC Member Banks	**27**	**68**	**33**	**103**	**144**	**27**	**51**	**77**	**57**	**27**	**16**	**47**	**22**	**22**	**19**	**4**	**19**	**763**

Source: Consolidated Statement of Condition and Consolidated Statement of Income & Expenses.
Zero (0) means value is less than five hundred thousand (500T)

ERRATUM: Table 2 on Rural Banks Statistics by Region, page 22 under Industry Scan Section of Vol. 1. (December 2003), No. 1 should have read ***"Amounts in Billion Pesos"*** *instead of* ***"Amounts in Million Pesos".***

Figure 1

Selected Financial Ratios of the Philippine Banking System (in %)
(as of December 31, 2003)



	NPL to Gross Loans	LLP to NPL	NPA to Total Assets + Total Allow.	Tot. Allow to NPA	Quick Asset Ratio	Return on Equity	Return on Assets	Net Interest Margin	Oper. Efficiency Ratio	Oper. Efficiency w/o Prov	NPL to Capital	NPA to Capital
PBS	14.73	54.26	13.62	33.24	47.86	8.44	1.12	3.78	82.50	68.96	51.89	92.90
KB	15.02	55.54	13.35	34.92	49.46	9.26	1.20	3.50	80.31	65.85	52.87	92.10
TB	12.61	41.64	16.43	20.32	33.71	-0.46	-0.07	5.54	104.09	93.39	45.64	105.92
RB	11.86	41.22	15.15	20.92	35.84	10.78	1.73	9.45	84.87	82.79	39.12	82.67

Source: Consolidated Statement of Condition and Consolidated Statement of Income & Expenses.

Table 3

Domestic Deposit Liabilities by Size of Account

As of December 31, 2003

(Amounts in Million Pesos)

A. PHILIPPINE BANKING SYSTEM

DEPOSIT SIZE	TOTAL DEPOSITS				DEMAND/ NOW DEPOSITS		SAVINGS DEPOSITS		TIME DEPOSITS		FCDs	
	Account	% to Total Account	Amount	% to Total Amount	Account	Amount	Account	Amount	Account	Amount	Account	Amount
P 15,000 & Below	19,756,860	75.9%	47,371	1.9%	1,282,190	4,768	18,112,762	40,006	118,078	677	243,830	1,919
P 15,000.01 - P 40,000	2,000,560	7.7%	50,178	2.0%	212,993	5,382	1,602,865	39,448	69,441	1,790	115,261	3,558
P 40,000.01 - P 60,000	816,821	3.1%	40,410	1.6%	78,891	3,892	553,901	26,944	102,886	5,308	81,143	4,266
P 60,000.01 - P 80,000	466,383	1.8%	32,295	1.3%	50,627	3,513	307,584	21,112	26,761	1,855	81,411	5,815
P 80,000.01 - P 100,000	639,759	2.5%	58,734	2.4%	36,254	3,248	252,446	22,929	153,796	15,125	197,263	17,432
P 100,000.01 - P 125,000	465,934	1.8%	51,135	2.1%	35,897	4,012	329,071	35,670	29,677	3,233	71,289	8,220
P 125,000.01 - P 150,000	222,861	0.9%	30,608	1.2%	25,502	3,491	131,006	17,846	13,097	1,834	53,256	7,438
P 150,000.01 - P 200,000	284,214	1.1%	49,380	2.0%	35,988	6,238	176,457	30,266	21,678	4,034	50,091	8,842
Over P 200,000	1,362,842	5.2%	2,095,522	85.3%	167,465	265,792	755,368	1,011,860	105,631	129,336	334,378	688,533
Total	**26,016,234**	**100.0%**	**2,455,634**	**100.0%**	**1,925,807**	**300,336**	**22,221,460**	**1,246,082**	**641,045**	**163,193**	**1,227,922**	**746,023**

B. COMMERCIAL BANKS

DEPOSIT SIZE	TOTAL DEPOSITS				DEMAND/ NOW DEPOSITS		SAVINGS DEPOSITS		TIME DEPOSITS		FCDs	
	Account	% to Total Account	Amount	% to Total Amount	Account	Amount	Account	Amount	Account	Amount	Account	Amount
P 15,000 & Below	13,310,273	72.4%	36,721	1.7%	981,493	3,851	12,057,596	30,710	42,170	299	229,014	1,860
P 15,000.01 - P 40,000	1,577,345	8.6%	39,819	1.8%	182,133	4,613	1,248,820	30,860	37,001	949	109,391	3,398
P 40,000.01 - P 60,000	650,456	3.5%	32,144	1.5%	68,744	3,394	435,154	21,128	69,687	3,584	76,871	4,038
P 60,000.01 - P 80,000	367,054	2.0%	25,320	1.2%	44,582	3,095	244,628	16,785	16,092	1,108	61,752	4,333
P 80,000.01 - P 100,000	495,226	2.7%	45,103	2.1%	32,163	2,882	181,868	16,359	94,831	9,353	186,364	16,509
P 100,000.01 - P 125,000	368,206	2.0%	40,561	1.8%	32,055	3,582	255,421	27,731	13,039	1,437	67,691	7,810
P 125,000.01 - P 150,000	187,919	1.0%	25,808	1.2%	22,723	3,112	106,278	14,463	7,303	1,022	51,615	7,212
P 150,000.01 - P 200,000	234,906	1.3%	40,667	1.9%	32,561	5,644	144,123	24,664	13,009	2,422	45,213	7,936
Over P 200,000	1,183,808	6.4%	1,910,312	87.0%	154,946	253,852	633,089	879,786	79,477	107,569	316,296	669,105
Total	**18,375,193**	**100.0%**	**2,196,455**	**100.0%**	**1,551,400**	**284,024**	**15,306,977**	**1,062,487**	**372,609**	**127,743**	**1,144,207**	**722,201**

Source : Consolidated Report on Deposit Liabilities by Size of Account.
Note: Domestic deposits excludes deposits in overseas branches of Philippine banks.

Domestic Deposit Liabilities by Size of Account (cont.)

As of December 31, 2003

(Amounts in Million Pesos)

C. THRIFT BANKS

DEPOSIT SIZE	TOTAL DEPOSITS				DEMAND/ NOW DEPOSITS		SAVINGS DEPOSITS		TIME DEPOSITS		FCDs	
	Account	% to Total Account	Amount	% to Total Amount	Account	Amount	Account	Amount	Account	Amount	Account	Amount
P 15,000 & Below	2,003,846	74.6%	4,789	2.4%	217,020	695	1,740,123	3,882	31,887	153	14,816	59
P 15,000.01 - P 40,000	218,229	8.1%	5,387	2.7%	26,382	661	176,937	4,327	9,040	239	5,870	160
P 40,000.01 - P 60,000	92,451	3.4%	4,627	2.3%	8,848	436	63,454	3,113	15,877	849	4,272	229
P 60,000.01 - P 80,000	63,376	2.4%	4,489	2.3%	5,327	369	35,102	2,411	3,288	227	19,659	1,482
P 80,000.01 - P 100,000	65,505	2.4%	6,057	3.1%	3,636	325	36,596	3,396	14,374	1,413	10,899	923
P 100,000.01 - P 125,000	57,160	2.1%	6,197	3.1%	3,392	381	46,995	5,060	3,175	346	3,598	410
P 125,000.01 - P 150,000	21,227	0.8%	2,912	1.5%	2,455	335	15,500	2,122	1,631	229	1,641	226
P 150,000.01 - P 200,000	31,720	1.2%	5,609	2.8%	3,017	523	20,798	3,599	3,027	581	4,878	906
Over P 200,000	132,952	4.9%	156,899	79.7%	11,321	11,243	91,710	113,235	11,839	12,994	18,082	19,428
Total	**2,686,466**	**100.0%**	**196,965**	**100.0%**	**281,398**	**14,966**	**2,227,215**	**141,145**	**94,138**	**17,031**	**83,715**	**23,822**

D. RURAL BANKS

DEPOSIT SIZE	TOTAL DEPOSITS				DEMAND/ NOW DEPOSITS		SAVINGS DEPOSITS		TIME DEPOSITS	
	Account	% to Total Account	Amount	% to Total Amount	Account	Amount	Account	Amount	Account	Amount
P 15,000 & below	4,442,741	89.7%	5,861	9.4%	83,677	222	4,315,043	5,414	44,021	226
P 15,000.01 - P 40,000	204,986	4.1%	4,972	8.0%	4.478	108	177,108	4,262	23,400	602
P 40,000.01 - P 60,000	73,914	1.5%	3,640	5.9%	1,299	62	55,293	2,703	17,322	875
P 60,000.01 - P 80,000	35,953	0.7%	2,486	4.0%	718	50	27,854	1,916	7,381	521
P 80,000.01 - P 100,000	79,028	1.6%	7,574	12.2%	455	41	33,982	3,174	44,591	4,359
P 100,000.01 - P 125,000	40,568	0.8%	4,377	7.0%	450	49	26,655	2,879	13,463	1,449
P 125,000.01 - P 150,000	13,715	0.3%	1,888	3.0%	324	44	9,228	1,261	4,163	583
P 150,000.01 - P 200,000	17,588	0.4%	3,104	5.0%	410	71	11,536	2,002	5,642	1,031
Over P 200,000	46,082	0.9%	28,311	45.5%	1,198	698	30,569	18,839	14,315	8,774
Total	**4,954,575**	**100.0%**	**62,214**	**100.0%**	**93,009**	**1,345**	**4,687,268**	**42,450**	**174,298**	**18,419**

Source : Consolidated Report on Deposit Liabilities by Size of Account.
Notes: Domestic deposits exclude deposits in overseas branches of Philippine banks.
No recorded Foreign Currency Deposits (FCDs) for Rural Banks.

