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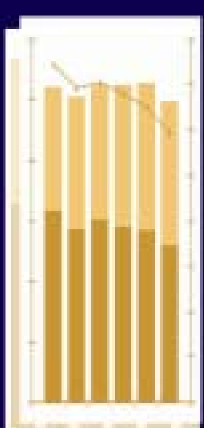

Special Purpose Vehicle Law: Did it serve its purpose?

The Cover

On the cover is a bar graph showing the trend and composition of non-performing assets (i.e., non-performing loans and ROPOA) of the Philippine banking system, together with a line graph indicating the gradual decline of its ratio to total assets during the period June 2002 to December 2004.

Publisher's Note

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

The fourth issue of the PDIC Forum focuses on asset management companies (AMCs) at a time of growing clamor for the extension of Republic Act No. 9182, the law creating special purpose vehicles or SPVs, as Philippine AMCs are more popularly known. This issue highlights the benefits reaped from the SPV framework and appraises the banking industry's experience in utilizing such instruments made available to it.

In our main article, Dr. Gloria O. Pasadilla of the Philippine Institute for Development Studies (PIDS) investigates the non-performing assets (NPA) problem in relation to the country's insolvency laws as well as assesses parallel reforms particularly the rehabilitation and insolvency law. She further analyzes the effects of existing and proposed insolvency reforms on SPVs and other creditors.

For the first time, ***Straight Talk*** *features two interviews on the issue's theme. This "double feature" will provide a wider scope of information to readers as the Philippine and Malaysian experiences with AMCs provide interesting counterpoints to each other. Philippine SPVs are private AMCs on the verge of a new lease on life. On the other hand, Malaysia's Danaharta is a government AMC about to wind down operations. Bangko Sentral ng Pilipinas (BSP) Governor-designate Amando M. Tetangco Jr. shares his insights on the passage and implementation of the SPV Law while Danaharta Managing Director Zukri Samat familiarizes us with the Malaysian AMC.*

PDIC Front *features our in house research group's study on the relevance of the SPV Law to the PDIC. The article presents the implications of the law to PDIC. With the SPV framework, financial incentives extended by PDIC would help minimize bank losses and capital impairment as a result of the sale of assets to third party investors at deep discounts. The article also underscores PDIC's support for the extension of the SPV Act so it may continue providing financial assistance using the route.*

Industry Scan *shows the banking industry's overall resources by December 2004, with asset growth driven mainly by the increase in total deposits. Commercial Banks accounted for the bulk of the industry's assets.*

Finally, ***DI World*** *features a well-articulated paper detailing guidelines for countries that wish to follow the lead of France, Canada, and Taiwan and develop a differential premium system. The paper examines the advantages, disadvantages, and trade-offs associated with this system and provides guidelines for those countries contemplating switching their flat-rate system with the differential mode.*

Our survey question for ***Perspectives*** *elicited interesting answers. This time, we asked people on the street, "How can your bank serve you better?" Their diverse answers give leads on how the banking industry can improve on service delivery.*

I hope this issue of the forum will contribute to greater appreciation and understanding of AMCs and how they help in the overall efforts towards strengthening the financial system.

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SPVs and insolvency reforms in the Philippines

by Gloria O. Pasadilla, *Philippine Institute for Development Studies (PIDS)*

Unlike other Asian countries, the Philippines had not really had major reforms in its insolvency procedures since the Asian crisis. About the only major changes in the Philippine legal landscape that relate to nonperforming loans (NPLs) and corporate bankruptcies are: 1) the transfer of jurisdiction over corporate rehabilitation cases from the Securities and Exchange Commission (SEC), a quasi-judicial government body, to the Regional Trial Courts (RTCs) in 2000; and 2) the signing of the Special Purpose Vehicle (SPV) Act, which provides fiscal incentives for banks to solve their NPL problems, in January 2003. Thus, while the other severely affected countries like Indonesia and Thailand had taken advantage of the crisis to modernize their insolvency laws, the Philippines still awaits the dawn for major legal bankruptcy reforms.

Meanwhile, the NPL problem of the financial system has gone from bad to worse. From a mere 4 per cent NPL ratio in 1997, the Philippines now has the highest NPL ratio in Asia. The amount of foreclosed but undisposed assets has continued its increase and is now about half of the total nonperforming assets (NPAs). The government's response to this problem of the banking system is to provide a legal framework through which banks can transfer these NPAs to a separate entity called Special Purpose Vehicles (SPVs), which are private-owned asset management companies (AMC). In this, the Philippines differs from other Asian countries which sought to restructure their banks through centralized AMCs like Danaharta in Malaysia, Indonesia Bank Restructuring Agency (IBRA), KAMCO in Korea, and Thailand Asset Management Company (TAMC).

In many other countries that have experienced financial crisis, the transfer of banks' bad assets to a private or public AMC has become the norm. Yet, if the metric used is recovery maximization or efficiency of the disposition process, studies have shown that not all AMCs have been successful. Klingebiel (2000), Ingves, et.al. (2004) have pointed out important common factors that contribute to AMCs' success, such as leadership, commercial orientation, independence, adequate incentives, and very importantly, legal environment.

This paper focuses on the legal environment, particularly, the insolvency system that can help the Philippine SPVs succeed in putting back vitality in the bank and corporate sector.[1] Insolvency reforms can be considered as a long-run solution to the banking problems. They can help prevent the accumulation of large NPLs in the future, improve credit supply, and promote a better credit culture. Meanwhile, in the short-run, the SPVs are designed to help solve the mounting bad debt problems. But to the extent that SPVs will have to operate under a given insolvency regime once they acquire the bad assets, existing bankruptcy procedures have an impact on SPV behavior, *ex-ante*. That is, it affects the price that SPVs offer for the NPAs that, in turn, affects the banks' willingness to sell, and thus the achievement of the government goal of bank clean-up.

The paper argues that the SPV's effectiveness hinges on institutional factors, not the least of which are improved insolvency rules and procedures. Indeed, the SPV without good legal and institutional reform in the bankruptcy process would be hampered in much the same way as the banks. Poor insolvency process in the Philippines explains, in part, the huge discounts for the banks' bad assets and the consequent reluctance of banks to part with them through SPV sale.

The paper is organized as follows: the next section discusses the nonperforming assets problem in

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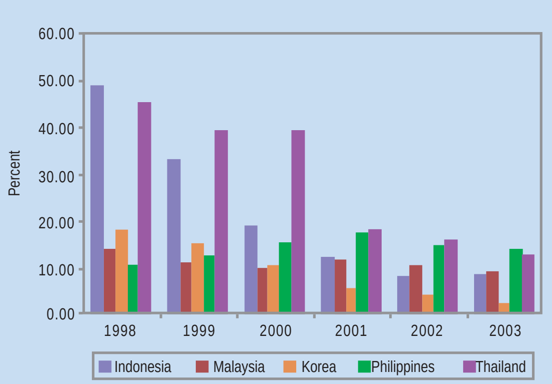
[1] *Ingves, et. al. (2004) include legal protection for the AMC staff, clean transfers of titles to AMCs, and special powers accorded to AMCs when they talk of the legal environment of AMCs. This paper, however, focuses only on the insolvency system.*

the Philippines and the trend in growth of Real and Other Properties Owned or Acquired (ROPOA). Section 3 evaluates the Special Purpose Vehicle (SPV) Law and the pace of asset transfers. Section 4 focuses on the parallel reforms in the legal/institutional front – the rehabilitation and insolvency law. Section 5 analyzes the existing and proposed insolvency reforms' effect on SPVs and other creditors, and Section 6 concludes.

NPL problem after the Asian Crisis

In contrast to other Asian countries, the Philippines boasted of a strong financial sector at the onset of the Asian financial crisis. In 1997, its bank capitalization was much higher than the 8% international minimum standard and its nonperforming loan was a mere 4% of total loans. Yet, a few years later, it emerged as a laggard in Asia because as NPL ratios of its neighboring countries went down, the Philippines' continued on its climb until 2001 (see Figure I).

Figure I: NPL Ratios in Crisis-Affected Countries

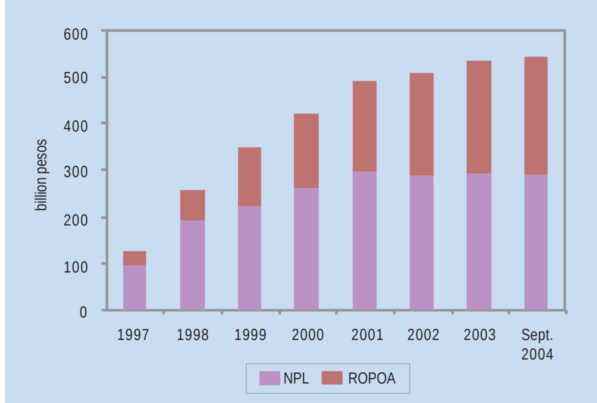


A major reason for these two different trends in NPL ratios is government intervention in the resolution of the banking problems. Aggressive recapitalization of the banks by the government as well as transfers of bad loans and assets to centralized Asset Management Companies (AMCs) helped bring down the banking system's bad loans burden in Korea, Malaysia, Thailand and Indonesia. In contrast, faced with a mild banking problem, the Philippines did no comparable major government initiative to bail out the banking sector. The result is a sustained increase in NPLs which reached its peak at 17% of total loans in 2001. The ratio dipped thereafter but the Philippines now has the highest NPL ratio in Asia, closely followed by Thailand. In contrast, Indonesia, Korea, and Malaysia now have single digit NPL ratios - a staggering feat, considering their high double digit figures during the financial crisis.

Nonperforming assets (NPAs), defined as NPLs combined with foreclosed assets or ROPOA, are now about P540 billion[2], with roughly 50-50 share of NPL and ROPOA, and constitute about 14% of total banking assets. In 1997, NPA share to total banking assets only stood at 4%. Of the total NPAs, close to 90% are in the books of commercial banks, while the rest are shared between thrift banks and rural banks.

One trend that is worth noting, though, is that even as NPLs have gone down starting in 2002, the amount of ROPOA in the banking system continued to go up. In 1997, ROPOA constituted only a quarter of total NPAs; now, it is close to 50% (see Figure II). One reason for this trend is that banks have converted unpaid loans into foreclosed assets, kept them in their books, without necessarily bringing down the level of the entire NPAs. Considering that more than 60% of bank lending is secured lending, of which, nearly 50% is collateralized by real estate properties, banks' ROPOA would indeed increase as borrowers are unable to pay their loans.

Figure II: Increasing Share of ROPOA *(entire banking system)*



Why have banks accumulated bad assets but not disposed of them quickly enough? The answer lies, partly, in the lackluster state of the real estate market since the Asian crisis until recently, and partly, on the relatively lower cost of maintaining ROPOA in the banks' books compared to NPLs. Following the Asian crisis, the property market has been characterized as a buyers' market, although, of late, some indications of a real estate recovery have been noted. If the recovery is sustained, this can encourage banks to unload their accumulated ROPOA and, thereby lessen total NPAs in the system. As for the cost of loss provisions, despite its maintenance cost, ROPOAs are less costly to keep in the books compared to keeping NPLs. For ROPOA, the Bangko Sentral ng Pilipinas (BSP) requires provisions of 10 per cent every year starting at the end of the sixth year after acquisition up to the 10th year, for a total of 50 per cent of the difference

[2] As of September 2004.

between the excess of book value over the appraised value of the real estate property. For NPLs, however, the provisioning requirement starts immediately, the moment the loan becomes specially mentioned. Provisioning cost is also higher, ranging between 5% to 100% of the total value of the unpaid portion of the loan depending on the quality of the loan (see Table 1). With an unbalanced loss provisioning cost, therefore, banks sought to reduce NPLs by shifting to ROPOA, continue to hold on to them, until the real estate market improves.

Table 1. Unbalanced Loss Provisioning and the Rise of ROPOA

Classification	Allowances (in %)
For NPLs	
Unclassified	0
Loans specially mentioned	5
Substandard	
Secured	6-25
Unsecured	25
Doubtful	50
Loss	100
General loan loss provision	
Unclassified restructured loan	5
Unclassified loans (not restructured)	1
For ROPOA	max of 50 (10% per year from 6th to 10th year)

Source: Bangko Sentral ng Pilipinas (BSP)

The Short-term Solution: Special Purpose Vehicle (SPV)

To provide relief from the huge burden of NPAs, the government passed the Special Purpose Vehicle (SPV) Law in December 2002 and signed in January 2003. The Law provides fiscal incentives for the transfer of NPAs from banks to SPVs which, as envisioned, would then dispose of them with greater flexibility and speed than banks. SPVs are private sector-owned asset management companies, much like the AMCs that were set up by the four other crisis-affected economies (i.e., KAMCO, Danaharta, IBRA, and TAMC) that purchased the bad assets in these countries' banking system and eventually disposed of them. Lack of government funds and the seemingly non-systemic nature of the banking problems in the Philippines have led to the private-sector led initiative that is encouraged by the SPV Law, instead of the establishment of government-funded centralized AMC. India and Taipei, China are the two other Asian countries that went by way of the private-sector owned AMCs.

Asset Management Companies

In general, asset management companies are effective means to expeditiously solve NPL problems. This explains why countries that experienced banking crisis, whether developed countries like the US or Sweden or developing countries like the Asian countries, have utilized AMCs. The usual procedure is that banks unload NPAs to an AMC, clean up their books, and continue on with its primary role of financial intermediation. The AMCs, either government- or private-owned, then take care of disposing the acquired assets through a variety of means: public auction, resale of assets to original borrowers, joint ventures, securitization, or even managing the acquired business themselves.

Typically, the special character of AMCs makes them more flexible than banks to carry out certain activities that help maximize asset values. For example, banks cannot easily grant loan discounts to one bad debtor, else, even the good borrowers will clamor for the same special discounts. AMCs, in contrast, can pursue bad debtors more aggressively and, likewise, entice them with favorable loan repayment schemes, discounts, or debt buybacks, with less moral hazard risk. AMCs, it is presumed, have, in addition, better expertise in collection and asset management than do banks. This, perhaps, explains why the length of a banking or financial crisis appears to have been made shorter in countries that made use of AMCs (Hagiwara and Pasadilla, 2004).

The SPV Law

Main Features

The SPV Act eliminates existing barriers in the acquisition of NPAs by SPVs (or individuals)[3] and provides fiscal incentives for banks to transfer these assets, as well as for their eventual disposition by the acquiring party. It is time-bound: registration of SPVs is only up to September 2004, transfer of assets from banks, up to April 8, 2005, and transfers of acquired assets to third parties have to be within five years following the date of acquisition. Otherwise, the transaction would no longer qualify for tax and other fiscal benefits available under the SPV Law.

The fiscal benefits include exemption from payments of documentary stamp tax, capital gains tax, creditable withholding tax, and value added tax or gross receipts tax. Transactions qualified under the SPV Law are also entitled to various fee reductions such as mortgage and land registration, filing fees and transfer fees. On top of these, banks are allowed to deduct a portion of their losses from the SPV transactions from their taxable gross income for up to 10 years.

Since the SPV Act stated that only loans/assets which are nonperforming as of June 30, 2002 are qualified, the BSP required all banks to report each loan that was

[3] The SPV Act includes transfer of assets to individual buyers but this is limited to a single family residential unit ROPOA or NPL secured by a real estate mortgage on a residential unit. It is further limited to one property per individual. The SPV Act also allows settlement by the borrowers through *dacion en pago* (debt-for-asset) arrangement. Subsequent discussion focuses on SPV transactions.

nonperforming or under litigation as of June 30, 2002. The BSP combined them in to a masterlist of all qualified NPAs in the financial system. Subsequently, all related transactions by banks or SPVs that are covered by the Act would have to be reconciled with the BSP's masterlist for the issuance of the Certificate of Eligibility (COE).[4] The COEs are then used by the seller or buyer of assets to avail of the tax exemption and fees reduction when approaching concerned government agencies e.g., the Bureau of Internal Revenue (see Figure III).[5]

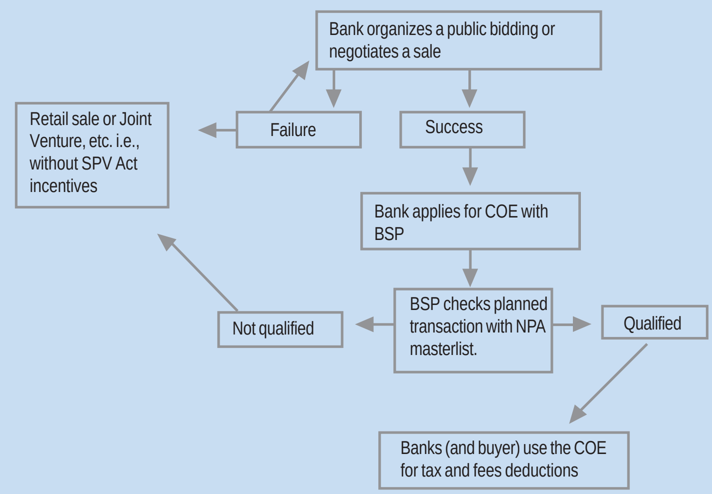


Figure III. Simplified NPA transfer process under the SPV Act

There are stringent conditions for the type of transactions that will qualify for the fiscal incentives. First, the bank-SPV transaction has to be 'true sale', i.e., the asset has been completely removed from the bank's or debtor's control, and the bank has no equity share exceeding 5 per cent in the buying SPV and no direct or indirect management.[6] The originating bank cannot even extend credit facility, guaranty or any similar financial transaction, whether directly or indirectly, to the transferee SPV. Furthermore, banks are required to notify the borrowers about the impending transfer of their loans and to give them a 90-day period for renegotiation and restructuring, if they are interested.

The SPV is organized as a stock corporation under Philippine laws with the primary purpose of investing in or acquiring NPAs of financial institutions, and disposing of them through various strategies. If the SPV will acquire land, foreign investors are subject to a maximum of 40 per cent share of its capital stock, with the rest being owned by Philippine nationals. The SPVs can issue equity or participation certificates or other forms of Investment Unit Instruments (IUIs) for the purpose of acquiring, managing, improving, and disposing of the NPAs. Banks are not allowed to purchase the IUIs issued by the SPV that acquired its NPAs.[7]

Philippines and India compared

The Philippines, India and Taiwan are the only economies in Asia that pursued private sector-led asset management companies, instead of government or centralized AMCs. To better appreciate the features of the Philippine SPV Act, this section presents some salient comparisons, particularly with India's SERFAESI Law which was passed at around the same time as the SPV Act (see Table 2). For instance, Asset Recovery Companies (ARCs) in India are partially owned by banks. While no one bank has controlling interest in an ARC, banks participate in the future uptake in the sale of bad assets, but the government does not grant them any fiscal incentives for transferring their assets to ARC. The downside is that the financial system is not necessarily cleaned out of its NPA problem because of the seemingly cosmetic solution. In the Philippines, the 'true sale' requirement attempts to give banks a clean break from the bad assets that saddle them, encouraging them to take losses in exchange for the fiscal incentives granted by the government.

Another major difference is the sweeping power granted to ARCs to seize assets and take over the management of companies. In contrast, Philippine SPVs have no other special privilege than what banks and other creditors have, making them hostage to a possibly lengthy judicial process. Other differences rest on the notification requirement, the equity limits for foreign investors, and qualified NPAs under the law. The Philippines has all

[4] The COEs are issued by the Appropriate Regulatory Authority (ARA). But since the BSP is the ARA for banks, the paper only mentions the BSP. Transactions by non-bank government institutions like the National Home Mortgage Finance Corp., for instance, need not go through the BSP but through the Department of Finance.

[5] For COE application, the bank has to submit details of proposed transactions, the identity of counterparties, and should disclose the terms and conditions and all material commitments related to the transaction to the BSP.

[6] *Under a 'true sale' requirement, the risk assessment of the banks would be improved because the market could evaluate the risk of sold NPLs separately from the other kind of risks that the bank assumes. Without it, and assuming asymmetry of information, both bank creditors and depositors would remain cautious about the general solvency of the bank, despite the NPLs' removal from its books. I thank Prof. Kozuka, my discussant in the RIETI Workshop, for this insight.*

[7] *However, originating banks may buy other type of debt instruments which the SPV may issue. This is one way by which banks can participate in the upside of their bad assets. These other debt instruments should have been disclosed in the SPV plan and would normally be subordinated to the IUIs.*

Table 2. Comparison of India's Asset Restructuring Corp. (ARC) with RP's SPV

	SPV	ARC
Enabling Law	Special Purpose Vehicle Law - December 2002	Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act - December 2002
Limitations on equity	5% max equity share of originating bank; 40% max for foreign investors	No one has controlling interest; Still partly owned by banks
Foreign participation in ARC or SPV	40% equity share max	None; but structural barriers to foreign investment in financial services applies.
Qualification of NPAs	Non-performing as of June 30, 2002 Notification of borrowers required	Any type of NPA. Assets where 75% of creditors (by value) have agreed to sell to ARC; No prior notification of borrowers necessary Foreign banks are not qualified to sell their NPLs under the Act
Loss carryover	10 years	?
Terms of sale of NPLs	'true sale' requirement (relinquish effective control over assets and legally isolated from transferor and its creditors); Do not participate in the profit of SPV; loss may or may not be reflected upon transfer from banks. No possibility of window dressing.	Banks can participate in the profit of the NPL sale but cannot underwrite; 'without recourse' - bank cannot assume liability if ARC makes a loss; Loss or profit are recorded on bank books once realized i.e., once ARC had sold the NPLs (although part may be reflected if 'fair' value at which NPLs were transferred to ARCs differs from book value) Possibility of window dressing exists
Special powers (statutory)	Nothing special for SPV; Same as banks	ARC has unprecedented power to take over management of the business of the borrower or seize assets
Fiscal Incentives	Tax and fees deduction	None; Law just allowed the establishment of ARCs
Time-bound	Yes	No
Main financial instrument	IUIs - Investment Utility Instruments - participation certificates	Third party investors can subscribe for security receipts

three, while India does not. Under the SERFAESI Law, transfer of NPAs is not time bound and thus, ARCs are projected to last as permanent business institutions.

SPV's incentive to rehabilitate

How would the SPV's preference of disposition strategies be affected by the time-boundedness of the fiscal incentives? The fact that the SPV Law mandates the disposal of assets within five years after acquisition, the SPVs are, likely, going to be more inclined towards short-term strategies, i.e., strategies that would allow quick returns. Examples of these disposition schemes include resale of debt to original borrowers or auctioning of assets after minimal improvements. Long-term rehabilitation of companies would likely be put in the back burner, while liquidation would be preferred.

To address this concern and to encourage infusion of capital by the SPV, the SPV Law grants additional tax holidays on net interest income arising from new loans that are extended for corporate rehabilitation, and exempts these loans from documentary stamp taxes. However, considering that all tax holidays would end within five years of acquisition, long-term rehabilitation by SPVs is going to be unlikely.

Current Performance under SPV Law

BSP-Approved transactions

Records of the BSP show that there are P520 billion of NPAs as of June 30, 2002, representing 14.9% of the banking system's gross assets of P3.5 trillion. Of this, about P80 billion are expected to be sold before the expiration of the SPV Law in April 2005, roughly P30 billion of which have already been completed, while the rest are awaiting the completion of required documents and the issuance of COEs. A total of 8 COEs have been issued to banks for SPV transactions worth more than P20 billion, 52 COEs for *dacion en pago* with loan equivalent of P9 billion, and 82 COEs for sale to individuals worth P345 million. Table 3 shows the approved transactions by the BSP classified according to type of banks.

The amount of announced NPA transactions by commercial banks, however, is bigger than the BSP-reported transactions. Table 4 shows that there are more P120 billion worth of planned asset disposition in 2005, if we include those transfers that are not going to be coursed via the SPV Law. For example, National Home Mortgage Finance Corp. (NHMFC) is tying up with a foreign partner in a joint venture provided in the SPV law, such transactions coursed

Table 3. BSP-Approved Transactions under the SPV Act *(December 2004, in million pesos)*

Bank Classification	ROPOA Sale to Individuals		Dacion En Pago		Sale to SPV	
	Book Value	Number of COEs issued	Book Value	Number of COEs issued	Book Value	Number of COEs issued
private domestic universal banks	71.729	37	7.613	30	8.510	3
domestic commercial banks	41.068	6	301.195	7	33.21	1
thrift banks	218.37	38	878.867	12	450.442	1
branches of foreign banks	13.781	1	409.51	1		
subsidiaries of foreign banks			4.679	1		
government banks			250	1		
NBQB					1.531	1
consortium of banks/non-banks[1]					11,050	2
TOTAL	344.946	82	9,458.00	52	20,046	8

[1] *National Steel Corp.*
Source: Bangko Sentral ng Pilipinas

through partially-owned joint ventures would not qualify for tax reprieve and other fiscal incentives. Other banks are also pursuing retail sales, instead of bulk sales to SPVs.

Registered SPVs

On the SPV registration, records from the Securities and Exchange Commission (SEC) show that 36 SPVs have registered before the deadline last September 18, 2004. Seventeen of the 36 SPVs, however, are owned by domestic banks. Absent any final negotiations with NPA buyers, banks have put up their own SPVs for the mere purpose of beating the deadline for SPV registration set in the SPV Law. However, if they want their NPA transfers to qualify for tax exemption, banks would have to divest, not only of their bad assets but also of their majority ownership in the SPVs. Since the SPV Law allows a maximum of only 5 per cent equity share by banks, the projected strategy is to proceed in a two-step process: the buyer of NPA buys the bank-owned SPV (assuming they do not have their own) then buys the NPAs from the banks.

NPL vs. ROPOA Transactions

Of the close to P30 billion transferred under the SPV Law, 70 per cent was sold to SPVs. These assets, as well as those that remain under negotiation, however, are comprised of NPLs and not ROPOA. The only ROPOA that have been transferred under the SPV Law were mostly single residential housing units sold to individuals, not to SPVs.