Table 4

Regional Distribution of Domestic Deposits

As of December 31, 2003

(Amounts in Million Pesos)

A. PHILIPPINE BANKING SYSTEM

AREA	No. of Banking Offices	TOTAL DEPOSITS		DEMAND/ NOW DEPOSITS		SAVINGS DEPOSITS		TIME DEPOSITS		FCDs	
		Account	Amount	Account	Amount	Account	Amount	Account	Amount	Account	Amount
TOTAL NCR	**2,565**	**9,895,103**	**1,642,812**	**1,031,432**	**190,780**	**7,823,795**	**737,907**	**297,479**	**107,057**	**742,397**	**607,068**
City of Manila	570	1,802,527	303,153	196,539	30,345	1,425,521	164,484	43,805	21,129	136,662	87,195
City of Muntinlupa	82	283,137	32,442	28,956	4,607	226,352	13,534	8,318	4,443	19,511	9,858
Kalookan City	88	326,562	43,158	34,817	4,262	264,705	27,380	7,990	3,179	19,050	8,337
Las Piñas City	63	223,524	13,442	21,739	1,744	183,113	8,423	3,805	633	14,867	2,642
Makati City	388	2,286,667	673,653	240,597	75,142	1,676,744	205,687	126,402	41,287	242,924	351,538
Malabon City	36	115,915	12,544	11,009	938	96,103	8,476	2,158	869	6,645	2,261
Mandaluyong City	103	521,789	63,101	42,772	6,492	449,340	34,097	4,048	1,297	25,629	21,216
Marikina City	56	195,556	14,028	17,399	1,629	160,392	8,810	6,189	938	11,576	2,651
Navotas	20	52,928	4,203	6,223	548	44,202	2,860	548	173	1,955	623
Parañaque City	131	447,330	42,641	46,647	5,484	365,672	21,182	7,541	1,790	27,470	14,185
Pasay City	78	385,404	36,149	27,150	4,092	338,207	21,756	4,997	1,301	15,050	8,999
Pasig City	152	538,761	72,930	62,871	13,353	432,903	35,817	13,359	3,509	29,628	20,251
Pateros	11	45,732	1,946	3,002	253	40,487	1,244	898	113	1,345	335
Quezon City	627	2,180,084	247,916	232,871	33,409	1,753,797	147,585	47,078	14,971	146,338	51,952
San Juan	88	247,353	62,801	38,952	5,805	161,281	25,550	14,687	10,272	32,433	21,174
Taguig	19	81,827	3,440	3,236	758	76,208	1,661	277	46	2,106	974
Valenzuela City	53	160,007	15,265	16,652	1,919	128,768	9,360	5,379	1,108	9,208	2,878
TOTAL PROVINCIAL	**4,786**	**16,056,473**	**812,661**	**893,565**	**109,588**	**14,333,134**	**507,946**	**344,214**	**56,191**	**485,560**	**138,936**
(Regions)											
1	364	1,184,433	51,146	43,931	5,826	1,061,763	34,054	33,876	3,636	44,863	7,631
2	198	578,823	21,680	26,001	3,231	531,409	14,968	8,312	1,003	13,101	2,478
3	785	2,249,392	120,525	131,537	13,082	1,963,619	75,398	60,906	8,560	93,330	23,486
4-A	1,146	3,612,596	168,614	192,066	18,903	3,233,433	102,486	72,591	11,343	114,506	35,883
4-B	118	383,610	18,708	15,558	2,144	358,721	13,945	4,510	755	4,821	1,863
5	214	747,856	31,446	46,255	5,133	669,818	20,403	15,801	1,973	15,982	3,937
6	387	1,364,823	77,173	88,870	10,250	1,197,699	51,771	28,490	3,805	49,764	11,347
7	481	1,566,988	130,397	108,201	16,957	1,349,456	69,970	46,084	14,051	63,247	29,419
8	123	497,351	20,777	25,257	4,337	455,240	13,304	7,627	1,061	9,227	2,075
9	110	461,356	26,428	25,484	3,983	417,321	17,693	8,159	1,829	10,392	2,923
10	241	890,139	37,956	49,496	7,577	809,679	23,949	13,835	2,197	17,129	4,234
11	236	858,983	47,874	57,259	7,722	765,846	29,829	14,668	3,202	21,210	7,122
12	161	657,059	24,208	36,256	4,395	595,838	16,331	17,379	990	7,586	2,493
CAR	105	446,271	22,185	21,373	3,038	402,013	15,152	6,616	955	16,269	3,040
ARMM	19	80,379	2,237	4,773	374	74,555	1,629	606	92	445	142
CARAGA	98	476,414	11,306	21,248	2,638	446,724	7,064	4,754	740	3,688	864
TOTAL PHILIPPINES	**7,351**	**25,951,576**	**2,455,473**	**1,924,997**	**300,369**	**22,156,929**	**1,245,853**	**641,693**	**163,247**	**1,227,957**	**746,004**

Source: Report on Breakdown of Deposit Liabilities by Type (BDL) submitted by member banks.
Notes: Domestic deposits exclude deposits in overseas branches of Philippine banks.
Banking offices refer to Head Offices, Branches, Money Shops, Extension Offices and Saving Agencies of banks as reported.

Table 4

Regional Distribution of Domestic Deposits (cont.)

As of December 31, 2003

(Amounts in Million Pesos)

B. COMMERCIAL BANKS

AREA	No. of Banking Offices	TOTAL DEPOSITS		DEMAND/ NOW DEPOSITS		SAVINGS DEPOSITS		TIME DEPOSITS		FCDs	
		Account	Amount	Account	Amount	Account	Amount	Account	Amount	Account	Amount
TOTAL NCR	**1,992**	**8,502,295**	**1,511,933**	**875,170**	**180,703**	**6,706,762**	**647,827**	**233,529**	**94,219**	**686,834**	**589,184**
City of Manila	469	1,617,686	283,656	173,135	28,990	1,277,367	149,873	37,917	19,642	129,267	85,151
City of Muntinlupa	56	225,009	27,284	21,832	4,184	181,077	10,298	5,583	3,835	16,517	8,967
Kalookan City	68	278,930	38,097	28,948	4,072	225,984	23,555	6,687	2,734	17,311	7,737
Las Piñas City	36	172,062	9,853	15,201	1,460	142,054	5,864	2,154	370	12,653	2,158
Makati City	317	2,026,177	638,645	214,443	72,942	1,462,156	180,397	115,797	39,018	233,781	346,288
Malabon City	29	100,495	11,255	9,670	842	82,986	7,547	1,986	757	5,853	2,109
Mandaluyong City	86	489,576	60,919	38,065	6,262	423,350	32,497	3,543	1,212	24,618	20,949
Marikina City	38	149,592	11,208	13,464	1,426	123,756	7,042	2,106	338	10,266	2,402
Navotas	16	46,477	3,894	5,371	514	38,766	2,637	477	142	1,863	601
Parañaque City	109	378,647	37,844	38,790	4,962	311,740	18,325	4,135	1,215	23,982	13,341
Pasay City	62	347,300	34,011	23,049	3,948	306,190	20,241	3,948	1,161	14,113	8,662
Pasig City	98	418,022	63,379	50,719	12,541	335,365	29,536	5,267	2,419	26,671	18,884
Pateros	5	21,160	1,240	1,833	200	18,157	760	81	5	1,089	275
Quezon City	487	1,830,991	217,358	191,050	30,415	1,482,427	127,806	29,223	11,538	128,291	47,600
San Juan	66	210,277	56,619	33,191	5,400	135,007	21,849	11,668	8,971	30,411	20,398
Taguig	11	57,904	3,165	2,692	735	52,842	1,413	264	43	2,106	974
Valenzuela City	39	131,990	13,505	13,717	1,810	107,538	8,186	2,693	819	8,042	2,689
TOTAL PROVINCIAL	**2,180**	**9,876,964**	**684,658**	**676,809**	**103,379**	**8,603,675**	**414,728**	**139,107**	**33,534**	**457,373**	**133,016**
(Regions)											
1	143	736,541	41,582	34,395	5,459	645,725	27,524	13,988	1,501	42,433	7,098
2	69	350,165	18,720	21,902	3,191	311,027	12,446	4,230	612	13,006	2,470
3	327	1,369,247	95,181	89,258	11,930	1,173,482	57,090	18,235	3,714	88,272	22,447
4-A	437	1,996,580	126,260	122,800	16,839	1,755,032	71,747	17,775	4,211	100,973	33,463
4-B	39	157,567	16,562	11,725	2,049	140,173	12,360	1,143	311	4,526	1,842
5	96	432,905	26,672	39,513	4,966	372,726	16,905	4,846	906	15,820	3,895
6	221	1,022,756	71,054	79,416	9,983	879,750	47,596	15,214	2,425	48,376	11,050
7	254	1,092,623	115,169	82,948	16,212	920,809	58,295	27,931	11,868	60,935	28,795
8	71	357,583	19,107	24,069	4,309	319,811	11,997	4,515	731	9,188	2,070
9	77	362,356	25,046	23,932	3,879	322,270	16,654	5,868	1,606	10,286	2,907
10	116	500,148	34,060	39,857	7,305	436,938	21,025	6,790	1,602	16,563	4,127
11	134	524,193	42,817	43,603	7,151	452,538	26,777	7,750	2,257	20,302	6,631
12	90	428,501	22,208	29,100	4,242	387,424	14,844	4,600	672	7,377	2,450
CAR	54	297,155	18,822	16,880	2,917	261,237	12,556	3,855	582	15,183	2,767
ARMM	14	67,417	2,129	4,773	374	61,623	1,524	576	90	445	142
CARAGA	38	181,227	9,270	12,638	2,573	163,110	5,387	1,791	446	3,688	864
TOTAL PHILIPPINES	**4,172**	**18,379,259**	**2,196,591**	**1,551,979**	**284,082**	**15,310,437**	**1,062,555**	**372,636**	**127,753**	**1,144,207**	**722,201**

Source: Report on Breakdown of Deposit Liabilities by Type (BDL) submitted by member banks.

Notes: Domestic deposits exclude deposits in overseas branches of Philippine banks.

Banking offices refer to Head Offices, Branches, Money Shops, Extension Offices and Saving Agencies of banks as reported.

Table 4

Regional Distribution of Domestic Deposits (cont.)