Several reasons explain why

Table 4. Announced Bank Transactions *(as of February 15, 2005)*

Name of Bank	Assets under Negotiation or Planned Transfer *(billion pesos)*	SPV Partner	Remarks
Allied Bank	12.55	ABC Resources Holdings, Inc.	
Asiatrust Development Bank	0.204	n.a.	
Bank of the Philippine Islands	8.6	Philippine Asset Investment (affiliate of Morgan Stanley Emerging Markets, Inc.)	additional 3 billion planned
		n.a.	
Bank of Commerce	1.6	Philippine Investment One, Inc. (partly	
Equitable-PCIB	10.5	owned by Lehman Brothers	
		n.a.	
Export Bank	5	Deutsche Bank - Cargill Financial	
Landbank	13.5	Services Int'l, Inc. and JP Morgan	two different pools of NPLs 4.3 ROPOA unsold; plan another 20 billion sale, of which 10 billion are ROPOA
		n.a.	
Metrobank	0.23	n.a.	Of which 10 billion is ROPOA
PNB	20	Unimark Investment Corp.	10 billion sale was a condition for PDIC
Philippine Bank of Communication	12.156	Philippine Investment One, Inc (partly owned	extending credit worth 8 billion
RCBC	7	by Lehman Brothers	additional 3.9 billion is planned
		First Sovereign Funds Corp. (owned by	
UCPB	13.6	South Koreas Shinhan Mergers and Acquisition)	
			through negotiated sale or public auction
Not through SPV:		n.a.	Joint venture; NHMFC equity share is 49%
China Bank	0.5 - 0.6		
		Deutsche Bank Real Estate Global	
NHMFC	13.4	Opportunities	

Source: Various Businessworld news articles

ROPOAs are not sold while NPLs were easy to dispose. For one thing, industry reports have it that potential buyers gave very low offer prices for the ROPOA that did not meet the banks' reservation prices. For NPLs, the story was different. Banks have already fully provisioned for the sold NPLs so that no matter how low the offer price might have been, banks could not lose from the sales. Any difference in the loan's face value and actual purchase value from the SPV transactions, therefore, would not adversely affect their balance sheets. In fact, banks have earned profits from the transactions because the book values of disposed NPLs were already zero, not to mention the additional liquidity benefits from the cash payments received in exchange for the NPLs.[8]

As regards ROPOAs, banks prefer to dispose of them on a piece-meal basis, rather than through bulk sale to SPVs. Or, they go into joint venture management of these assets to be able to participate in future profits from the asset sale. The former could still qualify for tax benefits under the SPV Law, especially if they are single-housing units sold to individuals; the joint venture schemes, however, are not going to give banks any tax exemption benefits under the SPV Act. Another downside from the joint venture scheme is that banks run the risk of prolonged warehousing of those assets instead of more quickly making a clean break from the NPA problems.

Evaluation

Judging from the less than P100 billion projected SPV transactions out of the more than P500 billion bad assets that are supposed to benefit from it, the SPV Law has not been all that successful. If the idea of the law is to get rid of the bad assets in the banking system, it will have achieved only roughly 20% of its avowed target by the time the Law expired in April.

Nothing yet can be said about the SPVs' role on corporate restructuring nor on their disposition strategies since only very few NPAs have been transferred, and the few that were, have taken place barely a few months ago. What this Section attempts to do is to explain the various factors that affected the low amount of NPA transfers from banks.

<u>*Government Factors*</u>

Several factors contributed to this result. One is the delay in drafting all the necessary rules and guidelines necessary for the implementation of the SPV Law. In particular, the Law was signed on January 10, 2003, the implementing rules and regulations were approved on March 19, 2003 and took effect April 9, 2003, but the BIR Revenue Regulation came out much later, leaving banks with little time to prepare all the necessary documentation and paper chase to meet the deadlines mandated by the SPV Law. In addition, the implementation of the Securitization Act which is supposedly a companion law to the SPV Act has been delayed for lack of implementing rules. This affects the use of asset-backed securities by SPVs in the future.

Another factor is the presence of the bureaucratic requirements for obtaining the COE from the appropriate regulatory agency, which for banks meant the BSP. On one hand, a BSP official considers the COE application a "cleansing process" for banks whose data documentation support or information systems for their bad assets have been relatively weak. Meeting the BSP requirements for the COE issuance, therefore, forces banks to have all their loan and asset records and documents in order. On the other hand, banks consider the process of reconciling any given pool of bad assets with what the BSP has in their masterlist, for purposes of verifying eligibility under the SPV Law, onerous. In addition, government agencies were also poorly coordinated in implementing the fiscal benefits to the extent that some government employees, when presented with the COEs for the availment of tax or registration fee reductions, were reportedly unaware of the fiscal perks from the SPV Law.

<u>*Banks' Considerations*</u>

On the part of banks, there are also important reasons for spurning low price offers, specially for their ROPOAs. First, the loss provisioning for ROPOA is capped at 50 per cent of the difference between book and appraised value of the real estate property and does not start until years 6 to 10 following the acquisition of the asset, while that for NPLs starts immediately and ranges from 5 to 100 per cent. Even with the maintenance cost of the ROPOAs, keeping them in banks' books is cheaper, on the basis of loss provisioning, than keeping NPLs.

Second, banks also have no reason to hurry on the disposition of bad assets because of concern over the effect of fire sale prices on real estate markets which, only now, appears to have a nascent recovery. Add to this the fact that the SPV Law has a stringent 5 per cent maximum bank equity share in SPVs, banks loathe the idea of not being able to fully participate in the eventual uptrend in the real estate market. This seems to explain why many banks are entertaining the idea of establishing joint venture companies instead of selling ROPOAs to SPVs.

Third, the terms of payments that were reportedly offered, particularly the portion paid in debt securities or notes, are riddled with uncertainties. Much of its value depends on the efficiency of the SPV partner and other contingent costs. If it turns out that the value of the notes is

[8] It is, however, expected that, as banks unload NPLs with less than 100% loss provisions, negotiated prices between banks and SPVs would go up.

worthless, the bank merely pushed back the book recognition of its loss. Thus, depending on the risk appetite of banks, they can accept full payment with majority paid in notes, or accept some losses upfront but with greater cash component. For a relatively conservative bank, more cash payment upfront is definitely preferred.

<u>Considerations by SPVs</u>

As a general rule, bulk sale mechanism, such as envisioned under the SPV Law, compared to other disposition mechanisms like retail sales, contract management, or joint ventures, usually tend to yield the maximum discount or the lowest value for assets. These discounts usually reflect the potential earnings by the SPVs which are, in turn, affected by the overall economic and legal environment. In particular, unsatisfactory insolvency regimes have an *ex-ante* impact on the transfers of assets and the strengthening of banks' financial positions. Put differently, the rock-bottom price offer by SPVs merely reflects many uncertainties that they would have to assume in the asset purchase, not the least important of which is the legal uncertainty which is tied up with the bankruptcy and foreclosure regimes in the country. Given the problems, expenses and delays of collection through the legal system, the SPVs are, understandably, unwilling to offer a high price to selling banks.

Typically, buyers price the pools of assets by assuming the worst of bankruptcy and foreclosure delays and litigation costs. After assuming the maximum delay, the projected value of loan collateral is conservatively estimated and the projected proceeds of sale in the far future is discounted back at a high rate to the purchase date. Once the buyers purchase the asset pool, it approaches the borrower with a heavy carrot and stick, but with greater flexibility than banks. They are normally willing to negotiate a settlement somewhere between the present collateral value and the steeply discounted purchase price from the banks. Negotiating a low acquisition value from the banks is, therefore, crucial to the SPV's profitability and its ability for quick disposal.

Are Prices Really Too Low?

A nagging question from the "price conflict" between SPVs and banks is whether the SPV offer prices are, indeed, too low. Without more available data, it is hard to make an assessment of this, but information from other countries can serve as a benchmark for comparisons. For example, Thorbum (2000), using data from Swedish firms which have undergone liquidation procedures, found that, for all debt classes, average recovery is about 35% of face value of the claims, while it is 27% for piecemeal liquidations, and 39% for going concern sales and successful reorganizations (see Appendix Table 1, Pasadilla, 2005.). This means that discounts on distressed asset average about 60-70%. Auction prepack, which is a going concern sale that is negotiated prior to bankruptcy filing, has a debt recovery rate of 32%, while the equivalent figure for Chapter 11 cases in the US, i.e. those reorganizations that were negotiated out-of-court, is 73%.

In Korea, KAMCO acquired assets depending on asset quality, whether secured or unsecured, with the unsecured getting a recovery rate of anywhere between 10 -30% of face value. Going concern assets were bought at higher prices than those from the Korea Deposit Insurance Corporation (most of the workout loans). Secured loans pitched the highest price, with recovery rates of about 70%. The average recovery rate for the loans sold to KAMCO is 36%, or an average discount rate of 64% (see Appendix Table 2, Pasadilla, 2005).

In the Philippines, if unofficial news that banks are offered 10%-20% of the claim value from NPA buyers is correct, then the price appears low, indeed, compared to figures presented in Thorbum (2000) or culled from KAMCO. But to the extent that recovery rates are a function of legal systems, and to the extent that more developed economies have stronger judicial institutions and more developed bankruptcy regimes, then the offer price from SPVs to banks would necessarily be lower than the 30% and above recovery rates found for developed economies. When the difficulty of maximizing asset values in an environment in which legal processes could be uncertain and strongly biased towards continuation even of inefficient firms, is considered, the high NPL discounts become understandable.

SPV Law Amendments

To attain the intended benefits from the SPV Law, Congress is considering extending the deadlines for both the SPV registration and the asset transfers to SPVs. Originally, the SPV registration was only up to September 18, 2004, and bank transfers up to April 8, 2005. The proposed bill is moving the deadlines two years hence, giving the SPVs up to 5 years to dispose of their assets. The qualified NPAs are also going to expand to include those that became nonperforming after June 30, 2002 up to December 2004.

In addition, the BSP is looking into changing some regulations to push banks to unload their ROPOAs. These include frontloading their loss provisions from years 6-10 to years 1-5. That is, banks have to immediately provision for bad assets they acquire and mark-to-market these assets every two years. The idea is to make holding on to soured loans more costly and pressure them to unload those loans earlier on.

Long-run Solution: Insolvency Reforms[9]

As discussed above, poor insolvency regime has affected the *ex-ante* behavior of SPVs in terms of influencing low offer prices for banks' NPAs. In turn, banks are reluctant to sell bad assets wholesale to SPV, thereby rendering the SPV Law ineffective in attaining its goal of lowering NPAs in the financial system. Conversely, an improved bankruptcy regime is expected to benefit, not only the SPVs, but bank restructuring as a whole. In the first place, a properly functioning insolvency system will prevent the high accumulation of NPLs because the shadow of effective foreclosures can lead to an enhanced credit culture. Should banks still accumulate some NPLs, good insolvency procedures would allow it to mitigate its losses through non-prolonged asset seizures, thus preventing NPLs in the entire banking system from rising into systemic proportions.

However, an effective insolvency system is not only pro-creditor but also pro-debtor. Indeed, it contains a balance between the rights of both creditors and debtors and is a legal system where both bank and corporate restructuring meet. Highly pro-debtor system can result to very slow exit procedures for truly insolvent and inefficient firms, thus a delay in resource realignment in the economy. It can also create adverse incentives for corporations to over-borrow and renege on their credit commitments lightly. However, highly pro-creditor procedures may also be too biased towards quick liquidation, without providing a breathing space for firms that are in temporary difficulties. This, too, can be wasteful of resources because, among others, the intellectual and non-physical assets of enterprises take years to build, not to mention the lost employment that accompanies liquidation. Besides, preservation of some firms as going-concerns tends to maximize recovery value which, in the end, is to the creditors' advantage.

Brief Background

Like other Asian countries, the Philippine insolvency laws are antiquated, dating back to the turn of the 20^{th} century. The principal law governing the remedies of insolvency and suspension of payments is the Insolvency Law (Republic Act 1956), enacted in 1909. Both remedies for ailing corporation were administered by the regular courts.

Republic Act 1956 did not provide for the rehabilitation of distressed corporations. This is a remedy provided in Presidential Decree (PD) 902-A, enacted in 1976, which lodged jurisdiction on the SEC over three different remedies, namely: 1) suspension of payments; 2) rehabilitation; and 3) dissolution. The SEC did not have clear rules and procedures for applying PD 902-A and had taken each petition for suspension of payments on an ad hoc basis. Pressured by the increase in petitions during the Asian crisis, the SEC belatedly issued, in December 1999, the Rules and Procedures on Corporate Recovery that set out a framework for processing and quickly resolving rehabilitation cases. The procedures are considered to be largely SEC-controlled or regulator-driven whereby the grant of the remedies depends exclusively in its sound discretion, albeit prudently exercised after notice and hearing (Concepcion, 2000). The SEC framework has a strong discretionary aspect in which the SEC wields the power to overrule creditors' oppositions.

With the passage of the Securities Regulation Code (SRC) in July 19, 2000, the jurisdiction over cases falling under RA 1956 and PD 902-A was transferred to the Regional Trial Courts (RTCs), except for cases that have already been filed with SEC before June 30, 2000. The Supreme Court, thereby, issued the Interim Rules on Corporate Rehabilitation ("Interim Rules") in December 2000 to provide a framework for resolving rehabilitation cases in the RTCs.

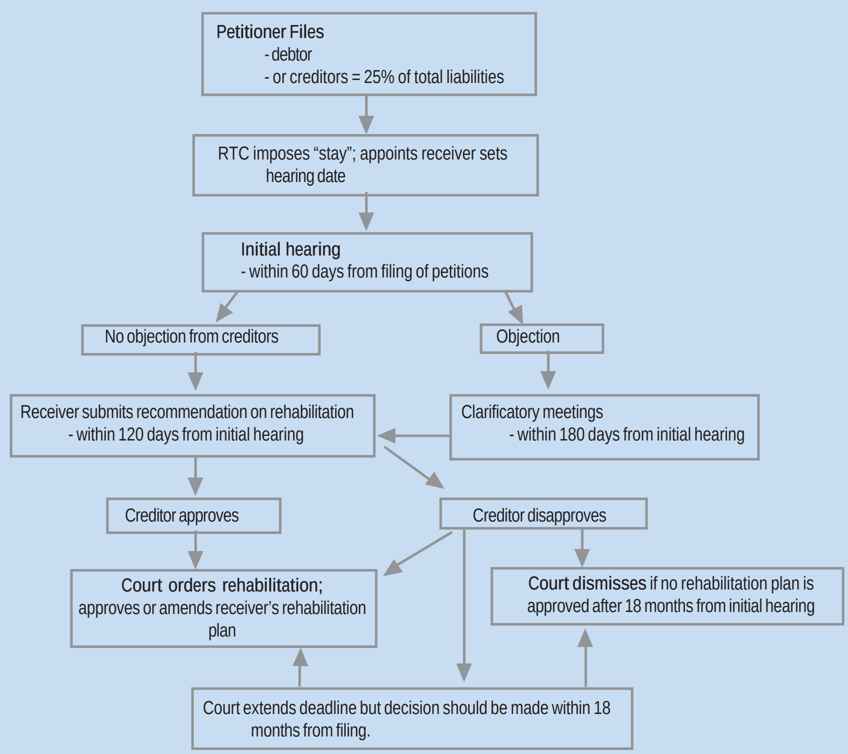
Interim Rules on Corporate Rehabilitation

Like the SEC Rules and Procedures on Corporate Recovery, the Interim Rules have a strong discretionary element on the part of the RTC. Creditors' concerns are considered but the final decision rests on the RTC judge. The Interim Rules, however, specifies criteria on when the judge can consider creditors' opposition as manifestly unreasonable (Rule 4, Section 23).

Most importantly, the Interim Rules have strict time-bound procedures whereby the petition is dismissed if no rehabilitation plan is approved within 18 months after the filing of the petition (Rule 4, Section 11) (see Figure IV). If the court approves a rehabilitation plan, the plan is immediately executory and is protected from restraining orders unless an Appeals Court orders a temporary restraining order (TRO). If no rehabilitation plan is approved, what happens to the firm afterwards, whether it goes straight away to liquidation, is unclear from the Interim Rules. Previously, the SEC also supervised the dissolution of the firm if rehabilitation is no longer feasible. In the current regime, however, there is no seamless transition from rehabilitation to dissolution. To address this, the Supreme Court is, reportedly, preparing another Interim Rules for Insolvency and Liquidation to address issues related to RA 1956.

[9] *This section is an abridged version of what is found in the original PIDS Discussion Paper DP 2005-06 available in www.pids.gov.ph.*

Figure IV. Rehabilitation Proceedings in RTCs



Comparison of RA 1956, PD 902-A, Interim Rules

Table 5 summarizes the main features of the three different insolvency regimes in the Philippines. The procedure under RA 1956 did not effectively provide for breathing space for corporations that are undergoing temporary difficulties; PD 902-A provided this avenue through rehabilitation. The rehabilitation remedy might have been unthinkable in 1909 but is very much part of common business life today. Furthermore, RA 1956 is deemed strongly pro-creditor in that creditors had an effective veto over any suspension of payments applications. Concepcion (2000) argues that creditors, in most instances, would have incentives to vote against suspension of payments because delays cause possible dissipation of assets and lessens the potential amount which they could collect. PD 902-A and the Interim Rules counterbalance this so-called "pawnshop mentality" of creditors through a more court- or regulator-controlled procedure.

The downside of PD 902-A was the lack of clear framework and procedures in its application by SEC. For example, even though, in principle, insolvent companies cannot apply to SEC for remedies, in practice, both insolvent and solvent corporations avail of suspension of payments remedy because creditors do not have the power to question the claim of solvency by the debtors. Typically too, government agencies have no incentive to question the solvency claim but are rather inclined to give petitioners the benefit of the doubt. Hence, the bias swung towards debtors, in particular, towards continuance of the operations of companies, whether deserving or not, and whether economically efficient or not. The procedures in SEC also did not follow strict timelines that creditors, prior to the Asian crisis, would cajole debtors not to file for suspension of payments with SEC and, instead, more quickly settled their problems outside its auspices. The result was that few companies availed of the remedies available with the SEC, until the Asian crisis forced many companies to run under its shelter.

The Interim Rules represent a marked improvement over SEC procedures because of its strict deadlines, forcing a rehabilitation decision within 18 months from the filing of the petition. However, an efficient bankruptcy procedure is marked not only by speed but also by accuracy. Bankruptcy lawyers claim that the advantage of the procedures with SEC is that the SEC officials were more familiar with commercial cases than judges. Thus, while, so far, the five RTC rehabilitation decisions on record since 2000 have met the 18 months deadline, there have been questions on the quality of the decisions (as seen in the case studies below). Of the five rehabilitation plans that were approved by the RTCs since 2000, three went to the Court of Appeals (CoA), of which, two are pending, while one CoA decision sustained the RTC decision.

Despite the strict timeline in the RTC, the procedures for appeal potentially carries the same problem of delays, because the procedure now follows other Civil Procedures with less stringent timelines than the Interim Rules. Fortunately, or unfortunately for some, the rehabilitation plan approved by the RTC remains enforced, even as the appeals process continues.

For debtors, the indirect costs, in terms of managerial time and negative reputational effects in product and capital markets, decreased with the new time-bound procedures. However, for banks, the immediate executoriness of the RTC

Table 5. Snapshots of Three Insolvency Regimes

	RA 1956	PD 902-A	Interim Rules
Date of enactment	1909	1976	2000
Remedies Available	Suspension of payments; Liquidation	Suspension of payments; Rehabilitation; Dissolution	Suspension of payments; Rehabilitation
Jurisdiction	RTCs	SEC	RTCs
Who can apply for suspension of payments	only solvent corporations	Only solvent corporations but because there is no need for creditor approval, effectively both solvent and insolvent corporations apply	No requirement of solvency
Liquidation filing	Separate filing by either debtor or creditors (or group of creditors)	Conversion from rehabilitation to dissolution is automatic; seamless procedure	Nothing is said; presumption is that it would be a separate filing.
"Stays" on creditors	Excludes secured creditors	Does not exclude secured debts	Does not exclude secured debts
Role of creditors	Creditor approval needed to approve suspension of payments petition; Needs at least 2/3 affirmative vote from creditors representing at least 3/5 of total liabilities	No creditor approval is needed; SEC-controlled process; overrule of creditors is possible	No creditor approval needed but oppositions are hears
Management of suspension/or rehabilitation	Stay on corporation excludes dispositions which are necessary in the ordinary course of business	Needs SEC approval for whatever corporate dispositions	Receiver oversees rehabilitation and approves or disapproves disposition
Time caps	None	None	Within 18 months from filing, rehabilitation should be approved; decision is immediately executory

decisions is not necessarily a cause for celebration, because most of the decisions have actually been highly pro-debtors. For example, the mandatory nature of 'dacion en pago' arrangements in RTC rehabilitation calls for a re-think about the proper authority of commercial courts over private business contracts.

Proposed Corporate Recovery and Insolvency Law

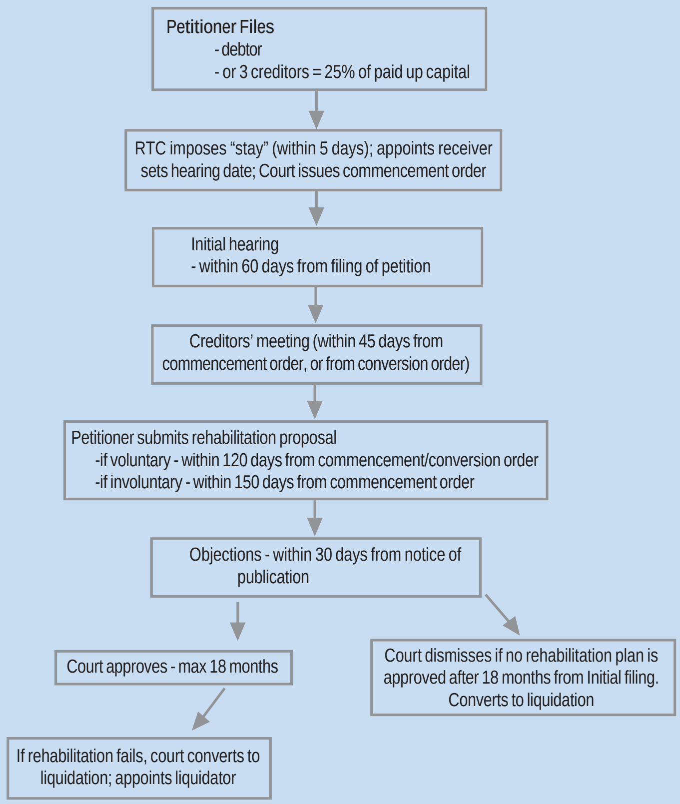
After a few years of RTC jurisdiction over insolvency cases, some of the laws' limitations have surfaced. First is the lack of seamless conversion from rehabilitation to liquidation. It is unclear, under the Interim Rules, whether there is need for a separate filing for liquidation and what procedures to follow. Second, while RTC process is guided by an 18 months deadline, the Appeals decision has no such timeline. Third, a strongly pro-debtor bias, similar to how it had been under the SEC, remains in the law. For instance, creditors' approval is not explicitly required by law for the court to approve the plan (even though, in practice, the courts wait until majority of the creditors has approved it or has withdrawn its opposition). Fourth, the Interim Rules do not explicitly require the use of only audited financial statements in court. Nevertheless, the existing regime had already been a marked improvement from previous ones, judging from a relatively high number of filings. Still, the fact remains that the existing legal basis are somewhat antiquated and is badly in need of modernization.

Corporate Recovery and Liquidation Act

There are two house bills filed in Congress addressing the issue of insolvency. One is House Bill 2204, or the Corporate Recovery and Liquidation Act (CRLA); the other is House Bill 2073, or the Corporate Recovery Act (CRA). The CRLA addresses the issue of seamless conversion from rehabilitation to liquidation through a court order of conversion, in the event that the rehabilitation plan fails, or no viable plan is approved within the prescribed 18 months duration of the proceedings. Of course, there is also a direct voluntary or involuntary filing for liquidation. In the case of the latter, however, the court can convert from liquidation to rehabilitation if the debtor files a motion within 15 days from commencement date of liquidation proceedings (see Figure V).

The proposed insolvency act had greatly boosted the power of creditors over the entire process. The creditors' vote is required for the approval of a receiver, for the extension of rehabilitation plan submission, and for the final approval of the plan. In particular, for a plan to be approved, it has to have the support of 80% of creditors or majority of creditors in each sub-class of creditors. Receivers are also required to meet with the creditors,

Figure V. The Proposed Corporate Recovery and Liquidation Act



unlike in the Interim Rules where this is left to the Receiver's discretion. The bill also contains similar timelines as the Interim Rules, with a maximum of 18 months for the entire court proceedings from filing to approval of the rehabilitation plan. In this regard, the proposal is a marked departure from PD 902-A, as applied by SEC.

The CRLA has also clearly established the Absolute Priority System (APS) in case of liquidation, where property tax is ranked high in priority, next only to administrative expenses related to court proceedings, and ahead of secured creditors. The proposed bill also contains provisions for the treatment of rapidly deteriorating assets, maintains the taxability of forgiven debts, and provides conditions for consolidated filing of affiliates. It continues, however, to grant debtor-in-possession (DIP) privilege, except in situations where a management committee may be called for. It is, however, silent on the use of audited financial statements.

Though the CRLA contains a chapter on Pre-Negotiated Rehabilitation, it is unclear on what the benefits under this procedure would be for the debtors and creditors that would take this route. Finally, the provision allows for debt-equity swap within the statutory equity ownership limits allowed for banks. However, the law prescribes a mandatory disposal of such acquired equity within five years.

Corporate Recovery Act

A major difference between the Corporate Recovery Act (CRA) and the CRLA is that the CRA contains provisions for fast track rehabilitation. The fast track rehabilitation is patterned after pre-packaged bankruptcy concept in other countries. It involves the creation of a new, debt-free company from the assets of the old one, auction of the shares of the new company to pay off the debts of the previous one, and the continuation of business under the new company. The fast-track process facilitates the sale of the company as a going-concern without the need for the court to decide on rehabilitation or liquidation.

In theory, fast track appears an efficient process, but given the novelty of the remedy, it is doubtful whether the Philippines is the right country to introduce such a major innovation in the insolvency system; the procedure crafted in insolvency law seems to be a first in the entire world. In the first place, the judges are just now gearing up to understand commercial cases better; introduction of even more novel ones would, likely, merely create confusion. Secondly, the fast-track process requires a deep capital market to get an adequate price for the new company's shares, a requirement which is not yet present in the Philippines.

Other points of difference between the two include: 1) timelines of the rehabilitation procedures; 2) voting by creditors; 3) debtor-in-possession provisions; 4) application for court-supervised rehabilitation; 5) use of audited statements. The CRA does not have an absolute maximum deadline for the court to approve the rehabilitation plan, even though there are timelines for the submission of plans by the petitioner, failure of which can result to conversion of the case to liquidation. The CRLA, in contrast, stipulates 18 months maximum. Second, approval of the plan is based on majority approval by each class of creditors as well as shareholders; the CRLA does not include approval by shareholders but only by majority of each class of creditors <u>or</u> the approval of 80 per cent of creditors regardless of class. Third, the CRA has confusing provisions on DIP. On the one hand, it vests full control on the conservator/receiver; on the other hand, it mandates delegation to debtor management, unless circumstances justify otherwise. The CRLA, in contrast, states clearly that the receiver only has power to review and to access all records available to its management and Board of Directors, thus, is unambiguous about DIP. Fourth, while both creditors and debtors are allowed to file for fast track rehabilitation, only debtors are qualified to apply for court-supervised rehabilitation, in the CRA. Fifth, the CRA has the advantage of stating explicitly that audited financial statements be part of the requirements for filing for rehabilitation.

As a whole, both CRA and CRLA grant improved powers on creditors, provide seamless conversion from rehabilitation to liquidation, contain provisions for APS, and address informal workouts. Both, therefore, introduce some improvements in the current insolvency law.

Implications for SPVs

Without a number of publicly available transactions by the SPVs at the moment, this section will merely advance some *ex-ante* or likely effects of the insolvency reforms on the SPVs. A more definitive, evidence-based appraisal of the reforms would have to come later after SPVs' operations in the Philippines have come in full swing. At present, many SPVs are still winding up negotiations with banks and presumably, finalizing their disposition strategies for those acquired assets.

Upon asset acquisition, the rights of the creditor banks are completely transferred to the SPV. Therefore, to the extent that insolvency laws have moved a little towards more creditor-friendly regimes, SPVs are benefited. For instance, the introduction of clear timelines and maximum periods in the Interim Rules allows SPVs to expect, barring any delays from any court appeals, a more predictable timeframe in which to base their restructuring or disposition plans. In addition, the continuing education of judges in commercial courts is another booster for the entire credit system.

Similarly, to the extent that both the CRLA and CRA address the concerns of creditors over an overly pro-debtor insolvency procedure, the proposed bills would also be beneficial for SPVs. The easy conversion from rehabilitation to liquidation, for instance, would remove another layer of confusion or difficulty for creditors. The granting of voting powers for creditors over the choice of the rehabilitation receiver and the approval of the plan would be, again, another plus for SPVs.

One remaining problem with existing and proposed laws is the DIP privilege which is retained in both versions of the insolvency reform laws. The problem is that SPVs, unlike banks which have their main expertise in financial intermediation, might actually have the turn-around experts among its personnel who could greatly improve the firm's performance, or have excellent asset managers who would maximize, not only the values of particular assets, but of the entire business as a whole. Yet, because of DIP, it is unlikely that the debtor management would voluntarily relegate their role.

A possible improvement that can still be introduced in the proposed bills is the granting of DIP privilege only in the case of voluntary insolvency procedures. In the case of involuntary filing for rehabilitation, the DIP should not apply. In this way, the DIP privilege also becomes the incentive for early rehabilitation filing before the company situation becomes worse. Another problem, specially with regard CRLA, is the mandated disposal of equity, which banks had swapped for debt, within five years. Banks should be allowed to dispose of these equity shares when they deem it beneficial for them, for instance, when the equity values of the company had sufficiently appreciated. Given unpredictabilities in the equity market, it is hard to tell whether such could be achieved within five years.

Summary, Conclusions, and Recommendations

What had become transparent from the study of insolvency procedures and NPLs is that banks are the institutions that are caught in the middle. On the one hand, courts are usually pro-debtor: they give breathing space to borrowers to regain profitability, impose 'haircuts' on banks, mandate *dacion en pago* arrangements, etc. On the other hand, the BSP exerts pressures on banks to reduce its ROPOA holdings which, in many cases, have been thrown at banks through court-mandated debt-for-assets swap. Meanwhile, banks have to provision for losses for these transferred assets as well as spend for their maintenance costs.

Courts, too, seem to operate on a different time frame from banks. While courts can approve 10 or 20-year rehabilitation plans, banks have a more pressing and shorter time frame. They want repayment of loans sooner; they want sooner conversion of those loans to performing status, or else, liquidate them altogether. Banks are also required to grant secured loans equivalent up to only 60% of the value of the collateral; yet courts accuse them of being overcollateralized, at times even interfering in the valuation of asset securities for loans.

The present situation, therefore, clamors for immediate reform of the insolvency regime. The two proposed bills on insolvency reforms appear on track, by improving the role of creditors and putting time-bounds in the entire process. To the extent that SPVs take over the rights of the creditor banks, a more pro-creditor improvement in the insolvency regime would also be good for SPVs.

What remains to be addressed are the use of DIP privilege, the timelines for the appeals process, as well as improvements in the informal workout process. The paper argues that DIP should only be a privilege for voluntary rehabilitation and should be made an incentive for early filing by firms. Maximum periods for review should also be put for cases on appeal. Finally, the insolvency law should make clear the incentives and the benefits for debtors and creditors to engage in informal work-outs.

Lastly, on the administrative side, the continuing education of commercial court judges through the Philippine Judicial Academy (Philja) should be given priority. After all, the effectiveness of the insolvency process lies not so much on how avant-garde the rules and procedures are, but on the competent, fair and open-minded decisions by the court. Better to stick to time-tested bankruptcy procedures that had worked well in many other countries than create a new and innovative one that is yet untested anywhere else.

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The SPV Act: Implications to PDIC

Since 1999, Philippine banking institutions have been saddled by the dramatic increase in non-performing assets (NPAs)[1] held from P253.1 billion in 1998 to P522.6 billion in 2003.[2] The huge build-up of NPAs absorbed by the banks during this period was largely attributed to the financial difficulties and failures of corporate borrowers that ensued following the Asian financial crisis in the late 1990s. Triggered by the drastic depreciation of regional currencies and worsened by the rise in domestic interest rates, corporate borrowers faced serious problems in repaying their debts particularly those denominated in foreign-currencies. This significantly contributed to the proliferation of loan restructuring and foreclosures.

Notwithstanding banks' efforts to immediately dispose of acquired assets, use of traditional methods were found to be inadequate to stem the growth of NPAs. The high cost of managing and the tedious task of disposing NPAs amid sluggish asset markets and cautious investment climate had weighed down banks, restricting their earnings potential and posing risks to their capital position.

To speed up the disposal of NPAs, governments of other countries affected by the Asian financial crisis established asset management companies (AMCs) as part of the rehabilitation efforts of their respective financial systems. The Philippines, burdened by the wide budget deficit and heavy debt overhang, was unable to set-up a centralized AMC to absorb the NPAs of financial institutions. During the 1980s, an asset disposal framework within the public sector was implemented although severe policy limitations hampered expeditious recoveries (see Box 1).

As a critical step towards restoring a sound financial sector, the Philippine Government approved Republic Act (R.A.) No. 9182 or the Special Purpose Vehicle (SPV) Act in December 2002. The Act envisioned to significantly pare down the volume of NPAs across financial institutions by offering tax incentives and reduced fees within

Box 1. Philippine Public Asset Management in the 1980s

In the 1980s, a government-sponsored AMC was established and used, albeit on a limited scale, as a resolution mechanism to relieve government financial institutions (GFIs) of their large portfolio of bad assets that accumulated due primarily to substantial exposure to DOSRI[a] loans. To rehabilitate these GFIs, Presidential Proclamation No. 50 dated 8 December 1986 created the Asset Privatization Trust (APT), which was mandated to take control of the NPAs of the Philippine National Bank (PNB) and the Development Bank of the Philippines (DBP) totaling P108 billion. The APT had an initial term of five years, subsequently extended until 31 December 2000 through Congressional acts. Its mandate was also later expanded to include the privatization of disposable government assets other than those of PNB and DBP.

The Philippine experience in this AMC had limited success. Out of the P147 billion NPAs transferred to APT, it was able to recover only P33 billion or 22% by 1999. The APT had limited powers and authority as all transactions had to be approved by the Committee on Privatization[b]. This slowed down the pace of asset disposal. Various legal impediments and depreciated condition of the properties, plus constraints in pricing the assets also hampered privatization efforts. APT had to sell at a minimum of 90% of the appraised value. If assets remained unsold after three months, they were re-appraised and re-offered for sale. The process was repeated until the assets were sold.

[a] *Refers to loans extended to the bank's directors, officers, stockholders and related interests.*
[b] *At the time the Committee was constituted per Proclamation No. 50, composed of the Minister of Finance as chair and as members: the Minister of Trade and Industry, the Director General of the National Economic and Development Authority, the Minister of Budget and Management, and the Minister in charge of the Presidential Commission on Government Reorganization.*

[1] *The sum of non-performing loans (NPLs) and real and other properties owned and acquired (ROPOA) in the banking system.*
[2] *The ratio of NPAs to total assets has also increased during this period except from 2002 to 2003. The NPA ratio declined because of the expansion of total assets. It was only in 2004 when the actual level of NPAs dropped to P497.3 billion.*

a specified period. With a minor role for Government, the law encouraged the private sector (domestic and foreign) to invest in SPVs (also known as AMCs), by lowering the transaction costs for the purchase and sale of NPAs. These SPVs purchased the NPAs either for resale or to develop them for productive use. The acquisition by SPVs of financial institutions' NPAs provided liquidity for banks and reduced the cost of managing these assets.

Providing Alternative Resolution Scheme

Although there was no existing formal mechanism similar to AMCs in other countries that would directly resolve bank failures in the aftermath of the Asian financial crisis, the Philippine Deposit Insurance Corporation (PDIC) had been involved in the rehabilitation of distressed banks through the grant of financial assistance (see Box 2). One of the modes of financial assistance extended by PDIC that responds to the banks' NPA problem is assets purchase. This form of financial assistance is almost equivalent to the SPV concept in that PDIC purchases the (non-performing) assets of the distressed bank and replaces them with earning assets such as financial instruments to help clean up the bank's balance sheet and address its liquidity or insolvency problem. PDIC subsequently undertakes the management and disposal of the assets purchased from the bank.

With the implementation of the Law, PDIC in granting financial assistance to banks has also imposed among its conditions the sale by the bank of its NPAs to an SPV within a prescribed period. This has reduced the level of NPAs in the bank's portfolio and has relieved PDIC of the burden of managing and selling these NPAs under less-favorable-than-market conditions[3] and incurring attendant costs.

In the broader sense, the SPV Law not only becomes significant to PDIC in granting financial assistance but also in terms of minimizing potential loss to the Deposit Insurance Fund (DIF). Prolonged deterioration in the asset quality of banks would impact on earnings and capital, which may lead to bank failure or closure. If left unaddressed, the cost of rehabilitating or closing banks would be higher and eventually be absorbed by the DIF. With the involvement of SPVs, banks have incentives to dispose their NPAs, in order to reduce the threat to capital of their worsening quality of assets. As banks strengthen their capital base, the probability of bank failures is lessened thereby building up the DIF and sustaining depositor confidence in the banking system.

Status of Implementation

The SPV Law created an alternative opportunity for banks to dispose their NPAs. As of 12 April 2005, the deadline for the availment of tax exemptions and privileges under the law, the Bangko Sentral ng Pilipinas (BSP) had issued 187 Certificates of Eligibility (COE)[4] to 31 banks and two non-banks comprising

Box 2. Grant of PDIC Financial Assistance

PDIC grants financial assistance to a distressed bank when the continued operation of such bank is essential to provide adequate banking services in the community or maintain financial stability in the economy. The financial assistance may also be provided to an institution acquiring control of, merging or consolidating with or acquiring the NPAs of a bank in danger of closing.

The financial assistance may be granted by PDIC through a mode suitable to rehabilitate the bank that could either be purchase of assets, placement of deposits, extension of loans, assumption of liabilities, or in the form of quasi-equity infusion. Choosing the mode of assistance is determined based on the extent of a bank's capital impairment or liquidity problem, the availability of interested investors/ acquirers and additional resource contribution from shareholders. Another consideration is a reasonable burden-sharing between PDIC, the bank owners and the incoming investors. In all cases, PDIC ensures that the cost of financial assistance does not exceed the estimated cost of payout and liquidation in case the bank is closed. However, for a bank failure that may have systemic repercussions as determined by the Monetary Board, PDIC may grant financial assistance in such amount as may be necessary to prevent its failure and to restore its operational viability. The grant is extended under such terms and conditions as may be deemed necessary by the PDIC's Board of Directors, concurred in by the Monetary Board and "without additional cost to the Deposit Insurance Fund" (DIF)[c].

[c] *Section 13 ©, RA No. 3591, as amended by R. A. 9302. The DIF is the capital account of the Corporation and consists of the following: (a) the Permanent Insurance Fund; (b) assessment collections net of charges; (c) reserves for insurance and financial assistance losses; and (d) retained earnings.*

[3] *PDIC's asset disposition is unable to freely follow market conditions being subject to government audit restrictions.*
[4] *Refers to the certificate issued by the appropriate regulatory authority, in this case the BSP, as to the eligibility of the NPL or ROPOA for purposes of availing of the tax exemptions and privileges of the SPV Act.*

P51.8 billion worth of NPA transactions. There are seven banks with applications under process covering P39.0 billion worth of NPAs.[5] Total NPAs among banking institutions including additional NPAs booked by banks as of March 2005 was reduced by P54.0 billion or 10.1% from the same period in 2004, which could be largely driven by sales to SPVs.

Although the drop in the level of NPAs in the banking system was not dramatic, the reduction of NPAs for certain banks was significant to cause a turnaround. Based on published statements of conditions of 12 banks that have announced ongoing or planned SPV deals in 2004, five recorded a substantial reduction in their NPA level from March 2004 to 2005. These are, Philippine National Bank (PNB), P9.0 billion; Equitable PCI Bank, P8.0 billion; Philippine Bank of Communications (PBCom), P4.7 billion; Bank of the Philippine Islands (BPI), P2.4 billion; and Rizal Commercial Banking Corporation (RCBC), P1.5 billion (see Table 2). All five banks have shown lower ratios of NPA to capital for the same reference period (see Table 3).

Other banks with pending NPA sales would likely improve their NPA/capital ratios once the transactions have obtained COEs from BSP and eventually sold to SPVs. However, losses to be borne by banks arising from the deeply discounted sale of the NPAs to SPVs are expected to adversely affect their financial condition if provisions for losses have not been fully set up for these NPAs. As temporary regulatory relief, BSP issued a memorandum allowing banks to stagger the recognition of losses over a period of 10 years.[6]

The BSP expects the NPA ratio of the banking system to go below 10% if the target P100 billion of NPAs were disposed. As of March 2005, NPAs as a percentage of total assets in the banking system stood at 10.8%. If the SPV Law is extended for two years, BSP expects disposal of another P100 billion, which will further bring down the banking system's NPA ratio to around 7.5%.[7]

The Law, however, will not necessarily prevent the recurrence of the NPA problem in the future. While economic slowdown affected the performance of bank borrowers causing loans to become non-performing, the failure of many banks in the past was found to have also been caused by weak corporate governance, poor credit policies and inadequate management of risks. Banks must be committed to strengthening management oversight and improving credit and risk management practices. Hence, the BSP and PDIC should be at constant lookout,

Table 1. Transactions under the SPV Act
As of April 2005 (Deadline for availment)

Total amount of transactions with COE issued	P51.8 Billion
Total no. of COE issued by the BSP	187[a]
Total no. of financial institutions with COE issued	33
Banks	31
Non-banks	2
Amount with pending COE issuance	P39.0 Billion
Total no. of banks with pending COEs	7
Total amount of transactions	P90.8 Billion

[a] *Includes 2 COE issued in favor of National Steel Corporation's consortium of creditors*
Source: Bangko Sentral ng Pilipinas, Supervision and Examination Department 1

Table 2. Comparative NPA Levels of Banks with Planned/On-going Negotiation for SPV Sale
(Amounts in P million)

Bank	Assets under Negotiation or Planned Transfer to SPVs [a)]	NPAs March 2004 [b)]	NPAs March 2005[b)]	Increase/ (Decrease)
Allied Bank	12,500.00	*14,121.05*	*13,349.77*	*(771.29)*
Bank of Commerce	1,600.00	*9,269.21*	*9,464.64*	*195.43*
Bank of the Philippine Islands	8,600.00	*23,279.60*	*20,879.98*	*(2,399.62)*
Equitable PCI Bank	10,500.00	*38,242.99*	*30,287.19*	*(7,955.80)*
Export and Industry Bank	5,000.00	*7,961.55*	*n.a.*	*-*
Land Bank of the Philippines	13,500.00	*38,965.24*	*38,308.92*	*(656.32)*
Metropolitan Bank & Trust Company	230.00	*61,591.06*	*62,918.45*	*1,327.38*
Philippine Bank of Communications	12,156.00	*7,750.40*	*3,086.81*	*(4,663.60)*
Philippine National Bank	20,000.00	*73,164.37*	*64,163.67*	*(9,000.70)*
Rizal Commercial Banking Corp.	7,000.00	*20,533.05*	*19,046.94*	*(1,486.11)*
United Coconut Planters Bank	13,600.00	*40,833.72*	*39,978.76*	*(854.96)*
Asiatrust Development Bank	204.00	*1,825.45*	*1,783.20*	*(42.24)*
TOTAL	104,890.00	*329,576.16* [c)]	*303,268.33*	*(26,307.83)*

[a)] *Source: Various Businessworld news articles, 2004*
[b)] *Source: BSP website. Published SOCs of selected banks, 2003-2004*
NPAs=(NPLs + Property Owned or Acquired (net)
[c)] *Total excludes Export and Industry Bank*

Table 3. Comparative Levels of NPA/Capital Ratios of Banks with Announced Negotiation for SPV Sale

Bank	March 2004	March 2005	Increase/ (Decrease)
Allied Bank	95.9%	95.8%	(0.1)
Bank of Commerce	246.8%	244.3%	(2.5)
Bank of the Philippine Islands	43.6%	37.8%	(5.9)
Equitable PCI Bank	89.5%	68.7%	(20.8)
Export and Industry Bank	178.3%	-	-
Land Bank of the Philippines	167.7%	176.4%	8.7
Metropolitan Bank & Trust Company	118.3%	127.5%	9.2
Philippine Bank of Communications	121.3%	46.6%	(74.7)
Philippine National Bank	309.7%	269.4%	(40.4)
Rizal Commercial Banking Corp.	133.4%	118.4%	(14.9)
United Coconut Planters Bank	3,861.2%	1,372.3%	(2,488.9)
Asiatrust Development Bank	117.6%	110.0%	(7.7)

Source: Published Statements of Condition, BSP

[5] *Source of data: Supervision and Examination Department 1, BSP*
[6] *BSP memorandum dated 26 September 2003 allowed loss recognition for 7 years, which was later extended to 10 years per BSP Memorandum dated 16 February 2004.*
[7] *According to BSP Governor Amado Tetangco, in reply to a question during the open forum in the Second General Membership meeting of the Corporate Planning Society of the Philippines held on 3 June 2005.*

strengthening the supervisory and prudential regulatory framework to ensure that banks operate soundly and safely.

Prospects of Extension

The banking system's NPA ratio has improved to 10.8% in March 2005 from 13.4% in March 2004, partly attributable to the disposition of NPAs via the SPV law. A total of P51.8 billion worth of NPAs have been disposed, with another P39.0 billion pending with the BSP for issuance of COEs as of 12 April 2005 (Table 1)[8]. With increased awareness and better appreciation of improving asset profile, banks will continue to dispose their NPAs notwithstanding the expiry of the law through other means. However, banks are saddled with a huge volume of NPAs and their capital remains at risk. As of March 2005, NPAs still comprised 78.4% of the banking system's total capital. The ratios present an improvement from the previous periods though still far from the pre-crisis levels. If the NPA problem is not resolved on a large-scale basis and without the corresponding strengthening of capitalization in banks, it still poses significant threat to their viability, to the DIF and to the stability of the whole financial system.

Extending the timelines of the SPV Act would encourage a steady stream of disposals and provide an effective resolution for the NPA drag over a prolonged period of time particularly against the backdrop of an improving climate in real estate. This is expected to be further fortified by crafting and revising rules of procedures together with enactment of other vital bills[9] that would create a favorable legal and market environment for NPA disposals.

An extension of the SPV Act would support PDIC's mandate to protect depositors and promote financial stability. Instead of going through bank closures or failure resolution modes, hastening the NPA disposal through the SPV Law would improve the bank's balance sheets and help revive financially troubled banks. The extension would be likewise beneficial to PDIC since it would enable the Corporation to continue providing financial assistance to banks in danger of closing using the SPV framework whenever applicable. While PDIC will be relieved from the burden of managing or selling the NPAs which should have been purchased from the distressed bank, bank owners who share with PDIC in absorbing the losses incurred from the transfer of NPAs to an SPV has an incentive to obtain the best price for the NPAs, potentially reducing PDIC's cost of financial assistance. Further, PDIC may dispose to SPVs the assets purchased from distressed banks and avail of the tax incentives, after complying with applicable governmental rules for disposal of assets.

The SPV Law is by no means a permanent solution to address the prevailing NPA overhang. It is acknowledged that stronger prudential regulation and supervision with more effective coordination among financial safety net players and stringent credit and risk management policies in banks are critical in making the financial system less vulnerable to crises and failures. However, the problem in the banking system remains significant. For lack of better alternative disposal schemes, the extended availment of incentives through sales to SPVs has been proposed by some quarters to provide opportunities for banks to improve their positions in the light of better prospects in asset markets. PDIC supports this direction and is ready to help strengthen banks towards greater depositor protection.

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** Written by the **Policy and Research Department***

<u>ERRATA on PDIC Forum, Vol. 2, No. 2:</u> *On page 12, insured deposit of Carlos is P125,000.00 while uninsured deposit of Patria is 0.*

On page 13, share in the deposit of Elena and Bayani is P125,000.00 each.

[8] *The BSP issues the COE upon compliance of the financial institution with the documentary (i.e., Deed of Sale, dacion en pago agreement, etc.) and data structure requirements. However, some SPVs require the presentation of the COE by the financial institution before a Deed of Absolute Sale may be executed. In such case, BSP accepts an Asset Sale & Purchase Agreement executed between the SPV and the financial institution.*

[9] *See related article by Dr. G. Pasadilla for a detailed discussion of the insolvency reforms in the Philippines such as the pending Corporate Recovery and Liquidation Act and Corporate Recovery Act.*

Incoming BSP Governor Amando M. Tetangco, Jr. talks about the SPV Law

Bangko Sentral ng Pilipinas Governor-designate Amando M. Tetangco, Jr., an economist by training and a monetarist by practice, will take over the leadership of the country's central bank in July, during a period when the banking system is in need of further strengthening not only to better serve depositors but also to become more competitive in a global environment. Among the initiatives being carried out to invigorate the system is the implementation of the Special Purpose Vehicle Law. As a career central banker and an acknowledged reformer, Tetangco is bent on fostering the sustained strengthening of the banking system and a more expedient development of capital market. He shares with **PDIC Forum**, his views on the law, its impact on the system and related matters.

Forum: What were the compelling scenarios that triggered the passage of the SPV law?

Amando M. Tetangco, Jr.: The Law was passed to address the non-performing asset (NPA) problem of the financial sector which was causing a heavy drag on banks' financial strength, thereby dampening new lending. The Law grants certain tax exemptions and regulatory privileges to eliminate the friction costs in the sale/disposition of NPAs.

The passage of the SPV Law intensified the existing regime of capital market-inducive regulation through legislative measures and strengthened public confidence in a highly speculative market.

Amando M. Tetangco, Jr.

Forum: How was the SPV received by financial institutions?

AT: Initially, banks were reluctant to recognize losses in their NPAs. It took a while for banks to undertake SPV deals. When the deadline for the tax incentives was about to end, banks realized that they have to move to avail of the tax incentives.

Forum: What were the major criticisms/issues from opposing quarters?

AT: The major issue raised on the law is that the two-year tax incentive window given should have been longer to accommodate more NPAs.

Forum: What were the drawbacks and bottlenecks in the implementation?

AT: The major problems encountered in the implementation of the SPV Law as contained in BSP memorandum to all banks and non-banks and quasi-banks (NBQB) dated 17 June 2003 were:

(1) poor state of records of loan data and documents;
(2) submission of incomplete data and failure to comply with the BSP-prescribed data structure which would facilitate the automated processing;
(3) non-submission/lack of documents such as board resolution on the approval of the sale of NPAs, certifications required and deed of dacion;
(4) the total non-performing loans (NPLs) and Real and Other Properties Owned and Acquired (ROPOAs) per

Masterlist do not tally with the consolidated statement of condition primarily due to under reporting of NPAs;
(5) lack of foresight in preparing the groundwork to execute SPV deals.