As of December 31, 2003

(Amounts in Million Pesos)

C. THRIFT BANKS

AREA	No. of Banking Offices	TOTAL DEPOSITS		DEMAND/ NOW DEPOSITS		SAVINGS DEPOSITS		TIME DEPOSITS		FCDs	
		Account	Amount	Account	Amount	Account	Amount	Account	Amount	Account	Amount
TOTAL NCR	**508**	**1,233,872**	**126,189**	**151,925**	**10,017**	**978,043**	**87,357**	**48,341**	**10,930**	**55,563**	**17,884**
City of Manila	101	184,841	19,497	23,404	1,355	148,154	14,610	5,888	1,487	7,395	2,044
City of Muntinlupa	20	49,754	5,000	6,503	420	38,076	3,143	2,181	546	2,994	891
Kalookan City	18	39,883	4,964	5,862	191	31,230	3,764	1,052	410	1,739	600
Las Piñas City	20	39,821	3,084	5,726	279	31,155	2,162	726	159	2,214	484
Makati City	68	255,468	34,036	26,092	2,200	210,599	24,714	9,634	1,872	9,143	5,250
Malabon City	6	14,267	1,268	1,339	96	11,972	909	164	111	792	152
Mandaluyong City	16	29,467	1,936	4,427	228	23,807	1,385	222	55	1,011	267
Marikina City	11	30,357	2,285	3,280	194	24,964	1,642	803	201	1,310	248
Navotas	3	3,656	291	852	34	2,642	205	70	31	92	21
Parañaque City	20	62,700	4,463	7,794	520	50,266	2,686	1,152	413	3,488	844
Pasay City	16	38,104	2,138	4,101	144	32,017	1,516	1,049	140	937	337
Pasig City	35	83,681	8,439	11,378	803	67,396	5,797	1,950	471	2,957	1,367
Pateros	4	6,432	446	876	50	5,041	287	259	47	256	61
Quezon City	138	336,979	30,493	41,764	2,991	259,522	19,739	17,646	3,411	18,047	4,352
San Juan	21	36,429	6,135	5,714	404	25,681	3,654	3,012	1,301	2,022	776
Taguig	-	-	-	-	-	-	-	-	-	-	-
Valenzuela City	11	22,033	1,714	2,813	108	15,521	1,143	2,533	275	1,166	189
TOTAL PROVINCIAL	**773**	**1,454,830**	**71,004**	**130,361**	**4,947**	**1,250,182**	**53,992**	**46,100**	**6,146**	**28,187**	**5,919**
(Regions)											
1	38	80,375	4,174	6,509	286	69,415	3,001	2,021	354	2,430	533
2	8	21,718	629	1,930	14	18,783	553	910	53	95	9
3	159	245,480	14,717	21,787	926	202,061	10,995	16,574	1,757	5,058	1,039
4-A	270	458,354	25,051	47,424	1,767	382,414	18,831	14,983	2,034	13,533	2,420
4-B	22	57,370	743	3,189	91	53,633	604	253	26	295	21
5	28	88,188	1,942	6,029	162	80,202	1,528	1,795	210	162	42
6	44	60,015	3,330	6,750	247	50,117	2,421	1,760	365	1,388	297
7	102	230,423	11,145	17,338	683	206,258	9,054	4,515	785	2,312	624
8	7	16,517	695	1,020	25	15,407	657	51	7	39	5
9	7	10,513	670	1,014	99	9,299	552	94	3	106	16
10	33	65,960	2,092	5,658	199	59,095	1,728	641	59	566	107
11	28	55,005	2,751	5,392	246	47,305	1,725	1,400	290	908	490
12	9	17,296	658	2,039	87	14,762	457	286	72	209	42
CAR	12	34,035	2,179	3,744	105	28,401	1,670	804	130	1,086	273
ARMM	-	-	-	-	-	-	-	-	-	-	-
CARAGA	6	13,581	229	538	9	13,030	217	13	2	-	-
TOTAL PHILIPPINES	**1,281**	**2,688,702**	**197,193**	**282,286**	**14,964**	**2,228,225**	**141,349**	**94,441**	**17,077**	**83,750**	**23,803**

Source: Report on Breakdown of Deposit Liabilities by Type (BDL) submitted by member banks.
Notes: Domestic deposits exclude deposits in overseas branches of Philippine banks.
Banking offices refer to Head Offices, Branches, Money Shops, Extension Offices and Saving Agencies of banks as reported.
No recorded Foreign Currency Deposits (FCDs) for Rural Banks.

Table 4

Regional Distribution of Domestic Deposits (cont.)

As of December 31, 2003

(Amounts in Million Pesos)

D. RURAL BANKS

AREA	No. of Banking Offices	TOTAL DEPOSITS		DEMAND/ NOW DEPOSITS		SAVINGS DEPOSITS		TIME DEPOSITS	
		Account	Amount	Account	Amount	Account	Amount	Account	Amount
TOTAL NCR	**65**	**158,936**	**4,690**	**4,337**	**60**	**138,990**	**2,723**	**15,609**	**1,907**
City of Manila	-	-	-	-	-	-	-	-	-
City of Muntinlupa	6	8,374	158	621	4	7,199	93	554	61
Kalookan City	2	7,749	97	7	0	7,491	62	251	35
Las Piñas City	7	11,641	505	812	5	9,904	397	925	103
Makati City	3	5,022	973	62	0	3,989	576	971	397
Malabon City	1	1,153	21	-	-	1,145	20	8	1
Mandaluyong City	1	2,746	246	280	1	2,183	214	283	30
Marikina City	7	15,607	535	655	9	11,672	126	3,280	400
Navotas	1	2,795	18	-	-	2,794	18	1	0
Parañaque City	2	5,983	334	63	2	3,666	170	2,254	162
Pasay City	-	-	-	-	-	-	-	-	-
Pasig City	19	37,058	1,111	774	9	30,142	484	6,142	618
Pateros	2	18,140	260	293	2	17,289	196	558	61
Quezon City	2	12,114	65	57	3	11,848	40	209	22
San Juan	1	647	47	47	0	593	47	7	0
Taguig	8	23,923	274	544	23	23,366	248	13	3
Valenzuela City	3	5,984	46	122	1	5,709	32	153	14
TOTAL PROVINCIAL *(Regions)*	**1,833**	**4,724,679**	**56,998**	**86,395**	**1,262**	**4,479,277**	**39,226**	**159,007**	**16,510**
1	183	367,517	5,391	3,027	81	346,623	3,529	17,867	1,781
2	121	206,940	2,332	2,169	26	201,599	1,969	3,172	337
3	299	634,665	10,627	20,492	226	588,076	7,312	26,097	3,089
4-A	439	1,157,662	17,303	21,842	296	1,095,987	11,908	39,833	5,098
4-B	57	168,673	1,404	644	3	164,915	981	3,114	419
5	90	226,763	2,832	713	5	216,890	1,970	9,160	857
6	122	282,052	2,789	2,704	20	267,832	1,754	11,516	1,015
7	125	243,942	4,082	7,915	63	222,389	2,621	13,638	1,398
8	45	123,251	975	168	3	120,022	650	3,061	322
9	26	88,487	712	538	5	85,752	488	2,197	219
10	92	324,031	1,805	3,981	73	313,646	1,196	6,404	536
11	74	279,785	2,306	8,264	325	266,003	1,327	5,518	655
12	62	211,262	1,342	5,117	66	193,652	1,030	12,493	246
CAR	39	115,081	1,185	749	16	112,375	926	1,957	243
ARMM	5	12,962	108	-	-	12,932	106	30	2
CARAGA	54	281,606	1,807	8,072	55	270,584	1,460	2,950	292
TOTAL PHILIPPINES	**1,898**	**4,883,615**	**61,689**	**90,732**	**1,322**	**4,618,267**	**41,949**	**174,616**	**18,417**

Source: Report on Breakdown of Deposit Liabilities by Type (BDL) submitted by member banks.
Notes: Domestic deposits exclude deposits in overseas branches of Philippine banks.
Banking offices refer to Head Offices, Branches, Money Shops, Extension Offices and Saving Agencies of banks as reported.
No recorded Foreign Currency Deposits (FCDs) for Rural Banks.
Zero (0) means value is less than five hundred thousand (500T).

The Philippine Archipelago

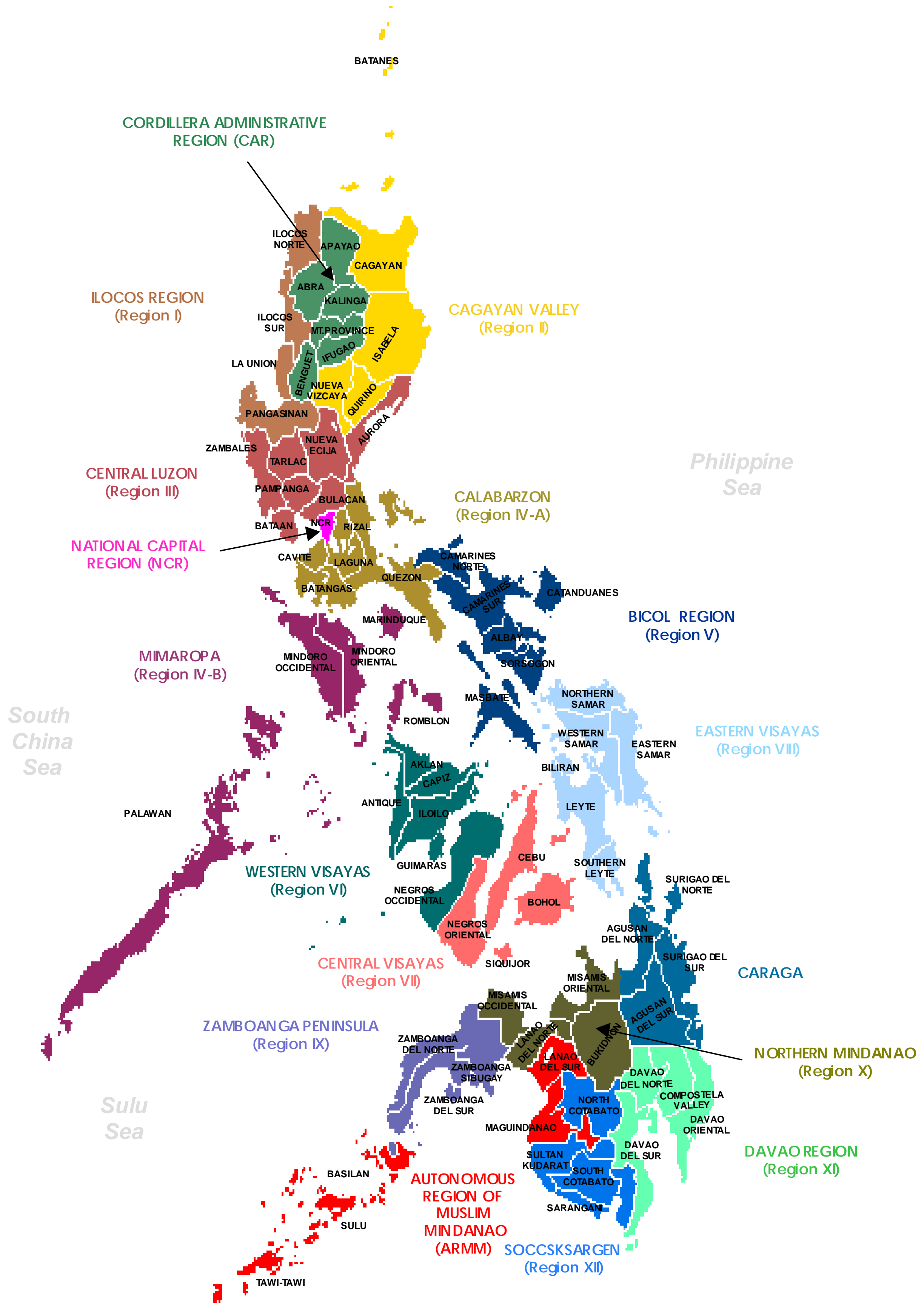


Table 5

Percentage Share of Domestic Deposit per Region

As of December 31, 2003

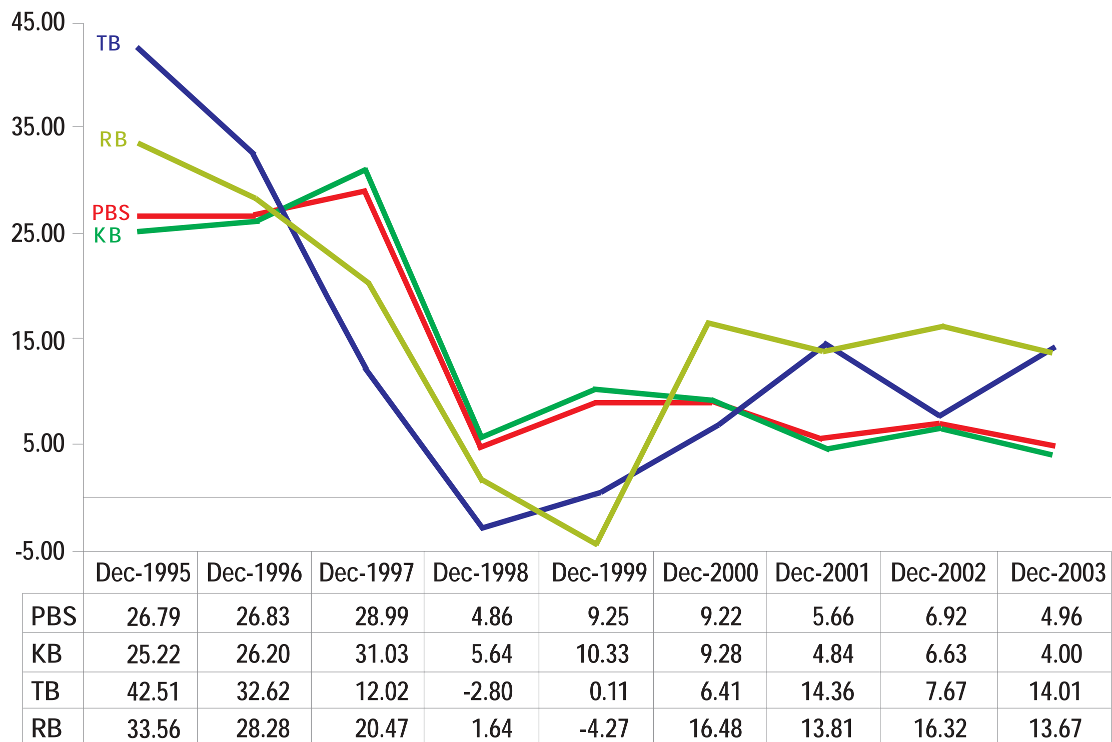
Region	Bank Type	No. of Offices	Deposit				
			Amount *(In Millions)* A	% to Industry	Accounts *(In Absolute Figure)* B	Average Size *(In Millions)* C=A/B	% Share In Region
NCR	KB	1,992	1,511,933	61.6	8,502,295	0.18	92.0
	TB	508	126,189	5.1	1,233,872	0.10	7.7
	RB	65	4,690	0.2	158,936	0.03	0.3
	Sub-Total	2,565	1,642,812	66.9	9,895,103	0.17	100.0
I	KB	143	41,582	1.7	736,541	0.06	81.3
	TB	38	4,174	0.2	80,375	0.05	8.2
	RB	183	5,391	0.2	367,517	0.01	10.5
	Sub-Total	364	51,147	2.1	1,184,433	0.04	100.0
II	KB	69	18,720	0.8	350,165	0.05	86.3
	TB	8	629	*	21,718	0.03	2.9
	RB	121	2,332	0.1	206,940	0.01	10.8
	Sub-Total	198	21,681	0.9	578,823	0.04	100.0
III	KB	327	95,181	3.9	1,369,247	0.07	79.0
	TB	159	14,717	0.6	245,480	0.06	12.2
	RB	299	10,627	0.4	634,665	0.02	8.8
	Sub-Total	785	120,525	4.9	2,249,392	0.05	100.0
IV-A	KB	437	126,260	5.1	1,996,580	0.06	74.9
	TB	270	25,051	1.0	458,354	0.05	14.9
	RB	439	17,303	0.7	1,157,662	0.01	10.3
	Sub-Total	1,146	168,614	6.8	3,612,596	0.05	100.0
IV-B	KB	39	16,562	0.7	157,567	0.11	88.5
	TB	22	743	*	57,370	0.01	4.0
	RB	57	1,404	0.1	168,673	0.01	7.5
	Sub-Total	118	18,709	0.8	383,610	0.05	100.0
V	KB	96	26,672	1.1	432,905	0.06	84.8
	TB	28	1,942	0.1	88,188	0.02	6.2
	RB	90	2,832	0.1	226,763	0.01	9.0
	Sub-Total	214	31,446	1.3	747,856	0.04	100.0
VI	KB	221	71,054	2.9	1,022,756	0.07	92.1
	TB	44	3,330	0.1	60,015	0.06	4.3
	RB	122	2,789	0.1	282,052	0.01	3.6
	Sub-Total	387	77,173	3.1	1,364,823	0.06	100.0
VII	KB	254	115,169	4.7	1,092,623	0.11	88.3
	TB	102	11,145	0.5	230,423	0.05	8.5
	RB	125	4,082	0.2	243,942	0.02	3.1
	Sub-Total	481	130,396	5.4	1,566,988	0.08	100.0
VIII	KB	71	19,107	0.8	357,583	0.05	92.0
	TB	7	695	*	16,517	0.04	3.3
	RB	45	975	*	123,251	0.01	4.7
	Sub-Total	123	20,777	0.8	497,351	0.04	100.0
IX	KB	77	25,046	1.0	362,356	0.07	94.8
	TB	7	670	*	10,513	0.06	2.5
	RB	26	712	*	88,487	0.01	2.7
	Sub-Total	110	26,428	1.0	461,356	0.06	100.0
X	KB	116	34,060	1.4	500,148	0.07	89.7
	TB	33	2,092	0.1	65,960	0.03	5.5
	RB	92	1,805	0.1	324,031	0.01	4.8
	Sub-Total	241	37,957	1.6	890,139	0.04	100.0
XI	KB	134	42,817	1.7	524,193	0.08	89.4
	TB	28	2,751	0.1	55,005	0.05	5.7
	RB	74	2,306	0.1	279,785	0.01	4.8
	Sub-Total	236	47,874	1.9	858,983	0.06	100.0
XII	KB	90	22,208	0.9	428,501	0.05	91.7
	TB	9	658	*	17,296	0.04	2.7
	RB	62	1,342	0.1	211,262	0.01	5.5
	Sub-Total	161	24,208	1.0	657,059	0.04	100.0
CAR	KB	54	18,822	0.8	297,155	0.06	84.8
	TB	12	2,179	0.1	34,035	0.06	9.8
	RB	39	1,185	*	115,081	0.01	5.3
	Sub-Total	105	22,186	0.9	446,271	0.05	100.0
ARMM	KB	14	2,129	0.1	67,417	0.03	95.2
	TB	-	-	-	-	-	-
	RB	5	108	*	12,962	0.01	4.8
	Sub-Total	19	2,237	0.1	80,379	0.03	100.0
CARAGA	KB	38	9,270	0.4	181,227	0.05	82.0
	TB	6	229	*	13,581	0.02	2.0
	RB	54	1,807	0.1	281,606	0.01	16.0
	Sub-Total	98	11,306	0.5	476,414	0.02	100.0
TOTAL		**7,351**	**2,455,476**	**100.0**	**25,951,576**	**0.09**	

Source: Report on Breakdown of Deposit Liabilities by Type (BDL) submitted by member banks.
*Notes: *Signifies insignificant deposit amount relative to total domestic deposit.*

Growth in Domestic Deposit

Figure 2

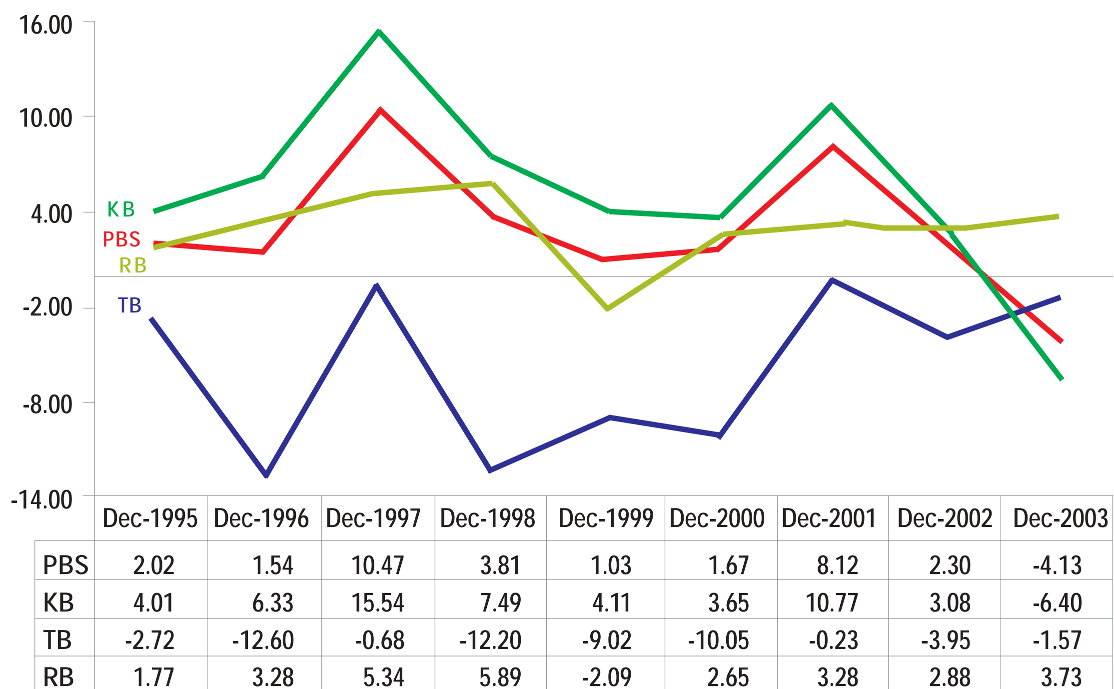
Growth in Amounts (in %)



	Dec-1995	Dec-1996	Dec-1997	Dec-1998	Dec-1999	Dec-2000	Dec-2001	Dec-2002	Dec-2003
PBS	26.79	26.83	28.99	4.86	9.25	9.22	5.66	6.92	4.96
KB	25.22	26.20	31.03	5.64	10.33	9.28	4.84	6.63	4.00
TB	42.51	32.62	12.02	-2.80	0.11	6.41	14.36	7.67	14.01
RB	33.56	28.28	20.47	1.64	-4.27	16.48	13.81	16.32	13.67