The BSP memo made it very clear that the Masterlist of NPAs must be reconciled and finalized before the BSP could accept any application for a Certificate of Eligibility (COE) from a bank/NBQB. This would allow the BSP to properly comply with Section 12 of the SPV Law to validate the eligibility of banks' NPAs.

Forum: How were these problems resolved?

AT: We first ascertain that the assets to be transferred are eligible, after which we closely coordinate with banks in addressing the problems. Compliance requires mainly the submission of complete and reconciled documents.

Forum: What were the criteria used by the BSP and the processes involved in approving applications for COE from financial institutions who wish to avail of this program?

AT: Basically, these are the standards and guidelines contained in the law. Specifically, the criteria used in determining eligibility of the account for the issuance of a COE are:

(1) The assets to be sold/ transferred are eligible NPAs as defined under the SPV Act.
(2) The proposed sale/transfer of NPAs partake the nature of a true sale.
(3) The notification requirement to the borrowers has been complied with (in the case of NPLs).
(4) The maximum 90-day period for renegotiation and restructuring has been complied with (in the case of NPLs).

The procedures in obtaining a COE include:

(1) Prior to filing of application, a bank/NBQB submits to BSP a masterlist of its eligible NPAs which must reconcile with the bank's/NBQB's consolidated statement of condition as of June 30, 2002.
(2) The bank submits an application describing in sufficient detail its proposed transaction, identifying its counterparts and disclosing the terms, conditions and all material commitments related to the transaction.
(3) The application shall be accompanied by a written certification along with other requirements.

Forum: Were there cases of disapproval?

AT: Yes. These cases of disapproval were only due to the accounts not being eligible under the SPV Law. Banks are advised of the deficiencies in their application so they can comply, provided the accounts are eligible.

Forum: What were the stumbling blocks in the expeditious disposal of assets? Are the quality of assets, the selling price or the discount not too attractive for the asset management corporations (AMCs)?

AT: Agreeing to the selling price is a major factor in the expeditious disposal of the NPAs. The selling banks are reluctant to recognize losses on the assets being sold.

Forum: In general, private AMCs are chosen over public AMCs if the bad loan problem is not systemic and when the legal framework is fairly sound. In the case of the Philippines, while the NPL ratio at 17% was lower than the 50% in other countries, our insolvency laws date back to the turn of the 20th century. Why do you think was the private AMC route still chosen?

AT: Funds may not be generated for the establishment of public AMC, hence the private AMC route.

Forum: In an earlier interview *(PDIC Forum Vol. 1 No. 1)*, BAP President Cesar EA Virata said the SPV Law has not really put a dent into the reduction of NPAs because the discounts being asked are deep. Would you comment on this?

AT: Deep discounts mean losses, thus, banks are reluctant to dispose of their NPAs. However, we don't think that the SPV Law has not really put a dent into the reduction of NPAs because the NPL ratio has dropped from 14.65% in end-2002 to 12.54% in end-2004. And with the extension of the SPV Law, this ratio may be reduced to a single-digit level.

Forum: What are your views on mandating that NPAs be limited to a

certain level as is being done in other countries?

AT: The BSP does not mandate a certain level of NPAs for banks. However, banks are constantly told to be mindful of their NPA stocks. They actually are beginning to see the urgency of NPA clean-up as these unproductive assets continue to eat up on their capital position, particularly with the implementation of new regulations.

Recently, BSP regulations have been modified so that the minimum capital charge for NPLs has been raised from 10% to 12.5% through the assignment of higher risk weights for non-performing exposures over performing accounts. The capital charge for NPAs will be increased to 15% in 2007.

Banks with high levels of NPAs would be forced to raise their capital just to support their bad loans and/or bad assets. In the end, banks would find it cheaper to sell (even at a discount) than to retain these NPAs in their books.

At the same time, the BSP has allowed the staggered booking of losses arising from the sale of NPAs under the SPV Act of 2002. This deferred recognition, however, is subject to strict disclosure requirements.

Collectively, these moves plus the extension of the SPV Law should eventually bring NPAs to pre-crisis levels.

Forum: Overall, how would you assess the implementation of the SPV? Did it serve its purpose of trimming down considerable volume of idle assets/NPLs in the banking system? What do you think were the major accomplishments on the implementation of the SPV Law?

AT: Notwithstanding the incentives provided, its benefits are admittedly modest, since the two-year window given to avail of tax incentives was not maximized.

It took a while for the banks to undertake SPV deals, as banks were basically reluctant to recognize the losses resulting from the sale of their NPAs.

As of 31 March 2005, the total NPAs transferred under the SPV Law amounting to P49.776 billion comprises only 9.57% of the P520 billion total NPAs as of 30 June 2002. We expect to unload about P90 billion NPAs covered by existing applications by 12 April 2005.

Although these deals were lower than expected, this translates to banks/NBQBs being able to effectively take out from their books almost 20% of the NPAs stock as of end-June 2002.

Moreover, banks/NBQBs have become more aware of the need for action. In fact, they are now clamoring for an extension.

The Lower House already passed resolution for a two-year extension. We are just waiting for the Senate to act on it.

If there is an extension, we'll see more response from the banking community. If we were able to do P90 billion, if the law is extended, then we can do even more that would bring the industry's NPL ratio down to a single digit.

Forum: With regard to the clamor for SPV extension and some uptick in SPV activities, to what do you attribute this shift? Have prices perked up?

AT: The increase in SPV-related activities (particularly during the first quarter of 2005) is mainly attributed to the 12 April 2005 statutory deadline and partly to the recent developments in the real estate sector. Other contributory factors may also be the development of different structures for unloading NPAs, which afforded banks alternative schemes deemed more acceptable or favorable, especially in terms of maximizing recovery on the assets sold. Some improvements in the real property sector have also been observed.

Forum: One of the amendments being proposed for the extended SPV Law is to include loans that became non-performing after June 30, 2002 up to December 2004. What is your position on this? Wouldn't this be seen as a signal condoning moral hazard behavior for banks?

AT: The BSP supports the proposal of extending the cut-off date for eligible NPAs. We view this more as an opportunity for banks to significantly clean their books of NPAs, subject to the usual prudential requirements. It cannot be seen as condoning moral hazard behavior of banks since the recommended extended cut-off date of eligibility shall cover only non-performing accounts as of December 31, 2004 that have been outstanding since June 30, 2002.

Moreover, we are not inclined to allow a protracted disposal period of NPAs by banks/NBQBs.

Forum: In your opinion, will a two-year extension after the April 2005 deadline be enough to take a chunk

off existing NPAs? What will be the projected NPL level then?

AT: Yes**,** we believe the two-year extension would be enough. This should bring down to a single digit the proportion of NPLs to total loan portfolio given that: banks are more convinced of the need to clean up their books, that there are newly developed alternative schemes of NPA disposals; and that the investment environment has relatively improved.

Forum: Would this level be acceptable?

AT: Yes, a level that shall result to a single-digit NPL/NPA ratio will be acceptable.

Forum: What is the NPL ratio now, two years after the SPV Law's effectivity?

AT: The NPL ratio of the banking system is down to 12.54 in end-2004 from 14.65% in end-2002. Meanwhile, NPL ratio of universal/commercial banks is now down to 11.30% as of March 2005 from 14.95% in end-2002.

Forum: On hindsight, what other similar reforms/policies do you think are imperative to reduce the banking system's idle assets and NPLs?

AT: One is the proposed updating of the Bankruptcy Code, the subject of certain bills under consideration in Congress, which should be enacted as soon as possible. This will allow creditors greater ability to resolve their claims in a fair and expeditious manner.

Another is the proposed Credit Information System Act (CIS), that will create a central credit information bureau system. This will also help reduce credit risk exposure of banks and provide greater credit discipline. The entry of rating agencies will complement the establishment of an exchange traded papers. As a critical player in the capital market, rating agencies ensure investor protection, particularly in discovering fair prices commensurate to risk.

Although we made progress with the accreditation of Philratings, we need more rating agencies to come in the future. They serve as guides to investor decision and accountants for disclosure requirements.

The proposed CIS Act is now pending in Congress and should be given priority.

Forum: Would you suggest other areas for improvement?

AT: Record-keeping of banks should be improved to facilitate processing of COEs. And the law should be extended for another two years to be able to clean up more NPAs. It is also important that we have the continued support of other implementing agencies like the Bureau of Internal Revenue and the Register of Deeds.

BSP Governor-designate Amando M. Tetangco, Jr. is currently the Deputy Governor of the BSP, in-charge of the Banking Services Sector, Economic Research and Treasury. He is also BSP's representative at the National Economic and Development Authority (NEDA), National Food Authority (NFA) Council, and Industrial Guarantee and Loan Fund (IGLF) Review Committee. Before joining the Central Bank in 1974, Tetangco was with the Management Services Division of SGV & Co. for about one year. He also served as Alternate Director of the International Monetary Fund in Washington, DC where he participated in policy-setting in the IMF Executive Board and provided economic policy advice to various governments. He was also involved in the activities of various international and regional organizations including the East Asia Pacific (EMEAP) Central Banks, ASEAN, South East Asia Central Banks (SEACEN) and APEC in the promotion of regional cooperation, and economic and financial surveillance of member-countries.

Tetangco is a cum laude graduate of AB Economics from Ateneo de Manila University. He obtained his MA in Public Policy and Administration (concentration in Development Economics) at the University of Wisconsin as a Central Bank scholar.

Danaharta: Malaysia's response to NPL woes

Malaysia's Pengurusan Danaharta Nasional Berhad, the country's national asset management company (AMC) is one of the most successful AMCs in Asia. Set up as a corporate entity but vested with special powers to resolve nonperforming loans (NPLs) by the Pengurusan Danaharta Nasional Berhad Act 1998, Danaharta is poised to wind down operations by year-end 2005, having achieved its goal of averting failure in the banking system.

Like a prism with many facets, Danaharta's operations are multi dimensional. Not only had it utilized several means of NPL resolution, but its triumphs also came with challenges. Mr. Zukri Samat, Danaharta's Managing Director, generously and candidly discussed with ***PDIC Forum*** through an electronic interview, the various aspects of the Danaharta experience.

Forum: Considering the other options in energizing the Malaysian financial sector, what made Malaysia decide on using a government-owned AMC like Danaharta?

Mr. Zukri Samat: At the start of the Asian financial crisis, the Government set up a National Economic Action Council (NEAC) to steer Malaysia out of the crisis. The NEAC came out with a National Economic Recovery Plan. The setting up of Danaharta (the NPL resolution agency), Danamodal (the recapitalisation agency) and Corporate Debt Restructuring Committee (the mediating body between large borrowers and their creditors) was part of the plan.

Forum: Did the absence of a formal deposit insurance scheme factor into the decision because this would, in effect pre-empt paying out depositors if banks closed under the heavy burden of NPLs?

ZS: The establishment of a deposit insurance corporation was included as one of the action plans in the National Economic Recovery Plan. However, given the urgency in resolving the escalating NPLs in the banking system during the Asian financial crisis, Danaharta was set up first as a pre-emptive action to tackle the NPL problem then. At the same time, preparations were under way to set up the deposit insurance scheme.

Forum: Can you give us a background on the legislation of the Danaharta Act?

ZS: The Danaharta Act 1998 was passed by the Parliament of Malaysia to provide for special laws in the public interest for the acquisition, management, financing and disposition of assets and liabilities by Danaharta.

Forum: Can you tell us about the special powers possessed by Danaharta?

ZS: There are three main special advantages conferred on Danaharta (as compared to banks in resolving NPLs) by the Danaharta Act.

First, the ability to acquire NPLs through statutory vesting, which basically means that Danaharta steps into the shoes of the selling bank, and assumes the selling bank's rights, interests and liabilities in the NPL. Although the Danaharta Act facilitates the acquisition of NPLs, transactions were done on a "willing buyer, willing seller" basis. There was no compulsory acquisition, banks were free to sell or keep their NPLs. Neither Danaharta nor the selling bank requires the borrower's consent to effect the transfer of the loan from the selling bank to Danaharta.

Second, the ability to appoint Special Administrators over corporate borrowers who were unable to repay their debts with Danaharta. The appointment must comply with conditions laid out within the Act, and must be approved by an Oversight Committee established under the Act.

And third, the ability to foreclose on property collateral and dispose them via private treaty after the expiry of a 30-day notice period to the borrower, without having to go through the normal court auction process under the National Land Code.

Forum: There were concerns that Danaharta has sweeping powers. Can you comment on this?

ZS: I would like to take this opportunity to clarify that although Danaharta's powers are strong, they are actually common AMC powers and are derived from general law.

Throughout the world lawmakers have given national AMCs like Danaharta special powers such as compulsory acquisition powers, the power to change shareholding, the power to substitute existing boards for new, and powers to repudiate contracts, transfer assets and liquidate companies. More often than not, such powers are exercisable unilaterally with limited rights of review if at all.

However, Danaharta's powers are less sweeping compared to some national AMCs. For example, Danaharta does not have compulsory acquisition powers or power to confiscate borrowers' assets.

Forum: Were there problems encountered during the creation of Danaharta? (a) If so, what were they? (b) How were these resolved?

ZS: In so far as the setting up of Danaharta, we did not encounter that much of a problem. However, one of the biggest challenges we faced was during the acquisition phase. As previously mentioned, Danaharta, unlike most national AMCs, does not have compulsory powers of acquisition. Thus, we were unable to direct banks to sell their NPLs to us. Instead, Danaharta relied on a market-based approach, and with the help of the Central Bank of Malaysia, formulated a "carrot and stick approach" which was accepted by the banks.

The "carrot" is a profit sharing mechanism where Danaharta shares 80% of any surplus recovery with the selling bank (i.e., where recoveries exceed the initial acquisition price plus related costs).

Meanwhile, the "stick" is that the NPLs that banks and financial institutions chose not to sell to Danaharta had to be immediately written down to 80% of Danaharta's valuation.

Forum: How did the banking and finance industry respond to the Danaharta Act? What were the major criticisms/issues from opposing quarters?

ZS: Initially, there was some resistance from certain quarters including the banking industry as they deemed the Danaharta Act too powerful. There were also fears that the powers contained in the Act would be abused.

The concern that the Danaharta Act is draconian is perhaps less a reflection of the type of powers conferred on Danaharta, but more a reflection of the fact that *the Act excludes the courts from its processes.* This is not unprecedented. In the United States, the AMC law prohibited the courts from taking any action to restrain or affect the exercise of powers or functions of the Resolution Trust Corporation (RTC).

Forum: That is a very interesting feature of the Act. What were the reactions to it?

ZS: Commentators have in fact recognised the exclusion of the courts as one of the reasons Danaharta has progressed as quickly as it has. What is important in such a situation is that effective checks and balance exist to prevent an abuse of the special powers conferred on Danaharta.

Forum: What check and balance mechanisms are in place?

ZS: Substantial safeguards were created both in the legislation and, more importantly, in the way in which Danaharta is structured and operates. These include the following:

(1) Although the Danaharta Act facilitates the acquisition of NPLs, loan assets could only be bought if the selling bank felt the price was right and agreed to sell;

(2) The law allows Danaharta to dispose foreclosed properties via private treaty, which could be by way of open tender, private auction or negotiated sale. However, Danaharta prefers to offer a foreclosed property for sale through open tender first because it is more transparent;

(3) To facilitate transparency, Danaharta's board comprises seven members from the private sector (with two representing the international community) and the remaining two representing the Government;

(4) The establishment of an Oversight Committee made up of three representatives, one each from the Ministry of Finance, Securities Commission and the Central Bank of Malaysia to oversee, approve and terminate the appointments of Special Administrators; and

(5) The appointment of an Independent Advisor by the Oversight Committee to review the reasonableness of a work-out proposal prepared by the Special Administrators taking into consideration the interest of creditors and shareholders.

Forum: What loan restructuring principles were adopted by Danaharta to maximize recovery of NPLs?

ZS: When Danaharta acquires an NPL, Danaharta will first assess the viability of the loan.

If the loan is viable, Danaharta will employ the "soft approach", either by way of plain loan restructuring, settlement of loans or schemes of arrangement.

However, if the loan is deemed non-viable, then Danaharta will resort to the "hard approach" which could be appointing Special Administrators over corporate borrowers, foreclosing on property and securities collateral or taking legal action against the borrower.

Every borrower is given one chance to restructure his loan but the restructuring must comply with Danaharta's published Loan Restructuring Principles and Guidelines.

The loan restructuring principles that must be observed are:

(1) Haircut to the shareholders of the borrower;
(2) Fair treatment to secured and unsecured creditor;
(3) No dilution of inadequate security;
(4) Only one opportunity given to a borrower to implement a scheme; and
(5) Make borrowers work for lenders.

Forum: A World Bank Paper (Klingbeil, 2000) stated that AMCs are generally better as quick disposal agents rather than as restructuring ones. Would you comment on this?

ZS: All national AMCs are set up to suit the respective countries' specific needs. No one solution fits all. In the case of Malaysia, Danaharta believes there is no strategic benefit in selling NPLs to parties with lower or no advantage in realising value compared to Danaharta. Our comparative advantage over the financial institutions is derived from special powers accorded under the Danaharta Act 1998, its position as the largest creditor through buying from multiple financial institutions and its position as a debt-resolution specialist organisation.

Forum: What was Danaharta's initial targeted recovery from the NPLs in its portfolio and has Danaharta achieved its target?

ZS: Danaharta used Key Performance Indicators (KPIs) to drive the organisation to achieve its goals.

Danaharta's KPI for loan recovery was set at 49.8% of the adjusted loan rights acquired, derived from earlier estimates made upon review of the NPL accounts. As at end 2004, Danaharta was on track to exceed that KPI with an expected Loan Recovery rate of 59% (approximately RM30.8 billion from RM52.42 billion worth of NPLs).

Of the expected recovery of RM30.8 billion, RM29 billion is already in hand. We hope to announce the final Loan Recovery Rate at the end of this year prior to closure of operations.

To provide a proper context, it is worthwhile noting that a recent study by the Bank for International Settlements estimates loan recovery rates of similar agencies in Asia to range between 25% and 50%.

Forum: What do you think were the major accomplishments of Danaharta?

ZS: One major achievement is that we had helped to avert a banking failure in Malaysia. Had it not been prevented, the consequences would have been disastrous and would affect the country economically and socially.

At the same time, by generating good recovery from the loans, we have also helped reduce the cost to be borne by the government/ taxpayers for restructuring the banking system.

Another aspect of the accomplishment, which is less noticeable, is the fact that Danaharta's approach in resolving instead of disposing the NPLs had actually helped to prevent many job losses and saved viable businesses from being liquidated.

Forum: Moral hazard is said to be present when centralised AMCs buy back bad bank assets at highly subsidised transfer prices. How was Danaharta able to adhere to fair market prices?

ZS: Danaharta was able to adhere to fair market prices as we had a clear NPL acquisition mechanism which was made known to all the banks. For example, valuations of property collateral were done by professional valuers.

Talking about moral hazard, I would also like to point out that NPL resolution agencies such as Danaharta are not meant to be permanent institutions as their continued existence may present a moral hazard to the banking industry. The existence of NPLs and the need to manage them is part and parcel of banking life. It is believed that banks would be less encouraged to improve on this aspect if a permanent establishment funded by the taxpayers were around to take NPLs off them. In this regard, the target date for Danaharta to accomplish its mission and cease operations has been set as 31 December 2005.

Forum: Political independence is among the pre-requisites for an AMC's success. Was Danaharta able to achieve political independence considering that it is a government entity? If yes, how?

ZS: Being a Government-owned entity, Danaharta has to observe the Government's policies and guidelines.

This did not impede us in our

operations as the Government fully supports Danaharta's policy to be independent and transparent in our operations. All Danaharta's policies and guidelines were approved by the Government. Thus, with these policies and guidelines in place, all borrowers are accorded the same treatment.

Forum: Danaharta is acclaimed to be one of the most successful centralised AMCs in Asia. To what would you attribute this success?

ZS: Amongst the factors that have contributed to our success are:

(1) The special powers provided in the Danaharta Act enable us to accelerate NPL acquisition and resolution efforts;
(2) Danaharta deliberately chose to be an NPL resolution agency instead of an NPL disposal agency;
(3) Carefully planned processes in our operations;
(4) Danaharta concentrates on larger NPLs, i.e., NPLs of RM5 million and above, thus limiting the portfolio size to be managed to about only 3,000 accounts; and
(5) Dedication and commitment of staff.

Forum: How successful was Danaharta in relation to the funding support given by the Government?

ZS: Danaharta received seed capital of RM3 billion from the Government. To fund its acquisitions, Danaharta issued zero-coupon bonds with a total face value of RM11.14 billion. To support its operations, Danaharta initially took loans amounting to RM1.3 billion from Khazanah Nasional Berhad (the Government's investment arm) and the Employees' Provident Fund. In addition, Danaharta had also recently utilised a total of RM0.64 billion from a revolving credit facility to remedy a temporary timing mismatch between recovery collection and bond redemption.

As at 31 March 2005, Danaharta had fully redeemed all the bonds it had issued as well as the loans from Khazanah Nasional Berhad and the Employees Provident Fund.

Danaharta expects to fully repay the amount drawn down from the revolving credit facility before 31 December 2005. In addition, Danaharta expects to return a significant proportion of the RM3 billion seed capital to the Government.

National AMCs are generally loss-making entities due to the non-performing nature of their assets. Being a national AMC, Danaharta is likely to record a loss at its close, which will be a cost to be borne by the Government. However, this cost is small compared to the greater losses Malaysia would have suffered economically and socially had the banking system in the country collapsed. Nonetheless, Danaharta strives to minimize its eventual cost through maximizing the NPL recovery value.

Forum: Since you will be winding down operations of Danaharta very shortly, are there recommendations that you wish to make in order to build on the gains you have made and to further strengthen the Malaysian banking system?

ZS: From my observations, the NPLs were a result of a combination of three main factors – bad economic conditions, poor credit analysis and borrower mistakes. Bad economic conditions and borrower mistakes, e.g., unwisely diversifying into areas where they did not have expertise are outside the control of the banks. However, insofar as minimising poor credit analysis – much has been done by improving training and systems.

At the same time, banks must also be mindful of risk management. Risk management was an area that was pretty much absent before the crisis. Risk management systems, if properly implemented, would be able to pick out banks' increasing risk exposure in relation to the issuance of loans that are inadequately supported by collateral and the ability to repay the loans. The good news is a lot of banks and corporations in Malaysia have started believing in risk management after the crisis and have set up this division within their companies.

Forum: Thank you for taking time out to share your experiences and insights with us.

ZS: It was my pleasure.

Mr. Zukri Samat was appointed by Malaysia's Minister of Finance as the Managing Director of Danaharta on 1 July 2003.

He joined Danaharta in October 1998 as General Manager, Operations Division and was later promoted to Director of Operations on 1 August 2001, assuming direct line responsibility for all loan recovery activities of Danaharta.

Mr. Zukri has extensive experience in the banking sector, having served in both local as well as international financial institutions in various capacities. Prior to joining Danaharta, he was the General Manager of Credit Agricole Indosuez Labuan. He also worked in CIMB Berhad for a significant period of time; his last position being Deputy General Manager of the Capital Markets Department where he was responsible for transactions involving private debt securities, project finance, corporatisation and privatisation of state-owned companies. He currently sits on the Board of Malaysian Debt Ventures Berhad.

Mr. Zukri holds an MBA degree from the University of Hull, United Kingdom.

Industry Posted Improvement in Asset Quality and Capital Adequacy Indicators

Performance and Condition

The banking industry's overall resources reached P4.0 trillion by Dec-end 2004, up by 3.9% from P3.9 trillion as of Jun-end 2004, and 9.9% from P3.7 trillion recorded as of Dec-end 2003. Asset growth was mainly driven by the increase in total deposits. Commercial Banks (KB) accounted for the bulk of the industry's assets at 89.9% or P3.6 trillion, followed by Thrift Banks (TB) at 7.6% or P305.4 billion, and Rural Banks (RB) at 2.5% or P101.0 billion. Fresh funds generated were mostly channeled to fixed income securities instead of loans, indicative of banks' continuing cautious stance towards lending. As a result, the industry's liquidity was further bolstered as quick assets ratio (i.e. ratio of quick assets to total deposits) rose from 52.1% in Jun-end 2004 to 53.2% in Dec-end 2004.

Asset quality improved following reduction in non-performing loans (NPL) and non-performing assets (NPA). Correspondingly, both the ratios of non-performing loans to gross loans and non-performing assets to total assets declined from 14.2% to 12.9% and from 13.0% to 11.8%, comparing Jun-end and Dec-end 2004 figures, respectively. The decrease in non-performing assets was attributable to the continuing efforts of the industry to dispose of NPAs and clean up balance sheets. Meanwhile, compared to December 2003, income from operations (i.e. interest income plus other operating income) increased by 10.4%, outpacing growth in operating expenses (i.e. interest expense plus other operating expense and provision) of 8.8%, resulting to a 22.8% rise in banks' net income from operations for December 2004. However, the industry recorded a lower net income after tax and profitability compared to previous year as non-operating income, i.e. income from disposal of acquired assets, etc. , declined significantly by 58.1% for the period ending December 2004.

The decline in problematic assets together with the increase in capital funds resulted to improvement in the industry's capital adequacy ratios. Risk Assets Ratio (RAR) inched up from 13.1% as of Jun-end 2004 to 13.5% by Dec-end 2004. Comparing same periods, NPL to Capital and NPA to Capital ratios declined from 49.4% to 43.3% and from 91.0% to 82.8%, respectively.