Figure 3

Growth in Accounts (in %)

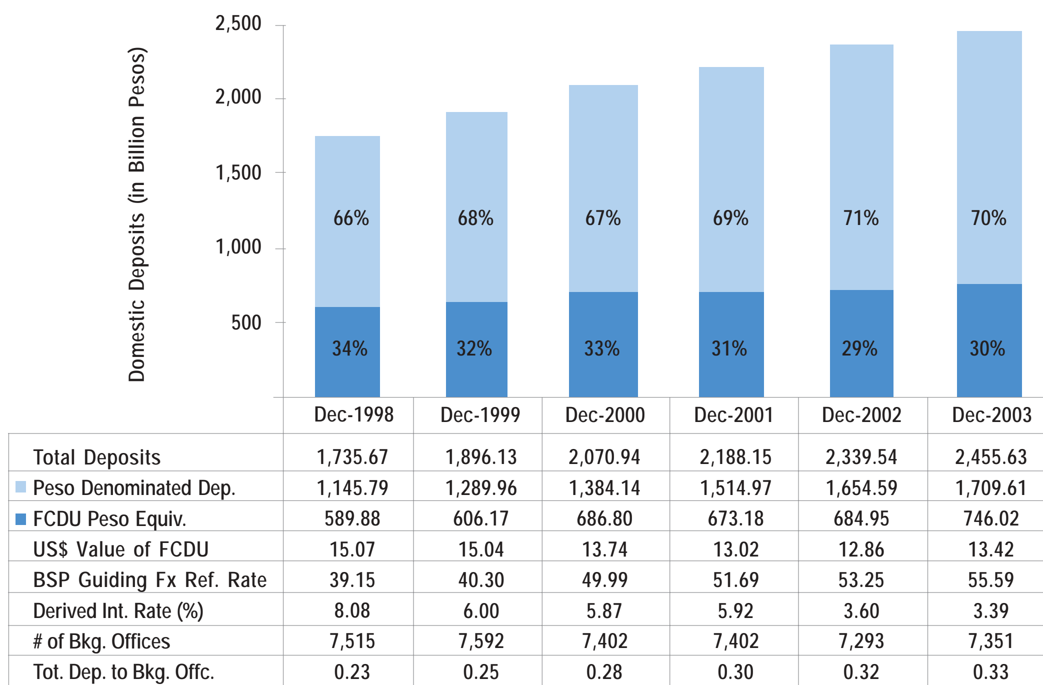


	Dec-1995	Dec-1996	Dec-1997	Dec-1998	Dec-1999	Dec-2000	Dec-2001	Dec-2002	Dec-2003
PBS	2.02	1.54	10.47	3.81	1.03	1.67	8.12	2.30	-4.13
KB	4.01	6.33	15.54	7.49	4.11	3.65	10.77	3.08	-6.40
TB	-2.72	-12.60	-0.68	-12.20	-9.02	-10.05	-0.23	-3.95	-1.57
RB	1.77	3.28	5.34	5.89	-2.09	2.65	3.28	2.88	3.73

Source : Consolidated Report on Domestic Deposit Liabilities by Size of Account.

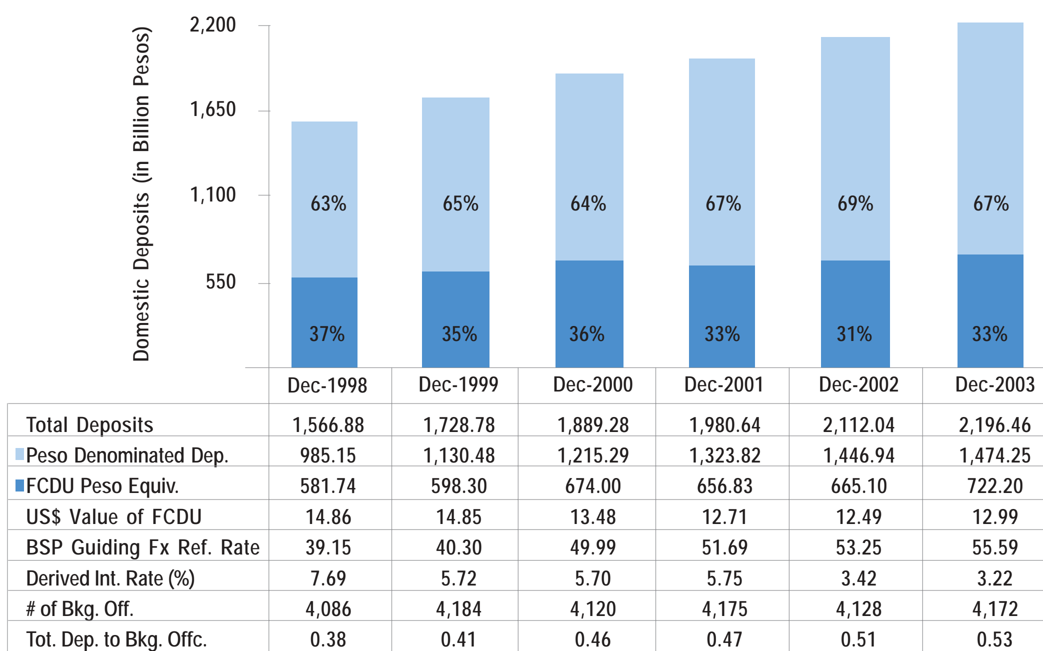
Year-on-Year Deposit Movement with Selected Variables Related to its Growth

A. PHILIPPINE BANKING SYSTEM



	Dec-1998	Dec-1999	Dec-2000	Dec-2001	Dec-2002	Dec-2003
Total Deposits	1,735.67	1,896.13	2,070.94	2,188.15	2,339.54	2,455.63
Peso Denominated Dep.	1,145.79	1,289.96	1,384.14	1,514.97	1,654.59	1,709.61
FCDU Peso Equiv.	589.88	606.17	686.80	673.18	684.95	746.02
US$ Value of FCDU	15.07	15.04	13.74	13.02	12.86	13.42
BSP Guiding Fx Ref. Rate	39.15	40.30	49.99	51.69	53.25	55.59
Derived Int. Rate (%)	8.08	6.00	5.87	5.92	3.60	3.39
# of Bkg. Offices	7,515	7,592	7,402	7,402	7,293	7,351
Tot. Dep. to Bkg. Offc.	0.23	0.25	0.28	0.30	0.32	0.33

B. COMMERCIAL BANKS



	Dec-1998	Dec-1999	Dec-2000	Dec-2001	Dec-2002	Dec-2003
Total Deposits	1,566.88	1,728.78	1,889.28	1,980.64	2,112.04	2,196.46
Peso Denominated Dep.	985.15	1,130.48	1,215.29	1,323.82	1,446.94	1,474.25
FCDU Peso Equiv.	581.74	598.30	674.00	656.83	665.10	722.20
US$ Value of FCDU	14.86	14.85	13.48	12.71	12.49	12.99
BSP Guiding Fx Ref. Rate	39.15	40.30	49.99	51.69	53.25	55.59
Derived Int. Rate (%)	7.69	5.72	5.70	5.75	3.42	3.22
# of Bkg. Off.	4,086	4,184	4,120	4,175	4,128	4,172
Tot. Dep. to Bkg. Offc.	0.38	0.41	0.46	0.47	0.51	0.53

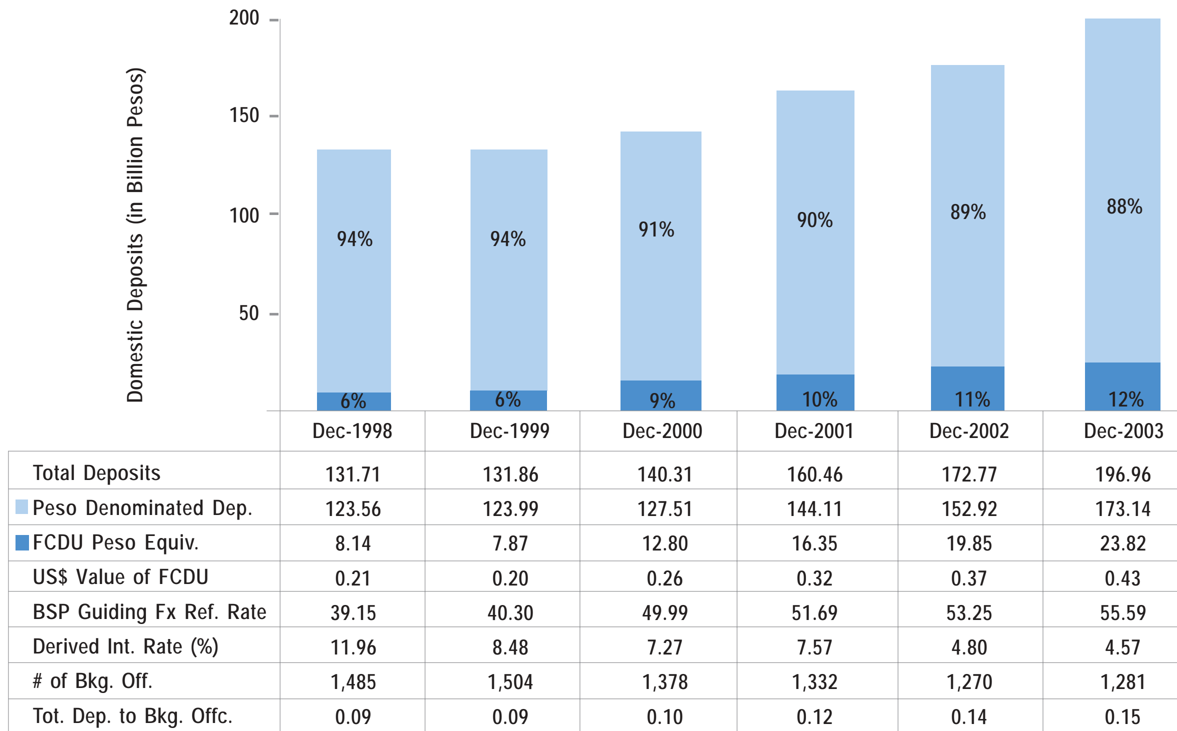
Source : *Consolidated Report on Domestic Deposit Liabilities by Size of Account and Report on Breakdown of Deposit Liabilities by Type (BDL) for number (#) of banking offices.*

Notes: *Domestic deposits excludes deposits in overseas branches of Philippine banks.*
Banking offices refer to Head Offices, Branches, Money Shops, Extension Offices and Saving Agencies of banks as reported.