Domestic Deposits Profile

Total domestic deposits as of December 2004 amounted to P2.8 trillion, of which 89.3% or P2.5 trillion were deposits in KB, 8.1% or P223.7 billion were in TB, and 2.6% or P70.7 billion were in RB. Savings deposits accounted for 45.0% of the total industry domestic deposits, foreign currency deposits, 31.8%, demand deposits, 12.1%, and time deposits, 11.1%. Geographically, the bulk of domestic deposits (68.1% or P1.9 trillion) was concentrated in the National Capital Region (NCR) where 35.0% or 2,605 of the 7,449 banking offices were located. Makati, a city of the NCR where most KB head offices were located, accounted for 29.0% of the total domestic deposits, followed by Manila City with 11.9%, and Quezon City with 10.1%. The rest of deposits (31.9% or P878.7 billion) were distributed to the remaining 16 regions of the country where 65.0% or 4,844 banking offices were located. Domestic deposits had been on an uptrend after recovering from a sharp drop in June 2003. By Dec-end 2004, domestic deposits increased by 6.8% over Jun-end 2004 level, with both peso and foreign currency deposits contributing to the growth.

Caveat

We present in the following pages, our bank statistics as of December 31, 2004. 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. 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. 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 on presented statistics, please contact the Insurance and Risk Assessment Data Department at telephone numbers (632) 841-4205, 841-4207 and 841-4000 locals 4209 to 4211 and 4297, 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

Selected Statistics of the Philippine Banking System (PBS)

As of December 31, 2004 (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	
BALANCE SHEET														
TOTAL ASSETS	2,315,508	310,557	546,236	445,304	3,617,606	227,393	63,165	14,612	268	305,438	6,381	94,566	100,947	4,023,991
Quick Assets	804,852	124,706	253,534	182,645	1,365,736	62,804	14,548	4,559	97	82,007	1,139	23,151	24,290	1,472,033
Net Loans	1,051,753	114,466	265,305	210,354	1,641,877	127,383	29,890	4,992	118	162,382	4,514	56,295	60,809	1,865,069
Gross Loans	1,147,682	126,870	278,981	236,293	1,789,826	132,608	32,573	5,375	125	170,680	4,787	59,180	63,967	2,024,473
Current Loans	981,016	106,313	262,955	207,001	1,557,284	118,744	27,254	4,344	115	150,457	4,030	49,918	53,948	1,761,689
Past Due Loans + Items in Litigation	166,667	20,558	16,026	29,292	232,542	13,864	5,319	1,030	10	20,223	756	9,263	10,019	262,784
Allowance	95,930	12,404	13,676	25,939	147,949	5,225	2,683	383	7	8,298	273	2,885	3,158	159,404
Equity Investments & Underwriting Accounts Equity Securities	86,983	1,912	1,442	7,043	97,381	87	131	37	0	255	12	83	95	97,731
Real and Other Properties Owned or Acquired ROPOA)	147,629	19,867	2,205	19,795	189,495	19,514	10,793	2,680	-	32,987	273	7,676	7,949	230,430
Deferred Income Tax	31,096	5,908	2,840	2,206	42,050	3,378	1,075	90	7	4,551	0	177	177	46,777
Other Assets	193,195	43,699	20,911	23,262	281,067	14,227	6,728	2,255	46	23,256	443	7,185	7,627	311,950
TOTAL LIABILITIES	2,032,185	270,436	459,616	404,899	3,167,136	196,676	57,557	11,406	123	265,762	5,288	79,634	84,923	3,517,821
Total Deposits	1,662,574	208,322	349,674	251,775	2,472,346	175,251	39,502	8,934	47	223,733	3,711	67,021	70,731	2,766,811
Total Borrowings	160,502	43,125	21,465	127,265	352,357	10,483	13,743	1,918	70	26,213	1,278	7,584	8,862	387,432
Other Liabilities	209,109	18,989	88,478	25,858	342,434	10,942	4,312	554	6	15,815	300	5,030	5,330	363,578
TOTAL CAPITAL	283,323	40,121	86,619	40,406	450,469	30,717	5,608	3,207	145	39,677	1,092	14,931	16,024	506,170
INCOME & EXPENSES														
Interest Income	120,815	20,395	36,356	29,724	207,288	18,458	4,829	1,036	63	24,386	782	10,867	11,648	243,323
Interest Expense	63,323	10,657	13,589	10,368	97,937	8,500	3,181	555	6	12,241	406	4,353	4,759	114,937
Net Interest Income	57,491	9,738	22,767	19,355	109,351	9,958	1,649	481	57	12,145	376	6,513	6,889	128,385
Other Operating Income	38,228	3,971	7,079	5,163	54,440	2,711	742	270	24	3,746	344	2,712	3,056	61,242
Other Operating Expense	63,936	9,404	18,411	17,481	109,232	11,407	2,737	891	83	15,118	564	7,643	8,207	132,558
Provisions for Loan Losses	10,986	1,285	2,769	2,896	17,936	1,266	112	48	-4	1,422	30	242	272	19,631
Net Operating Income	20,797	3,020	8,666	4,141	36,623	-4	-459	-189	2	-649	125	1,341	1,466	37,440
Non-Operating Income	3,842	510	1,238	528	6,119	849	420	108	0	1,377	17	505	522	8,017
Net Income Before Tax	24,639	3,530	9,904	4,669	42,742	844	-38	-81	2	727	142	1,845	1,988	45,457
Provision for Income Tax	5,360	664	3,350	163	9,536	379	192	33	0	604	0	296	297	10,437
Net Income After Tax	19,279	2,866	6,554	4,507	33,206	465	-230	-114	2	123	142	1,549	1,691	35,020
ANALYTICAL RATIOS (IN PERCENT)[1/]														
Capital Adequacy														
Capital to Risk Assets	11.7	13.6	20.9	13.2	13.4	13.9	6.8	29.1	73.6	13.1	18.4	17.5	17.6	13.5
Risk-Based Capital Adequacy Ratio	16.1	20.4	29.5	18.3	18.7	19.4	11.7	24.9	78.1	18.1	18.4	17.5	17.6	18.6
Non-Performing Loans to Capital	51.3	41.6	13.4	47.7	43.2	41.4	83.1	28.2	5.5	46.5	43.1	39.6	39.9	43.3
Non-Performing Assets to Capital	98.3	83.9	15.9	80.2	80.0	102.7	215.2	101.6	5.5	119.3	63.3	83.3	81.9	82.8
Asset Quality														
Non-Performing Loans to Gross Loans	14.7	15.1	4.7	13.4	13.0	10.2	16.6	18.4	6.4	11.7	12.3	11.8	11.9	12.9
Non-Performing Assets to Total Assets (inclusive of Total Allowance)	13.3	11.9	2.8	11.3	11.4	14.4	21.1	23.6	2.9	16.2	13.0	15.1	14.9	11.8
Loan Loss Provision to Non-Performing Loans	56.9	64.9	105.1	81.6	63.6	38.5	49.7	38.8	83.8	41.6	46.4	41.2	41.6	61.3
Earnings (Profitability)														
Return on Equity	6.9	7.8	8.1	11.1	7.6	1.5	-3.7	-3.6	1.4	0.3	14.0	10.9	11.1	7.1
Return on Assets	0.9	1.0	1.3	1.0	1.0	0.2	-0.4	-0.8	0.8	0.0	2.4	1.7	1.8	0.9
Net Interest Margin	3.5	4.8	4.7	5.3	4.0	6.0	4.4	5.6	28.8	5.7	7.9	9.8	9.7	4.3
Operating Efficiency (exclusive of Provision for Loan Losses)	66.8	68.6	61.7	71.3	66.7	90.0	114.5	118.8	102.9	95.1	78.5	82.8	82.5	69.9
Liquidity														
Quick Assets to Total Deposits	48.4	59.9	72.5	72.5	55.2	35.8	36.8	51.0	207.0	36.7	30.7	34.5	34.3	53.2
Gross Loans to Total Deposits	69.0	60.9	79.8	93.9	72.4	75.7	82.5	60.2	266.7	76.3	129.0	88.3	90.4	73.2
No. of PDIC Member Banks	12	9	18	3	42	32	24	29	2	87	44	718	762	891
Additional Information														
Interest Earning Assets	1,737,461	225,623	515,173	381,387	2,859,645	178,051	40,210	8,546	209	227,015	5,065	70,324	75,389	3,162,049
Non-Performing Loans	168,701	19,124	13,013	31,775	232,613	13,570	5,395	988	8	19,961	588	6,994	7,582	260,156
Non-Performing Assets	323,098	38,609	15,451	53,388	430,546	33,656	13,966	3,557	8	51,188	864	14,717	15,581	497,315
Risk Assets for Risk Assets Ratio Computation	1,821,451	237,070	397,252	286,824	2,742,598	185,638	50,677	10,508	188	247,011	5,798	82,827	88,626	3,078,234
Capital for Risk Assets Ratio Computation	213,764	32,346	83,150	37,744	367,004	25,743	3,463	3,053	138	32,397	1,064	14,508	15,572	414,973

[1/] Please refer to Glossary of Terms on page 47 for the computation of selected accounts/ratios.

Source: Consolidated Statement of Condition and Consolidated Statement of Income & Expenses submitted by member banks to PDIC.

Note: EKB refers to Expanded Commercial Banks; Non-EKB refers to Non-Expanded or Regular Commercial Banks; Foreign Banks includes Foreign Branches and Domestically Incorporated Foreign Banks; SGB refers to Specialized Government Banks (Land Bank of the Philippines, Development Bank of the Philippines and Al-Amanah Islamic Investment Bank. SMB refers to Savings and Mortgage Banks; PDB refers to Private Development Banks; SLA refers to Savings and Loan Associations; MFO refers to Microfinance-Oriented; Coops refer to Cooperative Banks.
Zero (0) means value is less than five hundred thousand (500T)

Table 2

Selected Statistics of Rural Banks by Region

As of December 31, 2004 (Amounts in Million Pesos)

Accounts	Regions																	GRAND TOTAL
	NCR[a/]	1	2	3	4-A	4-B	5	6	7	8	9	10	11	12	CAR[a/]	ARMM[a/]	CARAGA[a/]	
BALANCE SHEET																		
TOTAL ASSETS	9,656	7,272	4,937	17,244	23,626	2,292	4,943	4,484	6,152	1,422	1,513	5,168	4,652	2,102	1,825	146	3,512	100,947
Quick Assets	2,007	1,519	983	3,929	6,895	762	702	1,084	1,851	444	287	1,248	1,012	477	582	34	472	24,290
Net Loans	6,115	4,835	3,140	10,367	11,961	1,303	3,574	2,922	3,176	868	1,122	3,289	3,076	1,319	1,060	98	2,586	60,809
Gross Loans	6,283	5,063	3,323	10,780	12,615	1,389	3,740	3,164	3,428	949	1,169	3,550	3,169	1,397	1,129	105	2,713	63,967
Current Loans	5,681	4,157	2,693	9,284	10,215	1,109	3,160	2,477	2,850	792	1,039	2,949	2,869	1,197	977	98	2,400	53,948
Past Due Loans + Items in Litigation	602	906	630	1,496	2,400	280	580	687	577	157	131	601	300	200	153	7	313	10,019
Allowance	168	228	184	413	654	87	167	242	252	81	48	262	93	77	69	7	128	3,158
Equity Investments	24	1	9	2	7	1	5	4	1	0	0	8	14	0	8	0	9	95
Real and Other Properties Owned or Acquired ROPOA)	564	491	406	1,484	3,197	113	306	213	412	15	28	293	113	118	89	1	107	7,949
Deferred Income Tax	25	4	2	34	25	2	0	1	16	2	0	49	16	0	0	0	1	177
Other Assets	922	421	397	1,428	1,542	113	356	260	696	92	76	282	421	187	85	12	338	7,627
TOTAL LIABILITIES	8,536	6,199	4,179	14,488	20,150	1,846	4,352	3,860	5,273	1,176	1,153	3,642	3,856	1,729	1,484	97	2,906	84,923
Total Deposits	7,156	5,406	2,814	11,839	18,340	1,588	3,444	3,186	4,749	938	777	2,439	3,394	1,301	1,312	60	1,988	70,731
Total Borrowings	429	521	945	1,957	926	147	678	377	219	153	279	941	208	269	73	31	709	8,862
Other Liabilities	951	272	421	691	884	111	229	297	305	84	97	262	254	158	98	6	208	5,330
TOTAL CAPITAL	1,120	1,073	758	2,757	3,476	446	591	625	878	246	360	1,526	796	374	341	49	607	16,024
INCOME & EXPENSES																		
Interest Income	1,192	764	610	1,724	2,382	263	566	524	879	174	200	719	519	278	195	26	635	11,648
Interest Expense	550	332	261	749	1,065	107	336	222	384	79	58	190	107	68	52	4	194	4,759
Net Interest Income	641	432	348	975	1,318	156	230	302	495	95	143	529	411	209	142	22	441	6,889
Other Operating Income	158	250	227	435	598	66	106	156	168	36	59	212	210	83	55	10	226	3,056
Other Operating Expense	704	572	475	1,182	1,683	166	317	412	576	137	158	523	414	227	143	15	505	8,207
Provisions for Loan Losses	18	12	14	39	57	5	9	10	24	1	8	32	4	5	5	0	30	272
Net Operating Income	78	98	87	189	176	51	11	36	64	-6	36	187	203	59	49	17	131	1,466
Non-Operating Income	54	23	29	124	150	8	6	13	56	2	1	18	12	12	0	-	14	522
Net Income Before Tax	131	121	116	313	326	60	17	49	119	-5	37	204	216	72	50	17	145	1,988
Provision for Income Tax	35	6	22	19	43	3	4	8	26	4	5	42	43	13	3	0	20	297
Net Income After Tax	96	115	94	293	283	57	13	41	93	-9	32	162	173	59	46	17	125	1,691
ANALYTICAL RATIOS (IN PERCENT)[1/]																		
Capital Adequacy																		
Capital to Risk Assets	12.8	16.5	16.8	17.4	16.5	21.8	12.7	15.5	16.2	20.2	26.1	33.1	19.0	18.9	22.9	36.7	18.4	17.6
Non-Performing Loans to Capital	20.6	56.3	53.5	38.4	46.2	35.6	66.4	55.8	40.2	35.6	15.8	24.9	17.8	37.7	34.6	17.7	36.1	39.9
Non-Performing Assets to Capital	66.6	95.1	92.7	86.8	122.8	57.4	107.5	80.9	78.5	41.4	23.2	42.9	32.0	64.4	56.9	19.7	52.2	81.9
Asset Quality																		
Non-Performing Loans to Gross Loans	4.1	14.6	15.4	11.2	14.9	13.7	13.5	15.3	13.4	12.3	5.5	12.4	4.8	12.2	12.6	9.4	9.4	11.9
Non-Performing Assets to Total Assets (inclusive of Total Allowance)	8.6	16.6	17.2	15.4	20.5	12.8	16.0	14.9	13.9	9.0	6.1	13.9	5.8	13.3	12.4	7.2	10.1	14.9
Loan Loss Provision to Non-Performing Loans	64.8	30.7	36.0	34.3	34.9	45.6	33.1	49.8	55.1	69.3	73.5	59.5	60.8	45.5	48.3	65.8	49.9	41.6
Earnings (Profitability)																		
Return on Equity	9.8	11.7	13.0	11.3	8.4	13.4	2.3	6.9	10.8	-3.5	10.1	10.8	25.8	15.1	14.3	40.9	21.9	11.1
Return on Assets	1.1	1.6	2.0	1.8	1.2	2.6	0.3	1.0	1.6	-0.6	2.3	3.3	4.1	2.8	2.7	13.5	3.9	1.8
Net Interest Margin	9.6	8.2	10.4	8.1	8.4	9.3	6.5	9.5	11.5	8.2	11.9	13.8	12.4	12.9	10.2	19.8	17.4	9.7
Operating Efficiency (exclusive of Provision for Loan Losses)	88.1	83.9	82.4	83.9	87.8	74.7	94.1	90.0	86.8	104.1	78.2	70.5	66.6	77.8	72.7	46.2	75.8	82.5
Liquidity																		
Quick Assets to Total Deposits	28.0	28.1	34.9	33.2	37.6	48.0	20.4	34.0	39.0	47.3	37.0	51.1	29.8	36.7	44.4	57.3	23.7	34.3
Gross Loans to Total Deposits	87.8	93.7	118.1	91.1	68.8	87.5	108.6	99.3	72.2	101.1	150.5	145.6	93.3	107.4	86.1	175.3	136.5	90.4
No. of PDIC Member Banks	27	67	33	104	146	27	50	77	57	27	16	47	21	21	19	4	19	762
Additional Information																		
Interest Earning Assets	7,482	5,405	3,574	12,755	16,444	1,765	3,744	3,407	4,533	1,169	1,286	4,067	3,728	1,622	1,517	128	2,764	75,389
Non-Performing Loans	260	741	511	1,205	1,876	190	504	485	458	117	65	440	153	170	143	10	256	7,582
Non-Performing Assets	842	1,252	884	2,720	4,993	306	817	704	895	135	95	757	275	291	235	11	369	15,581
Risk Assets for Risk Assets Ratio Computation	8,414	6,459	4,494	15,384	20,339	2,029	4,592	3,948	5,291	1,206	1,380	4,466	3,982	1,904	1,490	135	3,111	88,626
Capital for Risk Assets Ratio Computation	1,076	1,064	756	2,670	3,350	443	583	612	857	243	360	1,477	757	361	341	49	574	15,572

[1/] Please refer to Glossary of Terms on page 47 for the computation of selected accounts/ratios.

[a/] NCR refers to National Capital Region; CAR refers to Cordillera Administrative Region; ARMM refers to Autonomous Region in Muslim Mindanao; CARAGA is composed of Agusan del Norte, Agusan del Sur, Surigao del Norte & Surigao del Sur.

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

Table 3

Domestic Deposit Liabilities by Size of Account

As of December 31, 2004

(Amounts in Million Pesos)

A. PHILIPPINE BANKING SYSTEM

DEPOSIT SIZE	TOTAL DEPOSITS				DEMAND/ NOW DEPOSITS		SAVINGS DEPOSITS		TIME DEPOSITS		Foreign Currency Deposits	
	Account	% to Total Account	Amount	% to Total Amount	Account	Amount	Account	Amount	Account	Amount	Account	Amount
P 15,000 & Below	19,457,067	74.3%	42,135	1.5%	1,145,556	4,785	17,988,350	35,455	112,942	578	210,219	1,317
P 15,000.01 - P 60,000	3,093,581	11.8%	100,071	3.6%	320,038	10,152	2,284,630	70,299	269,716	10,915	219,197	8,705
P 60,000.01 - P 100,000	1,118,937	4.3%	92,833	3.4%	93,796	7,306	575,632	45,057	181,362	17,027	268,147	23,443
P 100,000.01 - P 250,000	1,321,066	5.0%	205,955	7.5%	131,999	20,925	809,078	120,974	115,826	18,312	264,163	45,743
P 250,000.01 - P 500,000	503,343	1.9%	178,607	6.5%	64,937	22,781	268,659	93,643	59,149	23,395	110,598	38,788
P 500,000.01 - P 750,000	201,034	0.8%	121,119	4.4%	25,925	15,816	107,209	63,660	17,960	10,761	49,940	30,883
P 750,000.01 - P1, 500,000	238,221	0.9%	254,637	9.2%	28,238	29,755	118,733	124,973	37,306	38,891	53,944	61,017
P 1,500,000.01 - P 2,000,000	54,218	0.2%	94,483	3.4%	7,556	13,012	27,310	47,418	8,196	14,906	11,156	19,148
Over P 2,000,000	182,094	0.7%	1,664,693	60.4%	22,368	208,265	85,098	639,217	28,782	170,585	45,846	646,625
Total	26,169,561	100.0%	2,754,533	100.0%	1,840,413	332,797	22,264,699	1,240,697	831,239	305,370	1,233,210	875,669

B. COMMERCIAL BANKS

DEPOSIT SIZE	TOTAL DEPOSITS				DEMAND/ NOW DEPOSITS		SAVINGS DEPOSITS		TIME DEPOSITS		Foreign Currency Deposits	
	Account	% to Total Account	Amount	% to Total Amount	Account	Amount	Account	Amount	Account	Amount	Account	Amount
P 15,000 & Below	12,846,222	70.3%	30,333	1.2%	846,440	3,528	11,767,641	25,237	38,943	314	193,198	1,254
P 15,000.01 - P 60,000	2,464,752	13.5%	80,169	3.3%	274,111	8,739	1,781,218	54,983	203,260	8,259	206,163	8,188
P 60,000.01 - P 100,000	873,156	4.8%	72,088	2.9%	82,275	6,413	446,008	34,673	108,615	10,218	236,258	20,784
P 100,000.01 - P 250,000	1,066,355	5.8%	166,776	6.8%	118,047	18,734	643,584	96,432	62,285	9,737	242,439	41,873
P 250,000.01 - P 500,000	427,548	2.3%	151,650	6.2%	59,084	20,738	223,496	77,882	41,409	16,604	103,559	36,427
P 500,000.01 - P 750,000	172,994	0.9%	104,478	4.2%	23,742	14,490	89,643	53,307	13,149	7,893	46,460	28,788
P 750,000.01 - P1, 500,000	205,988	1.1%	220,183	9.0%	26,101	27,531	100,166	105,370	29,473	30,640	50,248	56,641
P 1,500,000.01 - P 2,000,000	47,757	0.3%	83,118	3.4%	7,055	12,155	23,414	40,635	6,806	12,352	10,482	17,975
Over P 2,000,000	162,762	0.9%	1,551,281	63.1%	21,225	200,885	74,753	576,564	23,170	145,511	43,614	628,321
Total	18,267,534	100.0%	2,460,076	100.0%	1,458,080	313,213	15,149,923	1,065,083	527,110	241,529	1,132,421	840,251

Source : Schedule of Deposit Liabilities by Size of Account submitted by member banks to PDIC.
Notes: The original report/schedule required by PDIC from member banks was condensed for purposes of this table.
Domestic deposits exclude deposits in overseas branches of Philippine banks.

Domestic Deposit Liabilities by Size of Account (cont.)
As of December 31, 2004
(Amounts in Million Pesos)

C. THRIFT BANKS

DEPOSIT SIZE	TOTAL DEPOSITS				DEMAND/ NOW DEPOSITS		SAVINGS DEPOSITS		TIME DEPOSITS		Foreign Currency Deposits	
	Account	% to Total Account	Amount	% to Total Amount	Account	Amount	Account	Amount	Account	Amount	Account	Amount
P 15,000 & Below	1,957,295	72.9%	5,236	2.3%	205,721	986	1,699,996	4,131	34,557	56	17,021	63
P 15,000.01 - P 60,000	325,154	12.1%	10,515	4.7%	39,219	1,213	245,455	7,560	27,446	1,225	13,034	517
P 60,000.01 - P 100,000	129,679	4.8%	10,705	4.8%	9,888	766	64,888	5,151	23,014	2,129	31,889	2,659
P 100,000.01 - P 250,000	151,986	5.7%	23,491	10.5%	12,257	1,921	98,087	14,519	19,918	3,180	21,724	3,870
P 250,000.01 - P 500,000	52,600	2.0%	18,740	8.4%	5,226	1,825	29,732	10,375	10,603	4,179	7,039	2,361
P 500,000.01 - P 750,000	20,834	0.8%	12,387	5.5%	1,951	1,184	12,509	7,375	2,894	1,734	3,480	2,095
P 750,000.01 - P1, 500,000	25,684	1.0%	27,652	12.4%	1,958	2,041	14,278	15,147	5,752	6,088	3,696	4,376
P 1,500,000.01 - P 2,000,000	5,398	0.2%	9,500	4.2%	469	802	3,167	5,525	1,088	2,000	674	1,173
Over P 2,000,000	17,282	0.6%	105,508	47.2%	1,099	7,243	8,930	57,198	5,021	22,762	2,232	18,304
Total	2,685,912	100.0%	223,733	100.0%	277,788	17,982	2,177,042	126,982	130,293	43,352	100,789	35,418

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	4,653,550	89.2%	6,566	9.3%	93,395	271	4,520,713	6,087	39,442	208
P 15,000.01 - P 60,000	303,675	5.8%	9,387	13.3%	6,708	200	257,957	7,757	39,010	1,431
P 60,000.01 - P 100,000	116,102	2.2%	10,040	14.2%	1,633	127	64,736	5,234	49,733	4,680
P 100,000.01 - P 250,000	102,725	2.0%	15,688	22.2%	1,695	270	67,407	10,023	33,623	5,395
P 250,000.01 - P 500,000	23,195	0.4%	8,217	11.6%	627	218	15,431	5,387	7,137	2,613
P 500,000.01 - P 750,000	7,206	0.1%	4,254	6.0%	232	142	5,057	2,978	1,917	1,134
P 750,000.01 - P1, 500,000	6,549	0.1%	6,802	9.6%	179	183	4,289	4,456	2,081	2,163
P 1,500,000.01 - P 2,000,000	1,063	0.0%	1,866	2.6%	32	55	729	1,258	302	553
Over P 2,000,000	2,050	0.0%	7,904	11.2%	44	137	1,415	5,455	591	2,313
Total	5,216,115	100.0%	70,724	100.0%	104,545	1,602	4,937,734	48,633	173,836	20,490

Source : Schedule of Deposit Liabilities by Size of Account submitted by member banks to PDIC.
Notes: The original report/schedule required by PDIC from member banks was condensed for purposes of this table.
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, 2004

(Amounts in Million Pesos)