Figure 4

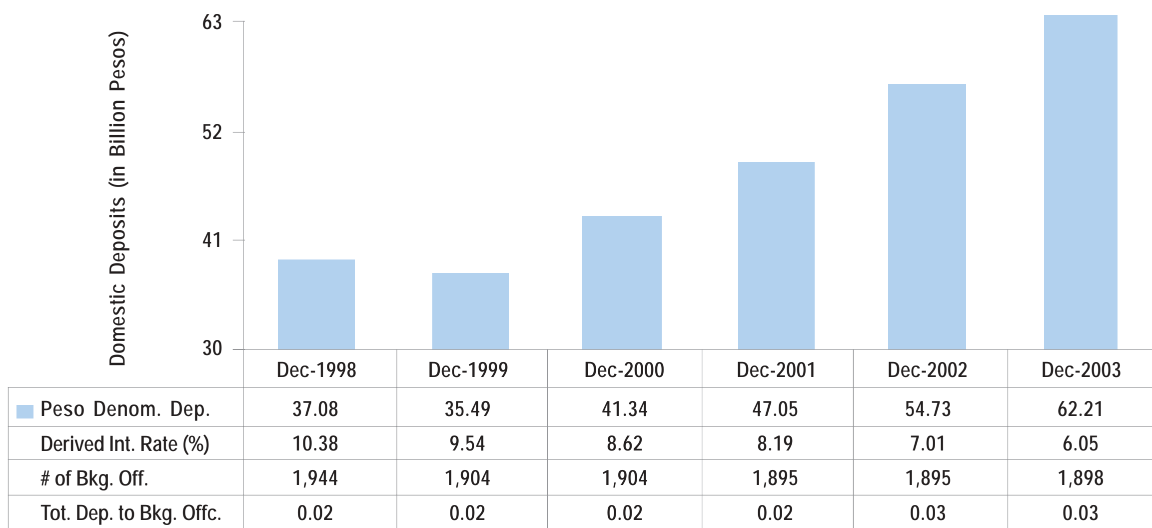
Year-on-Year Deposit Movement with Selected Variables Related to its Growth *(cont.)*

C. THRIFT BANKS



	Dec-1998	Dec-1999	Dec-2000	Dec-2001	Dec-2002	Dec-2003
Total Deposits	131.71	131.86	140.31	160.46	172.77	196.96
Peso Denominated Dep.	123.56	123.99	127.51	144.11	152.92	173.14
FCDU Peso Equiv.	8.14	7.87	12.80	16.35	19.85	23.82
US$ Value of FCDU	0.21	0.20	0.26	0.32	0.37	0.43
BSP Guiding Fx Ref. Rate	39.15	40.30	49.99	51.69	53.25	55.59
Derived Int. Rate (%)	11.96	8.48	7.27	7.57	4.80	4.57
# of Bkg. Off.	1,485	1,504	1,378	1,332	1,270	1,281
Tot. Dep. to Bkg. Offc.	0.09	0.09	0.10	0.12	0.14	0.15

D. RURAL BANKS



	Dec-1998	Dec-1999	Dec-2000	Dec-2001	Dec-2002	Dec-2003
Peso Denom. Dep.	37.08	35.49	41.34	47.05	54.73	62.21
Derived Int. Rate (%)	10.38	9.54	8.62	8.19	7.01	6.05
# of Bkg. Off.	1,944	1,904	1,904	1,895	1,895	1,898
Tot. Dep. to Bkg. Offc.	0.02	0.02	0.02	0.02	0.03	0.03

Source : *Consolidated Report on Domestic Deposit Liabilities by Size of Account and Report on Breakdown of Deposit Liabilities by Type (BDL) for number (#) of banking offices.*

Notes: *No recorded Foreign Currency Deposits (FCDs) for Rural Banks.*
Domestic deposits excludes deposits in overseas branches of Philippine banks.
Banking offices refer to Head Offices, Branches, Money Shops, Extension Offices and Saving Agencies of banks as reported.

No. of Unsubmitted Reports

As of December 31, 2003
Reference Period

Bank Type	Type of Report				
	SOC	SIE	RBCAR	C - 16	BDL
Commercial Banks	-	-	-	-	-
Sub - Total	**-**	**-**	**-**	**-**	**-**
Thrift Banks	1	1	2	1	1
Sub - Total	**1**	**1**	**2**	**1**	**1**
Rural Banks					
NCR	-	-	1	-	-
Region 1	-	-	4	-	2
Region 2	-	-	1	-	1
Region 3	2	4	7	2	-
Region 4A	2	5	10	2	6
Region 4B	6	6	5	6	3
Region 5	1	2	5	3	5
Region 6	2	2	9	4	5
Region 7	-	1	8	2	2
Region 8	-	1	4	1	1
Region 9	1	2	1	1	-
Region 10	2	3	4	2	-
Region 11	-	-	3	-	11
Region 12	-	-	2	-	3
CAR	-	-	2	1	-
ARMM	1	1	1	1	-
CARAGA	-	-	2	1	-
Sub - total	**17**	**27**	**69**	**26**	**39**
Grand total	**18**	**28**	**71**	**27**	**40**

Glossary of Terms

Selected Accounts

1. **Quick Assets.** Highly liquid assets composed of Cash on Hand, Checks & Other Cash Items, Due from BSP, Due from Banks, Due from Philippine Clearing House Corporation (PCHC), Trading Account Securities (TAS, Equity & Investments), Available for Sale Securities (ASS) and Investment in Bonds and Other Debt Instruments (IBODI). For Rural Banks (RBs), Quick Assets is composed of Cash on Hand, Checks & Other Cash Items, Due from BSP, Due from Banks and IBODI.

2. **Interest Earning Assets.** Assets which generate interest income, such as Due from BSP, Due from PCHC, Due from Banks, TAS, ASS, IBODI and Current Loans. For RBs, Interest Earning Assets consist of Due from BSP, Due from Banks, IBODI and Current Loans.

3. **Non-Performing Loans (NPL).** Defined under BSP Circular No. 202 dated 5/27/99 which includes certain Restructured Loans classified as Non-Performing, as amended by Circular No. 248 dtd 6/26/00 & Circular No. 351 dtd 9/19/02.

4. **Non- Performing Assets (NPA).** NPL, ROPOA (Real Properties Owned or Acquired) and Non-Performing Sales Contract Receivables.

5. **Gross Problematic Assets (GPA).** NPL, ROPOA (Gross) and Current Restructured Loans.

6. **Loan Loss Provision (LLP).** The sum of Specific and General Loan Loss Provision.

7. **Total Allowance.** LLP, Allowance for Probable Losses on ROPOA and on Sales Contract Receivable.

Selected Ratios

8. **Risk Assets Ratio (RAR).** Capital divided by Risk Assets. Capital is Booked Capital net of Appraisal Increment Reserves, Net Unrealized Gain on Securities Available for Sale (SAS), Deferred Income Tax, Goodwill and Unsecured DOSRI. Risk Assets is Total Assets net of Non-Risk Assets, Goodwill, Unsecured DOSRI and Accumulated Market Gain on private issuances (i.e. Underwriting Debt & Equity Securities Purchased, ASS excluding Accumulated Market Gain on ASS-Government).

   (Non-Risk Assets. Cash on Hand, Due from BSP, Due from PCHC, TAS Investments, ASS-Government, IBODI-Government, Bank Premises and Deferred Income Tax).

9. **Risk Based Capital Adequacy Ratio (RBCAR).** Qualifying Capital divided by Risk Weighted Assets reported by banks and as defined under BSP Circular No. 280. Due to unavailability of data for RBs, Capital to Risk Assets was used to represent RBCAR.

10. **NPL to Capital.** NPL is defined under note #3. Capital is inclusive of Total Allowance as defined under note #7 net of Appraisal Increment Reserves, Net Unrealized Gain on SAS, Deferred Income Tax, and Goodwill.

11. **NPA to Capital.** NPA is defined under #4. Capital is defined under note #10.

12. **GPA to Capital.** GPA is defined under #5. Capital is defined under note #10.

13. **Return on Equity (ROE).** Net Income After Tax (NIAT) divided by Average Equity. For Non-Year-end period, Income & Expense Accounts are Annualized in relation to Balance Sheet Accounts. Average Balance Sheet Accounts is the sum of Current and Previous Period divided by 2.

14. **Return on Asset (ROA).** NIAT divided by Average Total Assets.

15. **Net Interest Margin (NIM).** Net Interest Income divided by Average Interest Earning Assets as defined under note #2.

16. **Operating Efficiency.** Computed by dividing the sum of Other Operating Expenses and Provision Expense by the sum of Net Interest Income and Other Operating Income.

17. **Non-Operating Income (Non-OI) to Net Income Before Tax (NIBT).** Measures level of reliance to non-recurring, extra-ordinary income in generating revenues. These non-operating income are generally realized from the disposal/sale of ROPOA.

18. **Derived Interest Rate.** Computed by dividing Interest Expense on Deposit by Average Deposit.

The role of KDIC in the Korean financial restructuring process

Financial crisis swept through East Asian countries in 1997 and 1998 and Korea was among the countries hardest hit. Currencies and equity prices plummeted, economic growth turned into recession, with wealth eroded, and jobs lost.

The origin of the problems in Korea emanated from the intervening policies of the government, providing loans to *chaebols* at low interest rates. Compounding matters further were the presumption that the government stood behind all banks, and that large corporations were "too big to fail", exacerbating a moral hazard problem. Such practices reduced the managerial effectiveness in commercial banking and prompted the bank managers to engage in more risky lending behavior.

Although the extent to which each Asian country was affected by the crisis differs from each other, we can observe a common trait in that financial industry was deregulated and opened without securing a mature financial infrastructure. In these countries, lending was directed by government, while supervision and legal infrastructure were poorly implemented. Credit culture in which lenders and investors make judgments based on independent credit assessments was absent. Moreover implicit deposit insurance schemes allowed financial institutions to engage in excessive risk-taking.

Reforming the financial sector as a way of overcoming crisis in Korea can be characterized as setting up an advanced financial infrastructure laying ground for the market mechanisms to work.

Reforming the financial sector as a way of overcoming crisis in Korea can be characterized as setting up an advanced financial infrastructure laying ground for the market mechanisms to work. Insolvent banks were either closed or merged with credit unions, mutual savings & finance companies and other financial institutions. Bad loans were transferred to asset management companies. Prudential and supervisory regulatory device was set up.

Meanwhile, the onset of crisis gave rise to many decisions and events that had major impact on the role of the Korean Deposit Insurance Corporation (KDIC). Prior to June 1996, Korea was void of an explicit bank deposit insurance system. Instead, the government implicitly guaranteed depositors in the event of a failure. However, as the fierce competition under the highly liberalized financial environment was expected to cause the failure of individual financial institution, the government enacted the Depositor Protection Act in December 1995, and KDIC was established in 1996. KDIC contributed to financial market stability by protecting depositors and providing financial support during the restructuring and resolution process of financial institutions.