A. PHILIPPINE BANKING SYSTEM

AREA	No. of Banking Offices	TOTAL DEPOSITS		DEMAND/ NOW DEPOSITS		SAVINGS DEPOSITS		TIME DEPOSITS		Foreign Currency Deposits	
		Account	Amount	Account	Amount	Account	Amount	Account	Amount	Account	Amount
TOTAL NCR	2,605	9,899,000	1,875,849	975,773	214,819	7,750,340	728,675	455,432	208,321	717,455	724,034
City of Manila	578	1,815,163	328,501	182,284	33,433	1,436,118	160,691	51,904	37,866	144,857	96,511
City of Muntinlupa	85	255,397	35,906	29,342	4,827	193,938	12,804	10,697	6,584	21,420	11,690
Kalookan City	91	323,999	46,418	31,653	4,542	261,252	25,124	11,390	7,090	19,704	9,662
Las Piñas City	65	222,223	15,100	21,448	1,718	180,034	8,686	5,041	1,374	15,700	3,322
Makati City	392	2,392,888	798,787	226,804	82,835	1,731,219	193,586	238,246	86,016	196,619	436,351
Malabon City	36	116,397	13,020	10,675	1,132	96,545	8,241	2,099	1,203	7,078	2,444
Mandaluyong City	104	524,521	75,964	39,777	7,131	453,861	40,490	6,212	3,487	24,671	24,856
Marikina City	57	204,212	16,928	17,101	2,416	165,773	8,047	8,729	3,120	12,609	3,345
Navotas	20	53,028	5,180	6,121	589	43,865	3,355	972	422	2,070	813
Parañaque City	132	455,901	46,755	43,285	6,612	372,329	20,899	10,975	4,922	29,312	14,322
Pasay City	77	292,045	37,541	26,456	4,614	245,601	19,367	5,143	2,116	14,845	11,444
Pasig City	155	550,052	87,952	62,264	15,775	436,967	38,577	19,815	9,409	31,006	24,191
Pateros	11	39,636	2,119	2,988	248	34,245	1,289	980	164	1,423	417
Quezon City	635	2,161,643	279,333	219,903	39,169	1,730,723	152,124	59,024	29,143	151,993	58,898
San Juan	88	246,129	66,445	36,484	6,785	160,562	24,658	16,761	13,083	32,322	21,919
Taguig	23	83,772	3,987	3,380	877	77,373	2,193	331	106	2,688	811
Valenzuela City	56	161,994	15,914	15,808	2,117	129,935	8,544	7,113	2,215	9,138	3,037
TOTAL PROVINCIAL	4,844	16,255,100	878,734	864,217	118,039	14,498,779	512,028	376,364	97,032	515,740	151,635
(Regions)											
1	368	1,166,194	59,865	40,976	6,392	1,042,666	38,775	35,128	5,169	47,424	9,528
2	207	586,110	24,490	26,042	3,688	540,774	16,542	7,813	1,953	11,481	2,308
3	789	2,298,593	135,429	129,746	14,474	2,005,819	81,258	63,895	13,154	99,133	26,543
4-A	1,152	3,593,814	187,600	193,030	21,015	3,193,122	104,559	84,026	20,894	123,636	41,133
4-B	118	387,247	12,388	15,155	2,163	361,907	7,974	5,237	1,016	4,948	1,234
5	219	771,596	30,288	44,626	5,037	693,493	18,995	16,811	2,874	16,666	3,383
6	386	1,382,357	80,684	82,639	10,676	1,212,569	48,904	33,151	9,680	53,998	11,424
7	486	1,588,636	143,269	103,993	18,765	1,367,668	70,312	49,420	21,360	67,555	32,832
8	129	503,592	21,847	22,887	4,209	462,825	13,869	8,074	1,680	9,806	2,089
9	115	464,538	27,845	24,453	4,407	420,466	17,496	8,911	3,297	10,708	2,645
10	241	905,683	37,046	47,712	7,448	823,356	21,210	16,240	4,149	18,375	4,239
11	237	900,472	51,498	53,890	8,357	806,402	29,680	17,447	5,973	22,733	7,488
12	163	653,424	24,910	31,716	4,415	595,976	16,187	17,612	2,269	8,120	2,039
CAR	111	455,192	26,617	20,245	3,643	410,819	16,946	7,251	2,208	16,877	3,820
ARMM	19	77,491	2,185	4,595	438	71,999	1,619	473	60	424	68
CARAGA	104	520,161	12,773	22,512	2,911	488,918	7,703	4,875	1,297	3,856	862
TOTAL PHILIPPINES	7,449	26,154,100	2,754,582	1,839,990	332,858	22,249,119	1,240,703	831,796	305,353	1,233,195	875,669

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

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.

NCR refers to National Capital Region; CAR refers to Cordillera Administrative Region; ARMM refers to Autonomous Region in Muslim Mindanao; CARAGA is composed of Agusan del Norte, Agusan del Sur, Surigao del Norte & Surigao del Sur.

Table 4

Regional Distribution of Domestic Deposits *(cont.)*

As of December 31, 2004

(Amounts in Million Pesos)

B. COMMERCIAL BANKS

AREA	No. of Banking Offices	TOTAL DEPOSITS		DEMAND/ NOW DEPOSITS		SAVINGS DEPOSITS		TIME DEPOSITS		Foreign Currency Deposits	
		Account	Amount	Account	Amount	Account	Amount	Account	Amount	Account	Amount
TOTAL NCR	2,002	8,467,564	1,725,766	823,586	202,913	6,626,576	649,256	366,573	176,784	650,829	696,813
City of Manila	473	1,637,084	305,881	160,087	31,508	1,297,674	148,292	42,937	33,119	136,386	92,961
City of Muntinlupa	57	192,232	29,923	21,844	4,361	146,213	10,196	6,507	5,208	17,668	10,158
Kalookan City	68	277,211	40,493	26,129	4,296	224,269	21,106	9,233	6,401	17,580	8,690
Las Piñas City	37	166,404	11,004	14,891	1,424	136,082	6,159	2,472	794	12,959	2,627
Makati City	320	2,101,498	760,927	201,233	80,378	1,489,087	174,430	225,147	78,075	186,031	428,043
Malabon City	29	101,232	11,570	9,457	1,037	83,766	7,248	1,844	1,062	6,165	2,223
Mandaluyong City	85	494,614	73,516	35,580	6,900	431,293	39,027	4,252	3,096	23,489	24,494
Marikina City	38	154,837	13,718	13,020	2,199	127,542	6,631	3,370	1,864	10,905	3,024
Navotas	16	46,286	4,823	5,153	533	38,509	3,246	665	254	1,959	789
Parañaque City	107	388,850	41,270	35,788	6,042	321,368	18,299	6,515	3,691	25,179	13,238
Pasay City	61	251,618	35,357	22,346	4,447	211,915	18,008	3,843	1,850	13,514	11,052
Pasig City	98	428,076	76,420	49,834	14,912	343,035	33,190	7,651	6,156	27,556	22,162
Pateros	6	21,154	1,333	1,867	188	18,023	824	83	8	1,181	314
Quezon City	488	1,803,964	243,498	179,262	35,433	1,458,235	132,171	36,263	23,005	130,204	52,888
San Juan	64	208,234	58,466	31,259	6,405	135,547	21,021	11,648	10,388	29,780	20,652
Taguig	13	59,112	3,520	2,761	843	53,779	1,907	182	35	2,390	743
Valenzuela City	42	135,158	14,046	13,075	2,014	110,239	7,500	3,961	1,777	7,883	2,754
TOTAL PROVINCIAL	2,205	9,803,564	734,439	635,039	110,360	8,526,371	415,885	160,562	64,756	481,592	143,438
(Regions)											
1	145	701,811	49,045	30,944	5,962	610,484	31,676	15,414	2,522	44,969	8,884
2	70	358,151	20,829	20,938	3,620	322,034	13,387	3,771	1,527	11,408	2,295
3	331	1,375,942	106,714	84,412	12,969	1,178,327	61,678	20,350	6,985	92,853	25,082
4-A	446	1,986,677	141,260	120,215	18,492	1,734,073	74,588	24,977	10,185	107,412	37,995
4-B	39	157,934	9,927	11,187	2,054	140,296	6,141	1,804	529	4,647	1,203
5	96	419,733	24,648	36,948	4,824	361,261	14,965	5,144	1,549	16,380	3,311
6	223	1,036,585	73,202	73,218	10,348	892,083	44,435	19,045	7,545	52,239	10,874
7	255	1,112,216	126,122	78,501	17,872	940,254	58,896	29,219	17,775	64,242	31,579
8	71	351,907	20,018	21,613	4,172	316,421	12,554	4,200	1,236	9,673	2,056
9	78	345,045	26,166	22,925	4,312	305,293	16,409	6,239	2,832	10,588	2,613
10	115	488,383	32,662	37,527	7,134	424,377	18,279	8,687	3,141	17,792	4,107
11	136	524,558	45,928	40,790	7,663	452,811	26,682	9,461	4,557	21,496	7,026
12	90	405,407	22,455	24,809	4,185	367,313	14,633	5,425	1,671	7,860	1,967
CAR	57	295,260	22,964	14,894	3,485	260,413	14,343	4,200	1,621	15,753	3,515
ARMM	14	62,317	2,060	4,595	438	56,876	1,499	422	54	424	68
CARAGA	39	181,638	10,439	11,523	2,830	164,055	5,720	2,204	1,026	3,856	862
TOTAL PHILIPPINES	4,207	18,271,128	2,460,205	1,458,625	313,273	15,152,947	1,065,141	527,135	241,539	1,132,421	840,251

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

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.
NCR refers to National Capital Region; CAR refers to Cordillera Administrative Region; ARMM refers to Autonomous Region in Muslim Mindanao; CARAGA is composed of Agusan del Norte, Agusan del Sur, Surigao del Norte & Surigao del Sur.

Table 4

Regional Distribution of Domestic Deposits *(cont.)*

As of December 31, 2004

(Amounts in Million Pesos)

C. THRIFT BANKS

AREA	No. of Banking Offices	TOTAL DEPOSITS		DEMAND/ NOW DEPOSITS		SAVINGS DEPOSITS		TIME DEPOSITS		Foreign Currency Deposits	
		Account	Amount	Account	Amount	Account	Amount	Account	Amount	Account	Amount
TOTAL NCR	538	1,274,425	144,161	146,412	11,835	992,926	76,421	68,461	28,685	66,626	27,221
City of Manila	105	178,079	22,620	22,197	1,925	138,444	12,398	8,967	4,747	8,471	3,550
City of Muntinlupa	22	52,633	5,740	5,864	459	39,894	2,502	3,123	1,247	3,752	1,533
Kalookan City	21	39,752	5,828	5,517	246	30,187	3,954	1,924	656	2,124	972
Las Piñas City	21	43,850	3,557	5,591	287	34,255	2,149	1,263	427	2,741	694
Makati City	69	284,769	36,625	25,499	2,456	237,501	18,551	11,181	7,309	10,588	8,308
Malabon City	6	14,006	1,426	1,218	95	11,627	970	248	140	913	220
Mandaluyong City	18	26,644	2,063	3,897	229	21,067	1,269	498	203	1,182	362
Marikina City	12	33,103	2,554	3,424	210	26,169	1,280	1,806	743	1,704	321
Navotas	3	4,197	333	962	56	2,818	86	306	168	111	24
Parañaque City	23	61,120	5,106	7,424	567	47,229	2,424	2,334	1,030	4,133	1,084
Pasay City	16	40,427	2,184	4,110	166	33,686	1,359	1,300	266	1,331	392
Pasig City	38	84,944	9,933	11,463	846	65,863	4,727	4,168	2,330	3,450	2,029
Pateros	3	5,796	520	791	57	4,401	264	362	96	242	103
Quezon City	145	345,153	35,758	40,576	3,733	260,070	19,882	22,718	6,133	21,789	6,010
San Juan	23	37,203	7,919	5,153	379	24,405	3,578	5,103	2,695	2,542	1,267
Taguig	2	1,201	185	123	21	634	26	146	71	298	67
Valenzuela City	11	21,548	1,811	2,603	102	14,676	1,003	3,014	423	1,255	283
TOTAL PROVINCIAL	743	1,411,936	79,574	131,377	6,147	1,184,567	50,560	61,844	14,670	34,148	8,197
(Regions)											
1	36	77,109	5,058	6,109	339	65,438	3,198	3,107	877	2,455	644
2	8	19,573	955	1,933	26	16,651	861	916	56	73	13
3	157	240,097	16,547	22,902	1,227	191,495	10,867	19,420	2,993	6,280	1,461
4-A	254	439,242	27,243	45,676	2,192	355,286	16,276	22,056	5,638	16,224	3,138
4-B	22	60,368	901	3,511	105	56,192	718	364	47	301	31
5	32	93,065	2,303	6,207	195	84,673	1,706	1,899	329	286	73
6	36	53,690	4,209	6,176	306	43,063	2,353	2,692	1,000	1,759	550
7	105	230,580	12,400	18,807	805	202,527	8,405	5,933	1,937	3,313	1,253
8	7	20,368	751	1,114	35	18,883	600	238	85	133	33
9	6	9,409	789	627	88	8,321	466	341	203	120	32
10	29	54,958	2,253	5,504	232	47,875	1,482	996	407	583	132
11	26	51,106	2,827	6,180	294	41,365	1,405	2,324	666	1,237	462
12	8	16,740	804	1,995	151	13,991	451	494	130	260	71
CAR	11	33,004	2,265	4,137	142	26,686	1,515	1,057	303	1,124	305
ARMM	-	-	-	-	-	-	-	-	-	-	-
CARAGA	6	12,627	267	499	9	12,121	256	7	2	-	-
TOTAL PHILIPPINES	1,281	2,686,361	223,735	277,789	17,982	2,177,493	126,981	130,305	43,355	100,774	35,418

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

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.

NCR refers to National Capital Region; CAR refers to Cordillera Administrative Region; ARMM refers to Autonomous Region in Muslim Mindanao; CARAGA is composed of Agusan del Norte, Agusan del Sur, Surigao del Norte & Surigao del Sur.

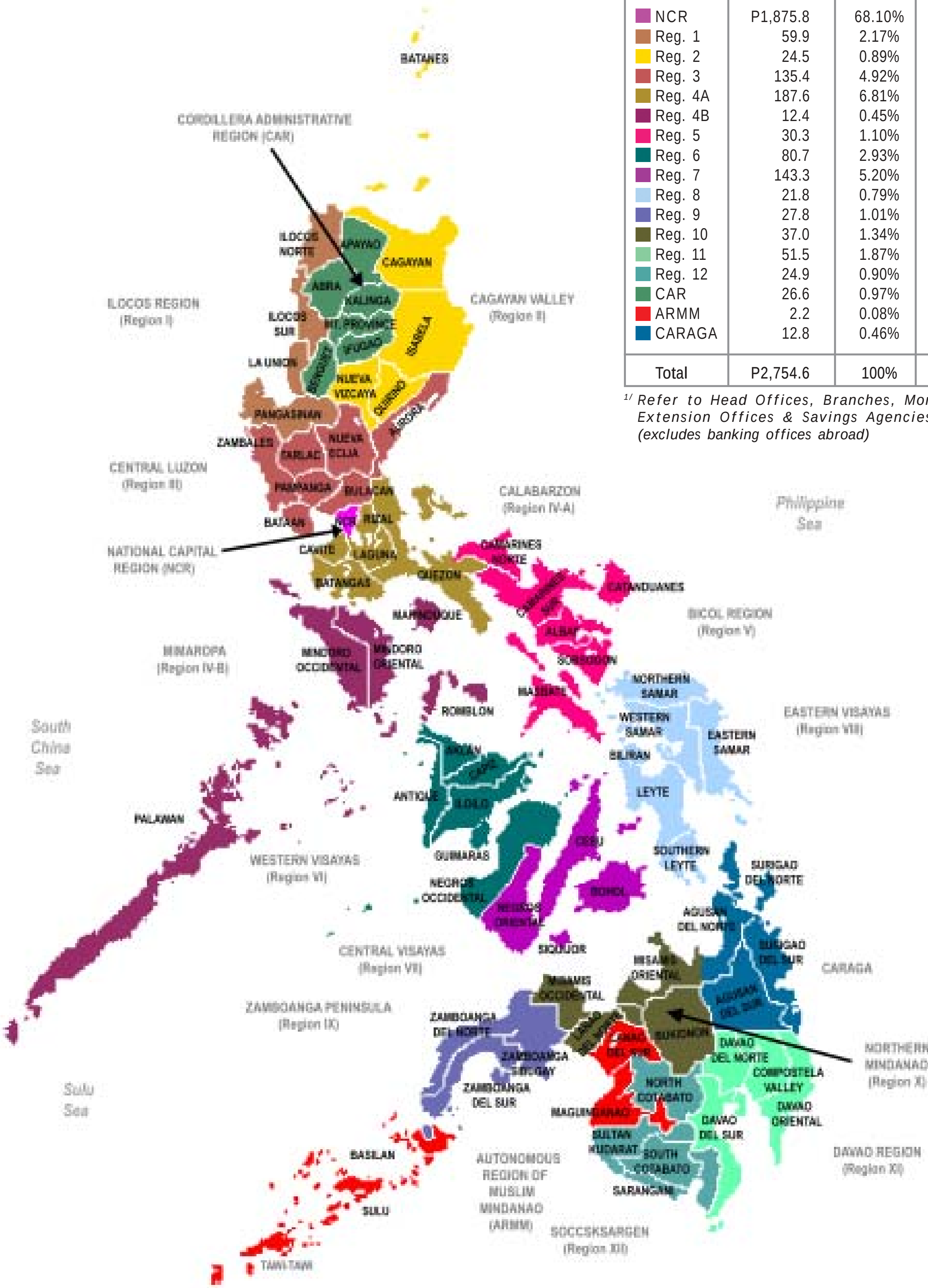
Table 4
Regional Distribution of Domestic Deposits (cont.)
As of December 31, 2004
(Amounts in Million Pesos)

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**	**157,011**	**5,922**	**5,775**	**71**	**130,838**	**2,998**	**20,398**	**2,853**
City of Manila	-	-	-	-	-	-	-	-	-
City of Muntinlupa	6	10,532	242	1,634	7	7,831	107	1,067	129
Kalookan City	2	7,036	97	7	0	6,796	64	233	33
Las Piñas City	7	11,969	539	966	7	9,697	379	1,306	153
Makati City	3	6,621	1,236	72	0	4,631	604	1,918	631
Malabon City	1	1,159	23	-	-	1,152	23	7	0
Mandaluyong City	1	3,263	385	300	2	1,501	194	1,462	188
Marikina City	7	16,272	656	657	7	12,062	136	3,553	513
Navotas	1	2,545	24	6	0	2,538	24	1	0
Parañaque City	2	5,931	379	73	2	3,732	176	2,126	201
Pasay City	-	-	-	-	-	-	-	-	-
Pasig City	19	37,032	1,599	967	17	28,069	659	7,996	923
Pateros	2	12,686	266	330	4	11,821	201	535	61
Quezon City	2	12,526	77	65	2	12,418	71	43	4
San Juan	1	692	60	72	1	610	59	10	0
Taguig	8	23,459	282	496	22	22,960	260	3	0
Valenzuela City	3	5,288	57	130	1	5,020	41	138	15
TOTAL PROVINCIAL *(Regions)*	**1,896**	**4,925,196**	**63,127**	**97,801**	**1,532**	**4,787,841**	**45,583**	**153,958**	**17,606**
1	187	382,519	5,864	3,923	91	366,744	3,901	16,607	1,769
2	129	206,637	2,738	3,171	42	202,089	2,293	3,126	370
3	301	680,760	12,203	22,432	278	635,997	8,714	24,125	3,176
4-A	452	1,174,889	18,820	27,139	331	1,103,763	13,695	36,993	5,071
4-B	57	167,651	1,507	457	4	165,419	1,115	3,069	441
5	91	251,107	3,182	1,471	17	247,559	2,323	9,768	996
6	127	289,572	3,208	3,245	22	277,423	2,116	11,414	1,134
7	126	247,799	4,208	6,685	88	224,887	3,011	14,268	1,648
8	51	127,264	1,026	160	2	127,521	715	3,636	360
9	31	100,074	817	901	7	106,852	621	2,331	262
10	97	345,133	2,014	4,681	82	351,104	1,449	6,557	600
11	75	297,240	2,610	6,920	400	312,226	1,592	5,662	750
12	65	221,277	1,481	4,912	79	214,672	1,103	11,693	469
CAR	43	121,412	1,328	1,214	15	123,720	1,088	1,994	284
ARMM	5	13,526	127	-	-	15,123	120	51	6
CARAGA	59	298,336	1,993	10,490	71	312,742	1,727	2,664	269
TOTAL PHILIPPINES	**1,961**	**5,082,207**	**69,049**	**103,576**	**1,603**	**4,918,679**	**48,581**	**174,356**	**20,458**

Source: Report on Breakdown of Deposit Liabilities by Type (BDL) submitted by member banks to PDIC.
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).
NCR refers to National Capital Region; CAR refers to Cordillera Administrative Region; ARMM refers to Autonomous Region in Muslim Mindanao; CARAGA is composed of Agusan del Norte, Agusan del Sur, Surigao del Norte & Surigao del Sur.

The Philippine Archipelago
with Domestic Deposit Distribution Per Region



Region	Deposit (In Billions)	% to Industry	Total No. of Offices [1/]
NCR	P1,875.8	68.10%	2,605
Reg. 1	59.9	2.17%	368
Reg. 2	24.5	0.89%	207
Reg. 3	135.4	4.92%	789
Reg. 4A	187.6	6.81%	1,152
Reg. 4B	12.4	0.45%	118
Reg. 5	30.3	1.10%	219
Reg. 6	80.7	2.93%	386
Reg. 7	143.3	5.20%	486
Reg. 8	21.8	0.79%	129
Reg. 9	27.8	1.01%	115
Reg. 10	37.0	1.34%	241
Reg. 11	51.5	1.87%	237
Reg. 12	24.9	0.90%	163
CAR	26.6	0.97%	111
ARMM	2.2	0.08%	19
CARAGA	12.8	0.46%	104
Total	P2,754.6	100%	7,449

[1/] *Refer to Head Offices, Branches, Money Shops, Extension Offices & Savings Agencies of banks (excludes banking offices abroad)*

Table 5

Percentage Share of Domestic Deposit per Region and per Bank Type

As of December 31, 2004

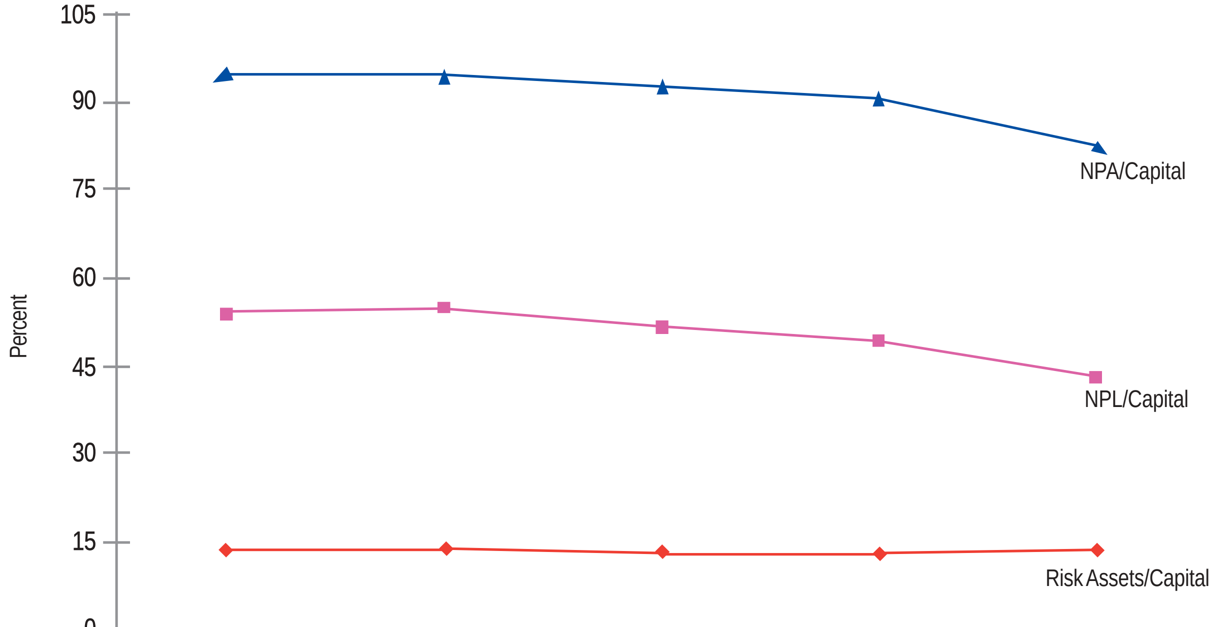
Region	Bank Type	No. of Offices	Deposit				
			Amount *(In Millions)* A	% to Industry	Accounts *(In Absolute Figure)* B	Average Size *(In Thousands)* C=A/B*1000	% Share In Region
NCR	KB	2,002	1,725,766	62.7	8,467,564	203.81	92.0
	TB	538	144,161	5.2	1,274,425	113.12	7.7
	RB	65	5,922	0.2	157,011	37.72	0.3
	Sub-Total	2,605	1,875,849	68.1	9,899,000	189.50	100.0
I	KB	145	49,045	1.8	701,811	69.88	81.9
	TB	36	5,058	0.2	77,109	65.60	8.4
	RB	187	5,762	0.2	387,274	14.88	9.6
	Sub-Total	368	59,865	2.2	1,166,194	51.33	100.0
II	KB	70	20,829	0.8	358,151	58.16	85.1
	TB	8	955	*	19,573	48.79	3.9
	RB	129	2,705	0.1	208,386	12.98	11.0
	Sub-Total	207	24,490	0.9	586,110	41.78	100.0
III	KB	331	106,714	3.9	1,375,942	77.56	78.8
	TB	157	16,547	0.6	240,097	68.92	12.2
	RB	301	12,168	0.4	682,554	17.83	9.0
	Sub-Total	789	135,429	4.9	2,298,593	58.92	100.0
IV-A	KB	446	141,260	5.1	1,986,677	71.10	75.3
	TB	254	27,243	1.0	439,242	62.02	14.5
	RB	452	19,098	0.7	1,167,895	16.35	10.2
	Sub-Total	1,152	187,600	6.8	3,593,814	52.20	100.0
IV-B	KB	39	9,927	0.4	157,934	62.86	80.1
	TB	22	901	*	60,368	14.93	7.3
	RB	57	1,560	0.1	168,945	9.23	12.6
	Sub-Total	118	12,388	0.4	387,247	31.99	100.0
V	KB	96	24,648	0.9	419,733	58.72	81.4
	TB	32	2,303	0.1	93,065	24.75	7.6
	RB	91	3,336	0.1	258,798	12.89	11.0
	Sub-Total	219	30,288	1.1	771,596	39.25	100.0
VI	KB	223	73,202	2.7	1,036,585	70.62	90.7
	TB	36	4,209	0.2	53,690	78.39	5.2
	RB	127	3,272	0.1	292,082	11.20	4.1
	Sub-Total	386	80,684	2.9	1,382,357	58.37	100.0
VII	KB	255	126,122	4.6	1,112,216	113.40	88.0
	TB	105	12,400	0.5	230,580	53.78	8.7
	RB	126	4,747	0.2	245,840	19.31	3.3
	Sub-Total	486	143,269	5.2	1,588,636	90.18	100.0
VIII	KB	71	20,018	0.7	351,907	56.88	91.6
	TB	7	751	*	20,368	36.87	3.4
	RB	51	1,077	*	131,317	8.20	4.9
	Sub-Total	129	21,847	0.8	503,592	43.38	100.0
IX	KB	78	26,166	0.9	345,045	75.83	94.0
	TB	6	789	*	9,409	83.86	2.8
	RB	31	890	*	110,084	8.08	3.2
	Sub-Total	115	27,845	1.0	464,538	59.94	100.0
X	KB	115	32,662	1.2	488,383	66.88	88.2
	TB	29	2,253	0.1	54,958	40.99	6.1
	RB	97	2,131	0.1	362,342	5.88	5.8
	Sub-Total	241	37,046	1.3	905,683	40.90	100.0
XI	KB	136	45,928	1.7	524,558	87.56	89.2
	TB	26	2,827	0.1	51,106	55.32	5.5
	RB	75	2,743	0.1	324,808	8.44	5.3
	Sub-Total	237	51,498	1.9	900,472	57.19	100.0
XII	KB	90	22,455	0.8	405,407	55.39	90.1
	TB	8	804	*	16,740	48.03	3.2
	RB	65	1,651	0.1	231,277	7.14	6.6
	Sub-Total	163	24,910	0.9	653,424	38.12	100.0
CAR	KB	57	22,964	0.8	295,260	77.78	86.3
	TB	11	2,265	0.1	33,004	68.63	8.5
	RB	43	1,387	0.1	126,928	10.93	5.2
	Sub-Total	111	26,617	1.0	455,192	58.47	100.0
ARMM	KB	14	2,060	0.1	62,317	33.06	94.3
	TB	0	-	-	-	-	-
	RB	5	126	*	15,174	8.30	5.8
	Sub-Total	19	2,185	0.1	77,491	28.20	100.0
CARAGA	KB	39	10,439	0.4	181,638	57.47	81.7
	TB	6	267	*	12,627	21.15	2.1
	RB	59	2,067	0.1	325,896	6.34	16.2
	Sub-Total	104	12,773	0.5	520,161	24.56	100.0
TOTAL		7,449	2,754,582	100.0	26,154,100	105.32	