An effective rescue and protection system including an exit procedure for insolvent financial

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Printed with permission. Paper presented by Wonkeun Yang, Executive Director, KDIC; Sun Eae Chun, Senior Economist, KDIC; and Zhigang Xie, Professor, Shanghai University of Finance and Economics at the 13th KDIC International Financial Symposium, 25 October 2002, "Overcoming Financial Crisis: Financial Reforms in Asia". http://kdic.or.ko/english/annual_report/files/2002_1_2(session1).doc

> *The importance of a deposit insurance system as one of the safety net players is understood and demonstrated by the fact that 68 countries expressively operate some type of deposit insurance system.*

institutions is needed to be established. Explicit deposit insurance scheme is one of the safety net mechanisms, which could minimize the adverse effects of failure of financial institutions.

The importance of a deposit insurance system as one of the safety net pillar is understood and demonstrated by the fact that 68 countries explicitly operate some type of deposit insurance system. The popularity of deposit insurance scheme has also been spread to developing and newly-industrialized countries, partly in response to the recent wave of banking and financial crises which has swept across the world since the 1980s.

There is a growing recognition, however, that the potential costs of utilizing an inappropriately-designed DIS can be extremely high (Garcia 1996). Some even question the wisdom of adopting any form of deposit insurance arguing that the net benefits are likely to be negative especially in respect of developing countries with a poor public infrastructure. However, an appropriately-designed scheme, complemented by a sound legal framework, a sound accounting regime, and a robust system of banking regulation and supervision is likely to be beneficial for society (Demirguc-Kunt and Detragiache 2000).

Korea created its own deposit insurer, KDIC, as a part of preparatory measure prior to the liberalization of financial industry.

Korean experience

The origins and outbreak of the Korea financial crisis in 1997

Korea's model of development worked remarkably well over a sustained period of time, producing an enviable record of development and poverty alleviation. However, as Korea advanced and had become more integrated with the global economy, the government-and chaebol-led system had not been sustainable (Chopra et al 2001). Brief illustration of origins and outbreak of Korean financial crisis is as follows.

The cause of the 1997 crisis can be traced back to structural weaknesses inherent in the Korean economy. The government-led industrialization economic growth strategy fostered unbridled growth of chaebols by channeling the country's household savings to fund capacity growth. By 1997, the Korean economy became highly dependent on the performance of several corporations, which in turn, came to rely heavily on bankrolling their operations of domestic banks. The high debt-to-equity ratios of the *chaebols* together with their low profitability made them particularly vulnerable to swings in their cash flow.

The soundness of the entire banking system became dependent upon fortunes and misfortunes of the *chaebols*. Before the crisis, the profitability of Korean banks was low due to factors such as poor asset quality, regulated interest rates and competition for deposits as well as overlooking aspects in asset-liability management. Compounding matters further was the assumption that the government stood behind all banks, and that large corporations were "too big to fail," exacerbating a moral hazard problem already prevalent in the industry. Also, regulatory and supervisory tools were not in place at the time of financial market liberalization, which caused banks to incur excessive risks without sufficient capital base to withstand systemic shocks. Inadequate accounting rules, lenient prudential standards and supervisory forbearance also contributed to inefficiencies of the financial system.

Beginning early 1997, an unprecedented number of highly-leveraged *chaebols* went into bankruptcy which dampened investor confidence, both domestic and foreign. Records show an abrupt outflow of short-term capital between September and November 1997. A refusal to roll over loans triggered a depreciation of the Won and drove Korea to the brink of default. Then, the IMF came up with a rescue package, but demanded that immediate structural adjustments be adopted in the financial sector.

Role of KDIC during financial restructuring process

The onset of the crisis gave rise to many decisions and events that had a major impact on the role of KDIC. At the height of the crisis, the most immediate need was to restore stability of the financial system. KDIC adopted a temporary blanket deposit insurance policy for a limited

term of three years, in mid-November 1997. The guarantees not only included deposit liabilities of banks and their foreign currency obligations, but also some of their trust department liabilities, those of merchant banks, and premiums paid to insurance companies. The efforts to reassure domestic creditors via the blanket deposit insurance was largely successful and major bank runs were avoided. Also, the segregated deposit insurance agencies of the non-bank financial institutions were consolidated under the KDIC umbrella in 1998.

The next step was to restore the solvency of the financial system. Priority was given to the insolvent merchant banks and commercial banks according to greatest systemic importance. Once these institutions were dealt with, attention shifted to the specialized and development banks and non-bank financial institutions.

The first element of this process was to distinguish unviable institutions from weak but viable institutions. This involved a systemic evaluation of credit institutions, merchant banks, commercial banks, and specialized and development banks. For nonviable institutions, exit strategies such as mergers, sales, or liquidation were developed and applied. For viable institutions, rehabilitation plans specifying detailed measures to achieve minimum capital adequacy and to restructure operations were required. Failure to comply with the performance targets triggered prompt corrective action procedures, including suspension and eventual closures.

A necessary ingredient in the financial sector restructuring process has been the large injection of public funds. With the crisis unpredicted[1] and the scale of the problem so huge, an astronomical sum of money was required for restructuring the entire financial sector so as to deter entry of any investor that did not have the backing of the government.

Government had moral responsibility in clearing up the NPL problem and a major role in creating policy directives to extend "cooperative" loans to the *chaebol* (Chung 2000). The government was averse to the idea that a number of Korean citizens will lose their deposits.

By 1999 yearend, 64 trillion Won in public funds raised through the issuance of bonds was depleted. It then became clear that raising additional public funds was inevitable with additional cost estimated at 50 trillion Won. By 2000 yearend, the National Assembly approved 40 trillion Won to finance further reform efforts while 10 trillion Won will be raised through asset recoveries. Mobilization of additional public funds assured the market of the government's commitment to complete the financial sector restructuring and stabilizing the markets.

As of end, June 2002, the gross infusion of public funds amounted to 156.7 trillion Won. When broken down by funding sources, bond issuance by KDIC[2] and KAMCO amounted to 102.1 trillion Won, recovered funds amounted to 32.2 trillion Won, and public money amounted to 20.9 trillion Won.

KDIC is charged with recapitalization of financial institutions, loss coverage, and depositor protection while bad loans were transferred to KAMCO. Broken down, the public funds infusion is as follows:

1. 60.2 trillion Won was used for equity participation in financial institutions
2. 42.9 trillion Won used for capital contribution and deposit payoff
3. 14.9 trillion Won was used for assets purchase, and
4. 38.7 trillion Won was used for NPL acquisition.

The use of public funds has been subjected to strict criteria to minimize moral hazard. Once the system stabilized, the use of public funds was made conditional on approved

Table 1. Breakdown of Public Funds Used

(Nov. 1997-June2002, Unit: KRW trillion)

	Equity Participation	Capital Contribution	Deposit Payoffs	Assets Purchase	NPL Purchase	Total
Bond Issuance	42.2	15.2	20.0	4.2	20.5	102.1
Recovered Fund	3.9	1.2	6.0	4.4	16.7	32.2
Public Money	14.1	-	0.5	6.3	1.5	22.4
Total	60.2	16.4	26.5	14.9	38.7	156.7

Source: White Paper, August 2002, MOFE

[1] *The Korean crisis was a result of mismanagement of companies and banks, not on poor macroeconomic fundamentals. However, previous crises elsewhere were largely balance of payments crises. Analysts and policy-makers looked for similar weaknesses in Korea and found few of the signs of a classic external crisis.*

[2] *From January 1998 to June 2001, the amount of DIF bonds issued by KDIC reached 66.6 trillion Won. By 1999 yearend, KDIC issued 43.0 trillion Won in DIF bonds for the first round of funding. The second round of DIF bond issuance resumed after December 2000 when the National Assembly approved the procurement of an additional 40.0 trillion Won. The terms of issuance featured primarily floating rate notes ("FRN"). In the interests of minimizing risks, 67.4% or 29.0 trillion Won from a total of 43.0 trillion Won in DIF bonds was issued in the form of FRN. However, as financial markets stabilized and interest rates fell, DIF bonds issued with FRN declined considerably.*

rehabilitation plans. When public fund is infused loss-sharing is achieved by a capital reduction for shareholders replacement or damage claims for the management, loss of deposit beyond the protection limit for depositors, and reduction of employees and branches for financial institutions.

In the case of recapitalization of financial institutions taken over by the government, the shareholder equity has been diluted to avoid moral hazard. Shareholders' capital should be written off against losses and their control surrendered before any government assistance is provided both for equity reasons and to improve the incentive structure. Share capital is intended to be at risk, and was explicitly accepted when invested in return for expected future profits. Further, if shareholders are protected, bank shareholders in general, both current and future, will have less incentive to ensure prudent management; this would foster future losses and repeated government rescues.

Borrowers found negligent are held accountable and are subject to scrutiny through investigation. As of June 2002, investigations commenced to identify causes of insolvency. Among these, were: 4,369 executives and managers of 306 financial institutions who faced claims for damages and indemnification; 1,159 billion Won from 4,404 cases of assets owned by the obligors responsible for the insolvency were placed under provisional attachment to maximize the recovery of the assets.

By adhering to the principle, accountability can be clearly defined, and through such experience, market players come to regulate themselves as watchdogs making sure the prudence of financial institutions are preserved. In addition, the non-market business practices of the past are expected to voluntarily correct itself with shareholders proactively exercising their rights and depositors carefully assessing the quality of prospective financial institution. This will lead institutions to strictly monitor their risk assessment and management activities.