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

Figure 1

Selected Financial Ratios of the Philippine Banking System

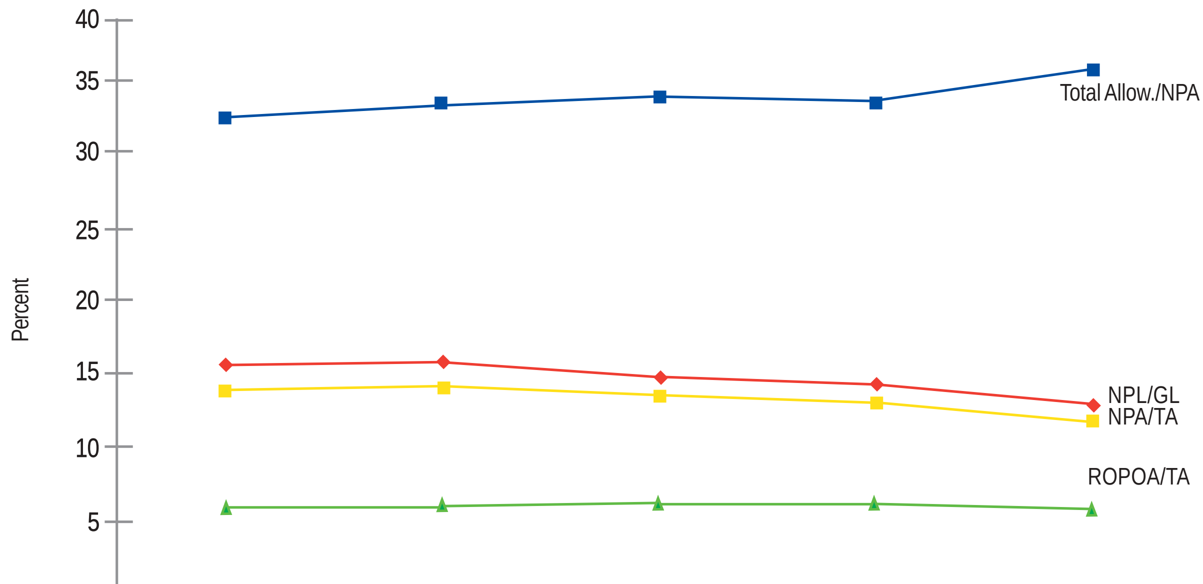
A. Selected Capital Adequacy Ratios of the Philippine Banking System, Semestral 2002 to 2004



	Dec-02	Jun-03	Dec-03	Jun-04	Dec-04
NPA to Capital	95.07	94.91	92.90	91.02	82.84
NPL to Capital	54.13	55.03	51.89	49.40	43.34
Risk Assets Ratio	13.67	13.80	13.19	13.11	13.48

Source of basic data: Consolidated Statement of Condition and Consolidated Statement of Income & Expenses submitted by member banks to PDIC.

B. Selected Asset Quality Ratios of the Philippine Banking System, Semestral 2002 to 2004



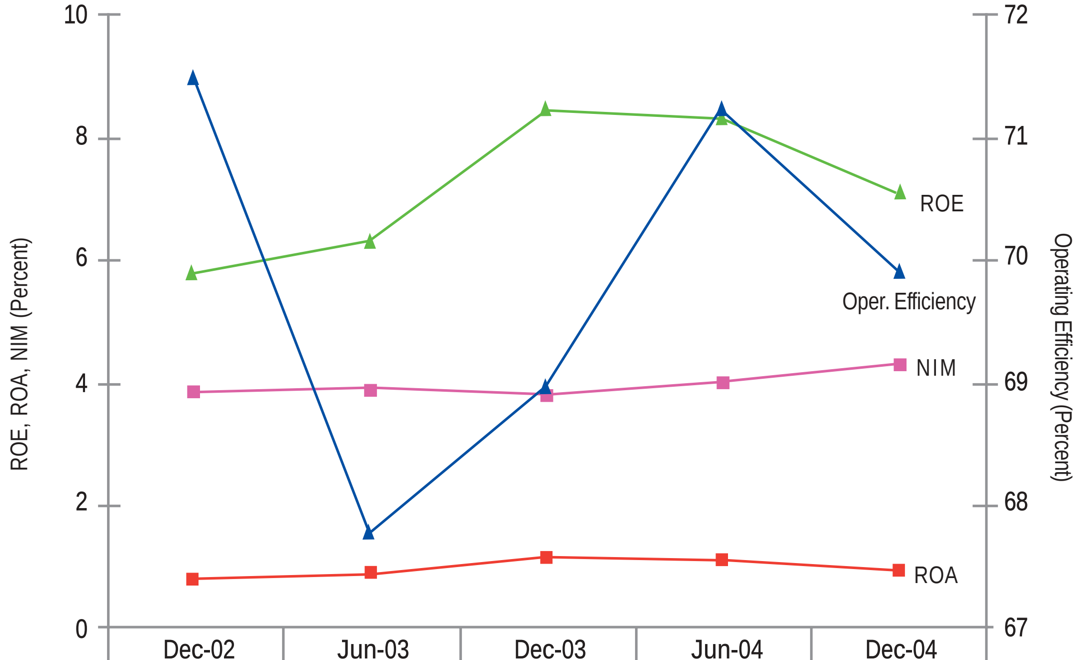
	Dec-02	Jun-03	Dec-03	Jun-04	Dec-04
Total Allow. to NPA	32.41	33.21	33.70	33.40	35.64
NPL to GL	15.49	15.80	14.73	14.24	12.85
NPA to TA	13.88	14.12	13.62	13.02	11.84
ROPOA to TA	5.98	6.09	6.22	6.16	5.91

Source of basic data: Consolidated Statement of Condition and Consolidated Statement of Income & Expenses submitted by member banks to PDIC.

Figure 1

Selected Financial Ratios of the Philippine Banking System *(cont.)*

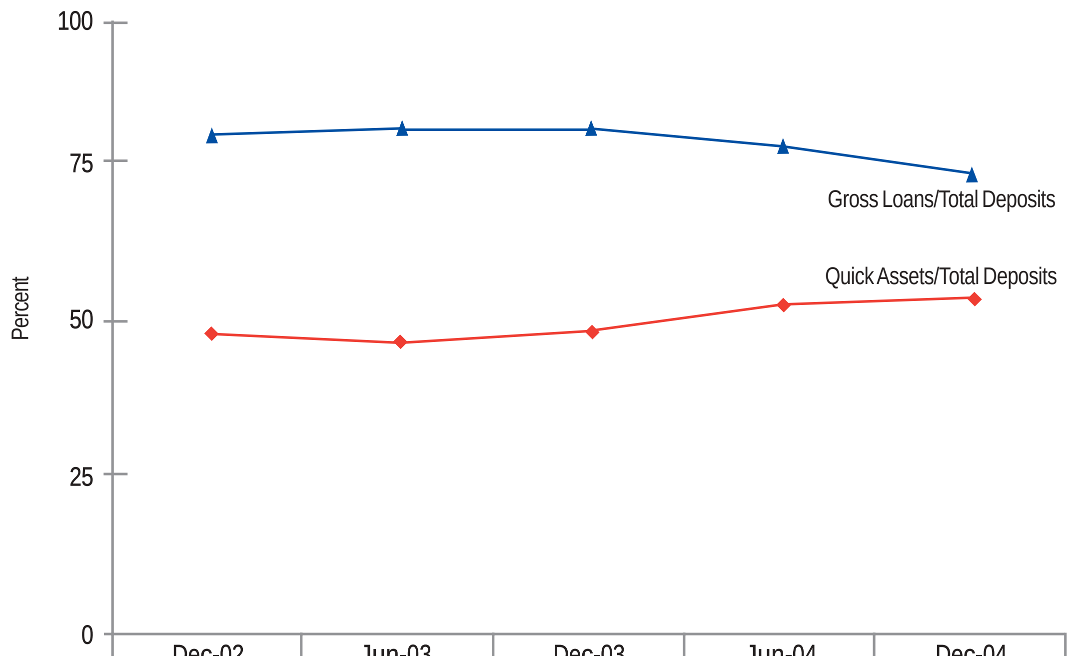
C. Selected Profitability Ratios of the Philippine Banking System, Semestral 2002 to 2004



	Dec-02	Jun-03	Dec-03	Jun-04	Dec-04
Net Interest Margin (NIM)	3.83	3.87	3.79	4.00	4.30
Return on Equity (ROE)	5.78	6.30	8.46	8.30	7.11
Return on Assets (ROA)	0.78	0.85	1.12	1.09	0.91
Oper. Efficiency (Exc. Prov.)	71.51	67.76	68.96	71.23	69.90

Source of basic data: Consolidated Statement of Condition and Consolidated Statement of Income & Expenses submitted by member banks to PDIC.

D. Selected Liquidity Ratios of the Philippine Banking System, Semestral 2002-2004

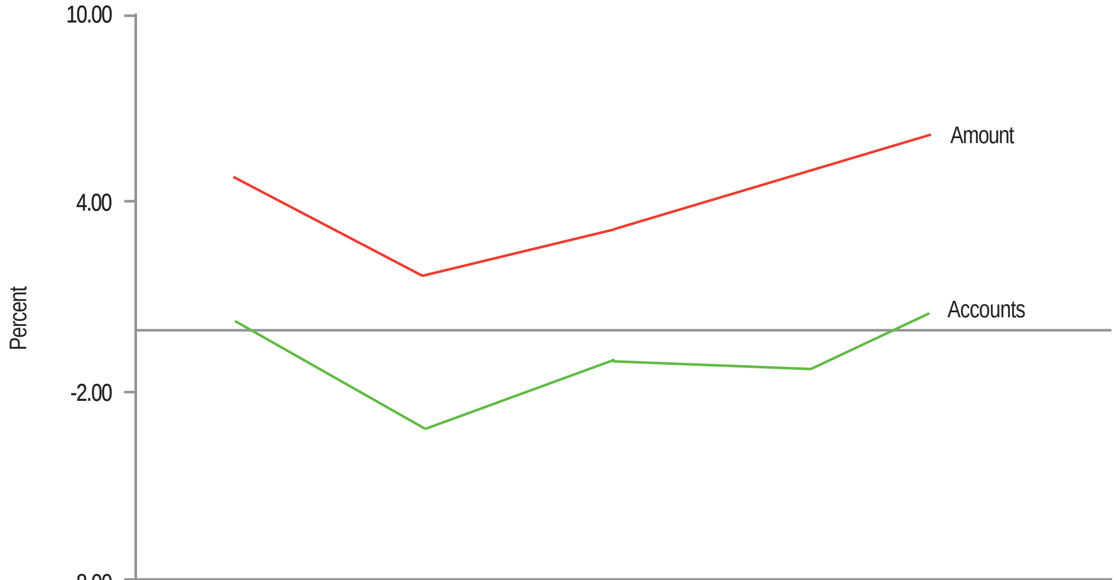


	Dec-02	Jun-03	Dec-03	Jun-04	Dec-04
Gross Loans to Total Deposits	78.91	80.21	80.26	77.55	73.17
Quick Assets to Total Deposits	47.70	46.16	47.86	52.13	53.20

Source of basic data: Consolidated Statement of Condition and Consolidated Statement of Income & Expenses submitted by member banks to PDIC.

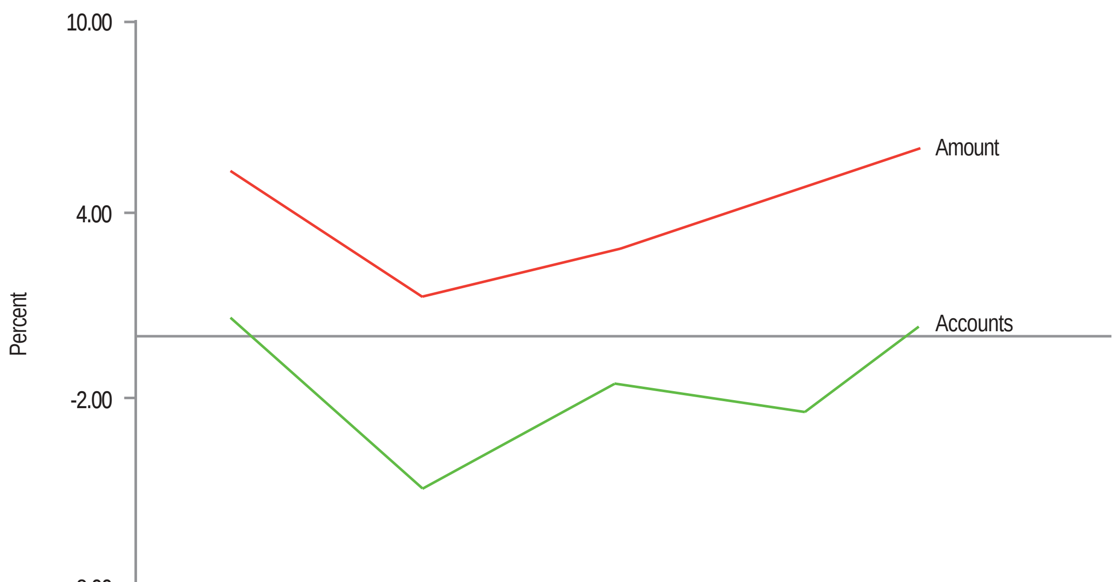
Figure 2
Trends in Deposit Amounts and Accounts

A. Growth Rate of Domestic Deposit Amounts and Accounts in the Philippine Banking System



	Jun 02 - Dec 02	Dec 02 - Jun 03	Jun 03 - Dec 03	Dec 03 - Jun 04	Jun 04 - Dec 04
Total Amount	4.76	1.69	3.21	5.00	6.73
Total Accounts	0.20	-3.16	-1.00	-1.28	1.59

B. Growth Rate of Domestic Deposit Amounts and Accounts in Commercial Banks



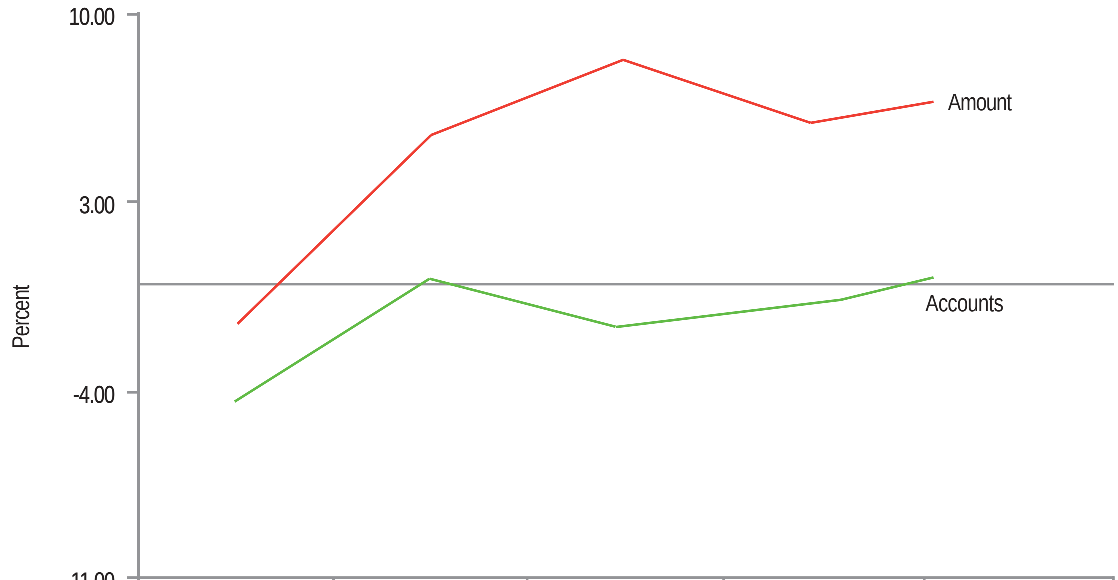
	Jun 02 - Dec 02	Dec 02 - Jun 03	Jun 03 - Dec 03	Dec 03 - Jun 04	Jun 04 - Dec 04
Total Amount	5.29	1.26	2.71	4.78	6.89
Total Accounts	0.52	-4.92	-1.55	-2.50	1.97

Source: Consolidated Report on Domestic Deposit Liabilities by Size of Account submitted by member banks to PDIC.

Figure 2

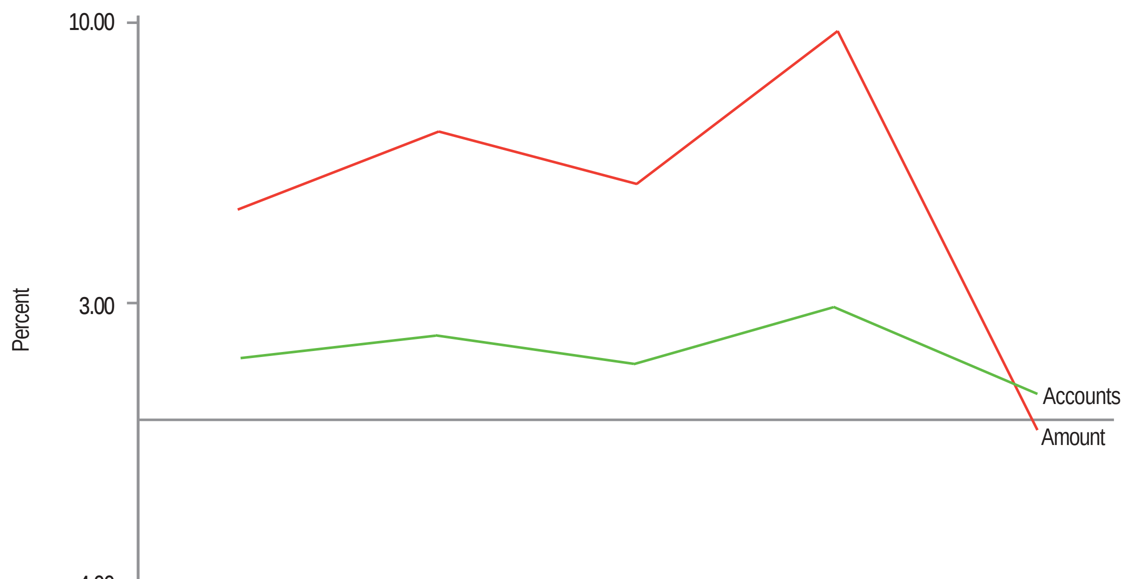
Trends in Deposit Amounts and Accounts (cont.)

C. Growth Rate of Domestic Deposit Amounts and Accounts in Thrift Banks



	Jun 02 - Dec 02	Dec 02 - Jun 03	Jun 03 - Dec 03	Dec 03 - Jun 04	Jun 04 - Jun 04
Total Amount	-1.42	5.28	8.29	5.89	7.27
Total Accounts	-4.34	0.11	-1.68	-0.67	0.66

D. Growth Rate of Domestic Deposit Amounts and Accounts in Rural Banks



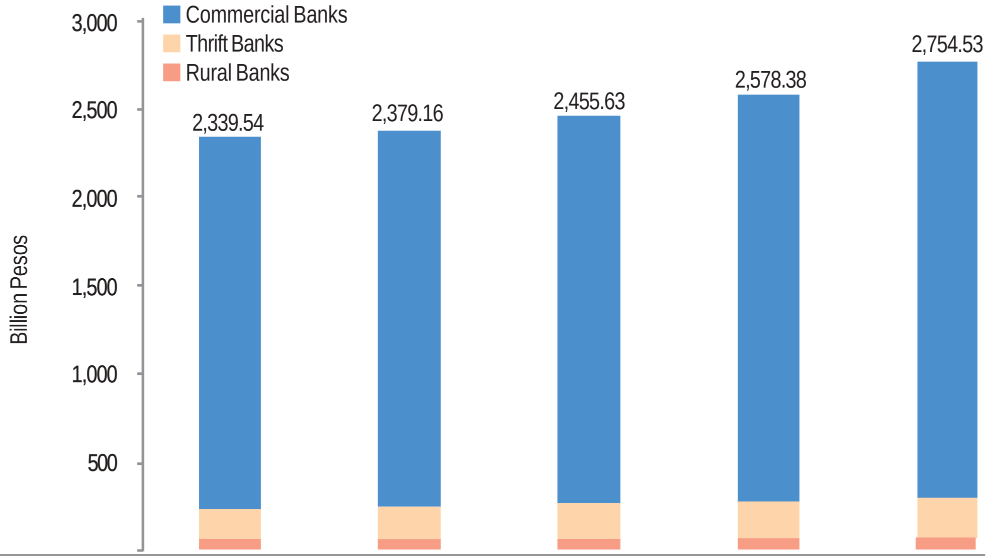
	Jun 02 - Dec 02	Dec 02 - Jun 03	Jun 03 - Dec 03	Dec 03 - Jun 04	Jun 04 - Dec 04
Total Amount	5.32	7.26	5.98	9.77	-0.19
Total Accounts	1.66	2.21	1.49	2.94	0.74

Source: Consolidated Report on Domestic Deposit Liabilities by Size of Account submitted by member banks to PDIC.