The role of KDIC, during the financial restructuring process has been broadened in recovery and post public fund management. Under the governing statutes of the Special Act enacted at the end of 2000, the execution of an MOU is a requirement if KDIC is to support an insolvent financial institution. The MOU sets clear and concrete goals concerning capital adequacy, productivity, and profitability on a quarterly basis, as well as stipulations

Table 2. Status of Damage Claim Suits Filed by KDIC

(As of the end of June 2002 No., 100 million won)

	Banks	Securities Companies	Insurance Companies	Merchant Banks	MSFCs	Credit Unions	TOTAL
No. of Institutions	6	4	13	22	80	182	307
No. of Defendants	45	39	169	149	859	3,108	4,369
Claim Amount	299	75	1,564	2,632	4,300	3,371	12,241

Table 3. Financial Institution Layoff Status

(Unit: No. of persons)

	End of 1997 (A)	End of 1998	End of 1999	End of 2000	End of Mar. 2001 (B)	Reduction Status (B-A)	Change (%)
Banks[2)]	144,121	101,778	97,736	92,560	92,560	-51,561	-35.8
Merchant Banks	3,587	1,353	912	590[2)]	594	-2,993	-83.4
Securities Companies	27,586	22,610	32,051	36,708	36,682	9,096	33.0
ITCs	5,875	3,689	3,352	1,243	1,308	-4,567	-77.7
Insurance Companies	83,152	64,894	61,745	53,902	54,970	-28,182	-33.9
Leasing Companies	1,548	1,336	985	979	979	-569	-36.8
Mutual Savings & Finance Companies	9,975	7,971	6,610	5,781	5,781	-4,194	-42.0
Credit Unions	30,122	2,775	26,313	24,424	24,109	-6,013	-20.0
TOTAL	305,966	206,406	229,704	216,187	216,983	-88,983	-29.1

Source: White Paper, August 2001,MOFE

regarding the restructuring plans. By setting the penalty terms for non-compliance with agreed terms, management directives are geared towards maximizing shareholder value. The KDIC monitors MOU compliance quarterly and reports result to the Public Fund Oversight Committee.[3]

The role KDIC plays in managing bankruptcy estate is a natural extension of its role as a deposit insurer with an incentive to maximize recovery of its funds. Under the Special Act, KDIC or KDIC employees are appointed bankruptcy trustees.[4] The Special Act also expanded the range of investigation from the financial institution to include default corporations, in addition to financial institutions.

Table 4. Recovery of Public Funds
(As of the end of June, 2002, 100 million won)

Type	Recovering Methods						
KDIC	Equity Disposition		Asset Sale	Dividends on Bankruptcy		Call of loans	Total
	44,602		37,239	74,788		1,151	157,780
KAMCO	International Bidding	Issuance of ABS	Sales to AMC & CRC	Individual Loan Sale, Foreclosure & Recovery	Recovery from Daewoo Loan	Recourses & Cancellation	Total
	16,016	41,406	17,593	87,389	17,012	96,518	275,934
Governments	Equity Disposition			Disposition of Subordinate debts			64,527
	12,474			52,053			
Total							498,241

Source: White Paper, June 2002, MOFE

Estimating the costs of financial restructuring is an evolving exercise because loss recognition is still taking place. The net costs will only be known after the losses are realized in the process of selling assets acquired in the restructuring process such as NPLs, equity, and other assets. As of June 2002, 49.8 trillion Won was recovered by way of divestitures in equity positions and asset dispositions.

KDIC recovered 15.7 trillion Won through sales in equity, asset sales and exercising calls on loans, while KAMCO recovered 27.6 trillion won primarily through NPL sales, issuance of asset-backed securities, and foreclosure auctions.

To minimize the burden of the financial restructuring, the recovery of public funds should be maximized through effective recovery efforts. However some losses are inevitable. Losses associated with the financial restructuring process can be borne, in general, by a combination of taxpayers and agents linked to the troubled bank. In allocating the loss among these groups, the most equitable distribution possible should be ensured within the constraint of ensuring a stable and efficient financial system.

The present value of the public fund losses associated with the financial restructuring process has been estimated to be 69.4 trillion Won as of the end of March 2002 (MOFE 2002).[5&6] The financial sector being the beneficiaries of the public fund infusion, is proposed to bear as much as possible within the resources of financial industry permit, and then the rest of the burden be borne by the national treasury. Accordingly, the financial sector is recommended to bear 20 trillion Won by being levied an additional 0.1% of the total insured deposits as a special deposit insurance premium each year over a period of 25 years, while the government (taxpayers) will bear the rest of the burden at 49 trillion Won.

Prudential and regulatory measures introduced so far have addressed a wide range of concerns, including strengthening prompt

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[3] *Currently, a total of 13 financial institutions has been counter-parties to MOUs with KDIC, including those in effect before the enactment of the Special Act.*

[4] *Approximately 200 companies that have filed for bankruptcy procedures prior to the enactment of the Special Act were required to apply this provision retroactively.*

[5] *These are calculated by subtracting the KDIC and KAMCO held assets from the liabilities of both institutions. For objective valuation, a private-sector oriented task force made up of an assessment committee and working level departments was established for the valuation of the KDIC and KAMCO held assets. For the KDIC held equities, the averages of the values calculated by accounting firms and securities companies have been used as optimistic and pessimistic values, respectively. For bankruptcy related debentures, the recoverable amount calculation was differentiated depending on the credits' characteristics such as existence of collateral or interest reimbursements.*

[6] *Among the total losses estimated, 67 trillion Won was incurred by KDIC and was calculated by subtracting 0.4 trillion Won of reserve funds earmarked for reimbursement and 17.4 trillion Won of expected recovery through sales of equity and bankruptcy dividends from the 84.8 trillion Won, KDIC's total outstanding liabilities.*

KDIC contributed in financial market stability by protecting depositors and providing financial support during the restructuring and resolution process of financial institutions.

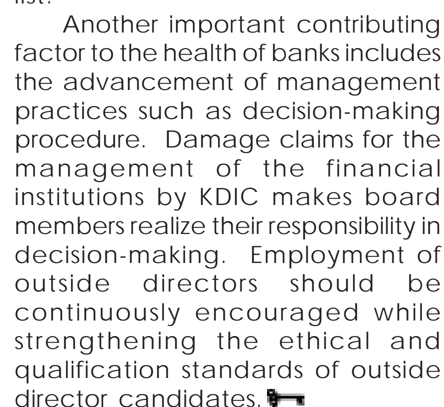
corrective action (PCA), loan classification and provisioning standards, capital adequacy, accounting and disclosure standards.

For almost all financial institutions, the PCA system was either significantly implemented and strengthened or newly established by June 1998. The most important indicator in the PCA system is the Bank for International Settlements (BIS) capital adequacy ratio for banks, the operational net capital ratio for securities companies, and the solvency margin ratio for insurance companies.

The assessment accuracy of capital adequacy was improved by strengthening revision of the loan classification standards[7], provision requirements[8], and accounting principles. The introduction at the end of 1999 of loan classification and provisioning based on "forward-looking criteria" (FLC) which takes into account the capacity of borrowers to service all obligations rather than focusing on delinquency criteria, was especially noteworthy. The newly adopted FLC would evaluate the insolvent assets based on international standards, and the PCA would determine an institution to be insolvent and facilitate appropriate resolution activity. As these mechanisms are implemented, financial institutions will be encouraged to exert their insolvency prevention efforts while swiftly resolving insolvent institutions to prevent it from impacting the whole system.

As a result of introduction of unified disclosure standards for financial institutions in October 1998, all financial institutions are now subject to the new disclosure system. This new system stipulates a regular disclosure to be made twice a year and strengthens the level of penalty for false or dishonest disclosure. Concurrently, by publicly and transparently announcing performance statistics such as NPL ratios, BIS ratios and performance of dividend paying products, depositors and investors are given the benefit of choosing a prudent institution of their choice.

From July 2000, mark to market accounting has been introduced, including new funds invested in ITCs, and on all traded securities and



derivative positions other than for hedging assets valued at historical cost. In addition, significant efforts have been made to improve financial institutions' CAMEL system. For commercial banks, risk evaluation and sensitivity to market risk have been added to the existing list.

Another important contributing factor to the health of banks includes the advancement of management practices such as decision-making procedure. Damage claims for the management of the financial institutions by KDIC makes board members realize their responsibility in decision-making. Employment of outside directors should be continuously encouraged while strengthening the ethical and qualification standards of outside director candidates.

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[7] *In accordance with international practices, loans in arrears of 3 months or more are now classified as substandard or below, and loans in arrears of 1 to 3 months as precautionary loans. As a consequence, most of the emergency loans made to technically bankrupt companies are now reclassified as substandard loans instead of precautionary loans.*

[8] *The provision requirement for precautionary loans have been raised from 1% to 2%. Provision requirements were newly introduced for commercial papers (CP), guaranteed bills, and privately placed bonds belonging to trust accounts.*

What are your views on integrated supervision of financial institutions?

Provided that is endowed with sufficient mandate for transparency, accountability, monitoring and analysis, a single financial supervision authority may improve financial regulation and perhaps avert future crisis. The systemic nature of the Asian crisis suggests that had separate authorities for corporations & the banking sector been able to show and process market information about corporate liabilities and thus, banking assets more effectively, the severity of the problem might have been reduced. - ***Renato Reside***, *Ph.D., UP School of Economics*

I dont think this is the time to consider an integrated supervision of financial institutions in the country. Whichever that body will be, it will have awesome powers and can even, by the policies it will enunciate, redefine the financial institutions makeup of the economy. This has to be properly studied. As it is now, each supervisory authority (i. e. BSP, SEC and OIC and to some extent DOF) needs to focus its meager resources to cope with their respective areas of supervision. Before an attempt at integrated supervision can be made therefore, a proper infrastructure should be in place, including the right people to man the job, appropriate training, streamlined rules and procedures, etc.

In other countries, the trend is that Bank supervision is split between those who actually do the supervision/ examination and those who receive and process bank reports and/or craft policies. In China for example, a bank reports to the China Banking Regulatory Commission (CBRC) for supervision and examination, the Peoples' Bank of China (PBOC) for policies and reports and the State Administration for Foreign Exchange (SAFE) for the forex regulations. And this is just a bank!

The present policy of the BSP for consolidated supervision of banks is a more rational approach to supervision rather than the proposed integrated supervision. - ***Carmelita R. Araneta***, *Banker*

I hope that integrated supervision can help eradicate pyramiding and such scams as MultiTel. That measure should address illegal financial products in the market today and why a lot of people are being lured to invest their hard-earned money without being properly guided and informed. - ***Mai Mai Abengoza***, *Staff, Committee on Appropriations, House of Representatives*

Bank supervision should provide check and balance so I am not sure about integrating process and functions into one agency. To protect depositors, bank supervision should implement complete transparency in the conduct of bank transactions, no ifs and no buts. It should also make sure bankers who go against the law and cheat depositors are brought to court to suffer the consequences of their illegal actions. - ***Gil Sombilla***, *cutflower businessman, Candelaria, Quezon*

In these uncertain times, the need for a stronger bank supervision program becomes even more important to ensure that our financial institutions safely manage their operations to be able to provide fair and equitable services to their clients. I am in favor of integrating supervision if it is able to improve monitoring of banks.

Through a better system of monitoring, i.e., regular on-site inspections and reviews of bank performance, well-established procedures can be put in place so that troubles are immediately identified and promptly addressed. Periodic audit of transactions should likewise be conducted to arrest possible anomalies and malversation. This way, bank runs can be averted and the interest of depositors are better insured and protected. - ***Raquel J. Aranilla,*** *Public Relations Officer IV, LIVECOR*

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