Figure 3

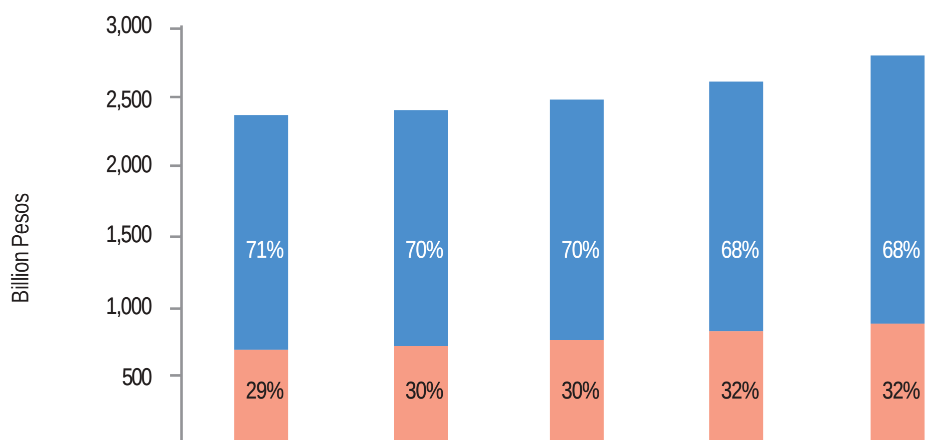
Domestic Deposit Distribution By Bank Type & By Currency or By Type of Deposit

A. Domestic Deposit Distribution of the Banking System, by Bank Type



Bank Type	Dec-02	Jun-03	Dec-03	Jun-04	Dec-04
Commercial Banks	2,112.04	2,138.57	2,196.46	2,301.53	2,460.08
Share to Total	*90.28%*	*89.89%*	*89.45%*	*89.26%*	*89.31%*
Thrift Banks	172.77	181.89	196.96	208.56	223.73
Share to Total	*7.38%*	*7.65%*	*8.02%*	*8.09%*	*8.12%*
Rural Banks	54.73	58.70	62.21	68.29	70.72
Share to Total	*2.34%*	*2.47%*	*2.53%*	*2.65%*	*2.57%*

B. Domestic Deposit Distribution of the Banking System, by Currency or By Type of Deposit



	Dec-02	Jun-03	Dec-03	Jun-04	Dec-04
Total Deposits	2,339.54	2,379.16	2,455.63	2,578.38	2,754.53
Peso Denom. Dep.	1,654.59	1,670.64	1,709.61	1,760.76	1,878.86
FCDs Peso Equiv.	684.95	708.53	746.02	817.62	875.67
US$ Value of FCDs	12.86	13.24	13.42	14.55	15.54
BSP Guiding FX Ref. Rate	53.25	53.52	55.59	56.18	56.34

Source: Consolidated Report on Domestic Deposit Liabilities by Size of Account submitted by member banks to PDIC.
Notes: Domestic deposits excludes deposits in overseas branches of Philippine banks.
KBs account for 96% of total FCDs while the balance of 4% is lodged with TBs

Glossary of Terms

Selected Accounts

1. **Quick Assets (QA)** is 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 Instrument (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** consist of Due from BSP, Due from PCHC, Due from Banks, TAS-Investment, 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)** as reported by banks per BSP Circular Nos. 202, 248 and 351.

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

5. **Loan Loss Provision (LLP)** is the sum of Specific and General Loan Loss Provision.

6. **Total Allowance** consists of LLP, Allowance for Probable Losses on ROPOA and on Sales Contract Receivable.

Selected Ratios

7. **Risk Assets Ratio (RAR)** is Booked Capital per Consolidated Statement of Condition (CSOC) divided by Risk Assets, whereby Booked Capital is net of Appraisal Increment Reserves, Net Unrealized Gain on Securities Available for Sale (SAS), Deferred Income Tax, Goodwill and Unsecured DOSRI, while Risk Assets are 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 are composed of Cash on Hand, Due from BSP, Due from PCHC, TAS Investments, ASS-Government, IBODI-Government, Bank Premises and Deferred Income Tax).

8. **Risk Based Capital Adequacy Ratio (RBCAR)** is Qualifying Capital divided by Risk Weighted Assets as 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.

9. **NPL to Capital**, whereby NPL is as defined under note #3 while Capital is inclusive of Total Allowance as defined under note #6 net of Appraisal Increment Reserves, Net Unrealized Gain on SAS, Deferred Income Tax, and Goodwill.

10. **NPA to Capital** whereby NPA is as defined under #4 while Capital is as defined under note #9.

11. **Return on Equity (ROE)** is computed as follows: 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 data divided by 2.

12. **Return on Asset (ROA)** is computed as follows: NIAT divided by Average Total Assets.

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

14. **Operating Efficiency (Exc. Provisions)** is computed by dividing Other Operating Expenses by the sum of Net Interest Income and Other Operating Income.

General guidance for developing differential premium systems

The International Association of Deposit Insurers (IADI)

was established in 2002 with a mission to "contribute to the enhancement of deposit insurance effectiveness by promoting guidance and international cooperation". As part of its work, IADI undertakes research to provide guidance on deposit insurance issues.[1] The objective of this paper is to develop general guidance for countries considering the adoption of differential premium systems.[2]

Deposit insurers collecting premiums from member financial institutions which accept deposits from the public (hereafter referred to as banks) usually choose between adopting a flat-rate premium or a system that seeks to differentiate premiums on the basis of individual-bank risk profiles. Flat-rate premium systems have the advantage of being relatively easy to understand and administer. However, they do not take into account the level of risk that a bank poses to the deposit insurance system and can be perceived as being unfair in that the same premium rate is charged to all banks regardless of the risks posed. Primarily for these reasons, differential premium systems have become increasingly adopted in recent years.

This paper: (1) discusses issues for deposit insurance systems that are associated with developing and implementing differential premium systems; (2) examines the advantages, disadvantages and trade-offs associated with various approaches to these systems; and, (3) provides guidance with respect to these issues.

The paper is designed for deposit insurance practitioners and other interested parties. It is based on the judgment of IADI's members, associates and observers and the experiences of various countries that have developed differential premium systems. It also draws on relevant literature available on the subject.

Background

Sound funding arrangements are critical for the effectiveness of a deposit insurance system. According to the Financial Stability Forum Working Group on Deposit Insurance (2001), a deposit insurance system should have available all funding mechanisms necessary to ensure the prompt reimbursement of depositors' claims when required to do so. Funding can be assured in many ways, such as through loans, guarantees, levies or premium assessments, market borrowings, or a combination thereof.

Most deposit insurance systems initially adopt an *ex-ante* flat-rate premium system because they are relatively simple to design, implement and administer. However, these systems are open to criticism in that they do not reflect the levels of forward looking risk that banks pose to the deposit insurance system. Flat-rate premium systems are viewed as being unfair as "low-risk" banks are required to pay the same premiums as "higher- risk" banks.[3]

The first step in designing a differential premium system is to identify the objectives that it is expected to achieve. The primary objective of most differential premium systems is to provide incentives for banks to avoid excessive risk taking and to introduce more fairness into the premium assessment process. Introducing more fairness into the system can help bolster industry support for deposit insurance in general. It is also important to

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[1] *The Research and Guidance Committee of IADI developed a research plan setting out study areas for developing guidance on deposit insurance. A copy of the research plan can be found at: http://www.iadi.org/html/Fx/Forms/ViewNews.aspx?ID=24*

[2] *The Subcommittee on Developing Guidance for Differential Deposit Insurance Premium Systems was composed of individuals from: Argentina, Canada (David Walker, Chair), Brazil, France, Hungary, Japan, Jordan, Korea, Mexico, Nigeria, Philippines, Ukraine and the USA.*

ensure that the goals of a differential premium system are consistent with the stated public policy objectives of the deposit insurance system.

The first recorded differential premium system was introduced by the **Federal Deposit Insurance Corporation** (FDIC) in 1993. Since that time, the number of systems has grown steadily and it is estimated that there are currently fifteen in operation. Examples of other countries in which such systems are operating include: Argentina, Canada, Colombia, Finland, France, Peru, Portugal, Romania, Taiwan and Turkey.[4] As well, many countries considering the adoption of or an enhancement to their existing deposit insurance systems have expressed interest in eventually transitioning to differential premium systems.

Nevertheless, differential premium systems are not appropriate for all deposit insurance systems at all times. The overall nature of the intermediation process of banking makes risk measurement and pricing a complicated task. In addition, it is difficult to find appropriate and acceptable methods of differentiating risk; obtain reliable, consistent and timely information and ensure that rating criteria are transparent. As well, differential premium systems require resources to administer the system appropriately.

Therefore, before establishing a differential premium system it is important to review the state of the economy, structure of the banking system, public attitudes and expectations, the strength of prudential regulation and supervision, the legal framework, and the soundness of accounting and disclosure regimes. Policymakers have a wider range of options available for designing a differential premium system if these regimes are sound. In some cases, country conditions may not be ideal and, therefore, it is important to identify gaps between existing conditions and more-desirable situations and thoroughly evaluate available options, since the establishment of a differential premium system is not a remedy for dealing with major deficiencies.

For instance, sound accounting and financial reporting regimes are necessary for an effective deposit insurance and differential premium system. Accurate, reliable and timely information reported by these regimes can be used by the deposit insurer and other safety-net participants to make decisions regarding the risk profile of a bank. Attributes of a sound accounting regime include accurate and meaningful assessments of information in areas such as asset valuation, the measurement of credit exposures, loan-loss provisioning, measurement of non-performing loans, the treatment of unrealised losses, off-balance-sheet exposures, capital adequacy, and bank earnings and profitability.

It is important to understand that even when it is decided that conditions are appropriate to introduce differential premiums, such systems are most effective at achieving their objectives when they provide good incentives for banks to manage their risks and when they are accompanied by effective early warning systems and prompt corrective supervisory action to deal with problem banks.

Approaches used to differentiate bank risk

One of the most challenging aspects of developing a differential premium system is finding appropriate methods for differentiating among the risk profiles of banks. A number of approaches are available and in general they encompass methodologies, which emphasize mainly objective or quantitative factors and/or those, which rely on more subjective or qualitative information. Although difficult to accomplish, the approach used to differentiate risk and assign premiums should be as forward looking as possible.

The following section describes some of the most commonly used criteria or factors for differentiating the risk profiles of banks for premium assessment purposes and some of the advantages, disadvantages and trade-offs associated with their use.

a) Quantitative Criteria Approaches

Quantitative criteria approaches generally try to use measures that are factual or data driven to categorize banks for premium assessment purposes. Some quantitative systems rely on only one factor to assess risk while others combine a number of factors. Information is usually gathered through on-site or off-site data collection and supervisory processes. Factors that are commonly considered for such systems usually include:

- A bank's adherence with regulatory capital requirements or other measures of the quantity, quality and sufficiency of a bank's capital;
- the quality and diversification of a bank's asset portfolio both on- and off-balance sheet;
- the sufficiency, volatility and quality of a bank's earnings;
- a bank's cash flows (both on- and off-balance sheet) and ability to generate and obtain

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[3] *Prior to making the decision to adopt a flat-rate or differential premium system, policymakers will need to choose between ex-ante, ex-post or some combination of these types of funding. Ex-ante funding is more amenable to differential premium systems as ex-post funding tends to be used infrequently and unexpectedly. In an ex-post funding environment, differential premiums could only be applied on certain occasions and only if the bank risks profiles are available.*

[4] *Refer to Appendix I in http://www.iadi.org/html/Default.aspx?MenuID=97 for further details.*

sufficient funds in a timely manner and at a reasonable cost;
- the stability and diversification of a bank's funding; and
- a bank's exposure to interest rate risk, and where applicable, foreign exchange and position risk.

Usually, one or a combination of quantitative factors is used to differentiate risk among banks. The most common factor used is capital adequacy. Capital is the primary cushion against adverse changes in a bank's asset quality and earnings. Although capital is extremely important, other quantitative criteria are usually taken into consideration such as earnings, which can contribute to the ability of a bank to sustain its capital.[5] The information is often collected directly from the bank based on industry-accepted accounting principles and banks are rated or categorized based on various criteria or peer group comparison.

Another quantitative approach, which can be used to calculate differential premiums, is expected loss pricing. The expected-loss price for a bank depends on the probability of default for the bank, the exposure of the deposit insurer to that bank, and the size of the loss that the deposit insurer might incur should that bank fail.

In addition to using traditional quantitative measures and expected loss pricing, a number of theoretical models have been proposed for use in differentiating bank risk. Merton (1977) likened deposit insurance to a put option written by regulators on the value of a depository institution's assets where the value of deposit insurance can be calculated using a Black-Scholes (1973) option pricing model. Marcus and Shaked (1984) and Ronn and Verma (1986) applied option pricing to estimate insurance premiums. Although quantitatively based and theoretically appealing to some, difficulties in obtaining suitable data and finding agreement on the methodologies employed among member banks, deposit insurers and other safety-net participants have so far prevented many of these models from being adopted.

The advantage of using primarily quantitative approaches to differentiate bank risk is that they rely on relatively objective factors and data and are viewed as being transparent and less open to argument than more subjective approaches. But, the principal drawback is that their effectiveness is heavily dependent on high quality, consistent, reliable and timely data – which may be difficult to obtain in many financial systems. For example, in the case of using expected loss pricing models, most countries simply do not have enough historical default and loss experience to accurately calculate parameters. Another shortcoming is that most quantitative techniques tend to provide information on the past financial condition of the bank. They are less effective at providing leading indications of the future risk profile of banks.

Finally, even when suitable data is available and the methodology employed is widely accepted, systems which rely mostly on quantitative criteria do not allow for consideration of important qualitative factors about a bank - such as the quality of an institution's governance and risk management practices – which may contain valuable information on the management and mitigation of risk.

b) Qualitative Criteria Approaches

Qualitative criteria approaches generally rely on a number of qualitative factors to categorize banks into different categories for premium assessment purposes. The primary method used is reliance on some form of regulatory and supervisory judgment or rating system and information such as adherence to guidelines, standards, compliance measures or other supervisory or deposit insurance requirements. The assessments are usually designed to provide an indication of the current financial condition of a bank, its key business practices, and some indication of its future financial and risk profile.[6] Examinations are performed "on-site", "off-site" or some combination thereof and the information collected is usually treated confidentially by the safety-net participants.

Examination criteria vary across countries but commonly include methods such as the CAMEL approach.[7] Although these approaches may include quantitative elements, a high level of judgment is usually employed in

[5] *As an example, Turkey utilizes a differential premium system where a basic premium is charged to all banks covered by the deposit insurer with additional premium charges based on various measures of capital adequacy, foreign exchange positions asset quality and provisioning.*

[6] *Key business practices looked at by examiners usually include an assessment of a bank's corporate governance, strategic management, risk management and external environment.*

[7] *Under CAMEL, each bank is subject to an on-site examination and is typically evaluated on the basis of five common factors. These are Capital, Asset Quality, Management, Earnings and Liquidity. In an effort to make the rating system more risk-focused, a sixth component relating to sensitivity to market risk was added to the CAMEL rating, making it CAMEL(S). Each of the component factors is rated on a scale of 1 (best) to 5 (worst). For more information see Sahajwala and Van den Bergh (2000)*
The French Banking Commission's Organization and Reinforcement of Preventive Action (ORAP) system is a multi-factor analysis system for individual institutions. The system works within a standardized and formalized framework, with specific ratings on 14 components related to prudential ratios, on- and off-balance sheet activity, market risk, earnings, and various qualitative criteria (shareholders, management and internal control). Each component is rated on a scale of 1 (best) to 5 (worst). Component ratings are converted to a composite rating similarly scaled between 1 (best) and 5 (worst).

determining weights and qualitative factors such as the quality of management may be heavily emphasized.[8]

A differential premium system can also use additional qualitative information, which can be classified as "other information". This can include: information received from supervisors about a bank or about other companies to which the bank is related (such as regulatory directives, letters of compliance, etc.); independent agency ratings and information; the views of industry analysts and other experts; parent company ratings, interest rates offered by banks and rates charged on the interbank market, market indicators such as stock price movements, and other information which may be considered relevant.

However, using "other information" to help categorize banks is relatively subjective. The deposit insurer would be required to use its judgment in determining whether or not the evidence might materially affect the operations and safety and soundness of a bank. Another issue is that consistent and comparable information may not be available for all banks.

The advantage of qualitative approaches are that they can provide important information on the current and future risk profiles of banks, which may not be captured by quantitative factors alone. However, such systems have drawbacks in that they are generally less transparent and utilize a higher degree of judgment and discretion compared to quantitative techniques. This may increase the number of requests for appeals of assigned rating categories and may be more difficult to defend should a bank question its categorization. Also, qualitative approaches by themselves do not give sufficient consideration to important quantitative factors such as the bank's capital adequacy.

c) Combined Quantitative and Qualitative Criteria Approaches

Combined approaches use both quantitative and qualitative measures to categorize banks. From the submissions received for this paper, combined quantitative / qualitative systems were the most common differential premium systems seen. For example, Argentina, Canada, France, Taiwan and the United States utilize this approach in their differential premium system methodologies.[9]

In Argentina, all institutions contribute a basic premium to the deposit insurer with additional premiums determined by a combined qualitative/quantitative differential premium system. The differentiated additional premium for each institution takes into account factors such as a CAMEL rating assigned by the supervisor and indicators which measure the excess or deficiency of capital over the required minimum capital levels and the quality of the loan portfolio.

The **Canada Deposit Insurance Corporation**'s differential premium system was introduced in 1999 and incorporates 14 individual quantitative and qualitative measures. Quantitative indicators such as capital adequacy, income volatility, and concentration ratios make up 60 per cent of the score while qualitative measures such as examiner ratings, adherence to CDIC Standards of Sound Business and Financial Practices and other measures make up the remaining 40 per cent. The system has four premium categories with category 1 being the best rated and category 4 the worst rated institutions.

The differential premium system in France, which came into effect in 1999, is based on a combination of prudential and financial risk analysis ratios which are applied to the amount of deposits with each member bank. In addition, a "synthetic risk" indicator is employed which is based on four criterion for solvency, profitability, risk diversification and maturity transformation.[10] The four criteria are then rated from 1 (best) to 3 (worst) and premiums applied according to a specified formula.

The differential premium system adopted by the FDIC in the United States was introduced in 1993. It incorporates a 3 by 3 matrix and ratings are determined by a score for capital adequacy and a supervisory rating. It is the longest running differential premium system in operation. Currently, the FDIC is considering modifying its system to expand on the criteria used to assess bank risks.

The **Central Deposit Insurance Corporation** adopted a differential premium system which also utilizes a 3 by 3 matrix. The rating factor used is capital adequacy and an examination data rating composite

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[8] In recent years, many supervisory authorities have been moving to more "risk-based" supervisory examination systems. These are designed to identify key business areas and risks and be more forward looking than more traditional examination techniques. Although these systems often incorporate both quantitative and qualitative factors, they can be even more subjective than traditional ratings as judgment is required to identify key risk areas and determine the appropriate supervisory period. And, in some cases, they rely heavily on self-assessment which requires quality assurance and appropriate incentives to work effectively.

[9] The subcommittee received descriptions of differential premium systems from: Argentina, Canada, France, Taiwan, Turkey and the United States.

[10] The solvency criterion is based on the tier 1 risk-based capital ratio; profitability is based on the level of the net cost-to-operating income ratio; risk diversification is based on the level of the 10 largest credit exposures; and, the maturity transformation criterion is derived from a bank's maturity gap exposure.

score which incorporates the CAMEL(S) framework.

An important consideration in systems which combine both quantitative and qualitative factors is the relative weighting between these factors. In some systems (e.g. the FDIC) quantitative criteria receive an equal weight to more subjective criteria such as examination ratings. In other countries, such as Canada, qualitative criteria are weighted less than quantitative criteria. In fact, the tendency among the systems studied seems to be to weigh more heavily quantitative elements than qualitative factors. This may reflect less comfort on the part of many banks with subjective assessments – even in situations where a subjective or qualitative assessment such as the quality of management may be one of the more effective leading indicators of risk.

The advantages of combining both quantitative and qualitative indicators, is that it can be a highly effective and comprehensive way to assess the risk profile of banks. Of all the general approaches discussed, this takes into account the widest range of information to help assess a bank's risk profile. The main drawback is that it may impose a higher level of information requirements on banks and could be more open to challenges compared to approaches using mostly quantitative criteria.

In summary, although there are a wide variety of approaches to differentiate risk among banks and assign premiums, the approach chosen should be effective at: (1) differentiating banks into appropriate risk categories; (2) utilize a variety of relevant information; (3) be forward looking; and (4) be well accepted by the banking industry and financial safety-net participants.

Authority, resource and information requirements

The adoption of differential premium systems requires policymakers to ensure that the deposit insurance authority has the necessary authority, resources and information (i.e. consistent, accurate and verifiable) in place to administer the system appropriately. One of the areas that need to be addressed is whether or not the information to be used is already produced and collected. One view is that the required information should be limited to that already provided to safety-net participants.[11] This, however, may not be sufficient for the needs of an effective differential premium system. Obviously, a balance needs to be struck between requiring necessary information for the classification of banks into premium categories and concern that the demands of the system not be unduly burdensome to banks.

In cases where the deposit insurance entity does not directly gather information but relies on the supervisor, formal agreements need to be in place to ensure that information required for administering the differential premium system is collected, verified for accuracy, and transmitted on a timely basis.

Another issue to be considered is whether the information used for differential premiums has been validated to ensure that it is accurate and consistent among banks and over time. This may require that reporting standards be established and that information be verified through on-site means. The use of previously audited information can also help contribute to the accuracy of the differential premium system and reduce unnecessary administrative and reporting burdens on member banks.

As for the timing of the information, the period for premium assessment should, as far as possible, reflect the most current bank risk profile determination. Given that the risk profile of a bank is always changing it would be ideal to constantly be assessing the factor measures. However, the resource requirements and administrative and reporting costs of such a system make this an unrealistic option. Therefore, many differential premium systems rely on a single risk profile determination period, such as a bank's fiscal year-end audited financial information, as their cut-off date.

Other issues include whether the deposit insurance system should apply the same assessment methodology to different types of member institutions covered such as banks and other financial institutions. In addition to ensuring that each type of bank receiving deposit insurance is well regulated and supervised, policymakers should take into consideration differences in accounting and information reporting systems for different types of financial institutions included in the deposit insurance system.

Premium categories and assignment of premium rates

Deciding on the number of premium categories is an important consideration when designing a differential premium system. Some

[11] *Although information may not be collected by safety-net participants (i.e. supervisory, regulatory, monetary or deposit insurance authorities), it may already be collected by banks for financial reporting purposes, or risk management purposes.*

insurers (e.g. the FDIC and CDIC (Taiwan)) use up to nine premium categories while others (e.g. Canada) use four categories. In Argentina and France, discrete categories are not used. Instead, the premium charged is a continuous function linked to the risk profile of the bank.

Using a large number of categories has the advantage in that it may result in less significant premium distinctions between categories and could provide greater risk differentiation between banks. This can allow the insurer to more easily differentiate banks according to their rating and can be beneficial in situations where there are a large number and variety of banks to categorize. In addition, using more premium categories (with smaller rate differentials between them) could potentially result in fewer requests for category review from banks. On the other hand, a large number of premium categories can increase the complexity of the system. As well, it may reduce the significance of, and therefore the incentive for, banks to move from one premium category to another.

Another issue related to the number of premium categories is the range of results that determine each category. It is acknowledged that any range selected must be arbitrary to some degree. However, banks receiving the best category (low risk) should be placed in the lowest premium categories and those receiving the worst results (high risk) should warrant classification into the highest. The remaining categories should be distributed between the highest and lowest. In summary, the objective should be to have different premium categories - given the size and number of banks - to ensure there is a meaningful distinction between premium categories to act as an incentive for banks to improve their risk profile.

In determining premium rates to apply to categories, rates should be set to ensure that the funding requirements of the deposit insurance system are met and to provide effective incentives for the sound risk management of banks. An initial step would be to determine the overall funding requirements of the deposit insurer and the premium revenue required.[12] In most instances, countries implementing a differential premium system have had as the primary objective the introduction of better incentives for banks rather than using the system to increase overall premium revenue. In fact, the total premium revenue required may even be lower in the long run under a differential premium system due to the expected positive incentives provided to banks to improve their risk management practices. As part of this incentive process, all banks should be charged a premium, even if very low, as all banks should pay the cost of deposit insurance since they and their clients directly benefit from having an effective deposit insurance system and every bank, no matter how healthy and strong, poses some risk to the deposit insurer.

In order to help assess the correct premium rate to charge for each category, some differential premium systems have conducted simulations, which apply rates to the different categories to determine the impact on overall premiums collected and the relation this has to the total funding requirements of the insurer. Finally, the spread between the various premium categories should be as wide as possible to provide a meaningful incentive for banks to improve their risk management practices.[13]

A remaining issue is whether each bank should be rated individually or the same category should be assigned to all parent/subsidiary member banks in a group. Under a number of differential premium systems, the bank subsidiaries receive the same category as the parent bank. However, where two or more related banking institutions are controlled by a shareholder that is not a deposit insurance system member, their categories should be determined separately.

Transition issues

A well-managed transition process can help contribute to the success and acceptance of a differential premium system. One of the first steps in ensuring a successful transition is to have a clear plan which sets out the transitioning objectives, responsibilities, resource requirements, timetable and deliverables. The transition plan should be communicated to all interested parties. As part of the plan, a number of deposit insurance systems have provided for a consultative process to accompany changes to the policy or legislative framework affecting the scheme. This can be done as a matter of law or as a matter of administrative process. The consultation process and resulting period is most often influenced by the complexity of the proposed differential premium system.

With respect to timing, a transitional period can enable banks to familiarize themselves with the elements of a differential premium

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[12] *For more information in this area, please refer to work by the Financial Stability Forum (2001).*

[13] *In cases where a high proportion of insured deposits are with a small number of large banks, the movement of a bank between categories could lead to substantial changes in total premium revenue for the insurer. Thus, in order to reduce this variability the premium spread between categories may have to be limited in such circumstances.*

system and provide an opportunity to further improve their financial results and risk management practices. A transitional period can also provide the deposit insurance entity with time to validate or fine tune the differential premium system. Transition periods generally range from one year to a number of years. The advantage of a longer transition period is that it gives banks more time to adjust to the new system (e.g. develop new reporting systems where necessary and improve performance on the measurement criteria) and the deposit insurer to adjust and fine tune its own resources, skill sets, and information systems. Generally, the more complex the differential premium system and the more demanding are its information requirements, the greater the adjustment period required.

Lastly, the adoption of differential premium systems may raise the issue of the potential destabilizing effects of imposing higher premiums on already troubled banks. One approach to dealing with this issue is to implement the differential premium system in stages with advance warning of when and how the stages will be introduced. To cushion the adjustment for banks in weak categories, a transition period where virtually all banks receive favourable treatment to place themselves in low premium categories, could be considered. This has the advantage of reducing the initial impact of a premium increase for troubled banks but it still provides them with incentives to improve their category ratings over time.[14]

Transparency, disclosure and confidentiality

The degree of transparency, the extent of public disclosure and confidentiality of ratings need to be addressed when developing a differential premium system. Practices in these areas vary between countries and can be influenced by the culture, legal system, the size, state and level of development of the financial system and prior experience with troubled banks.

Transparency refers to the process by which information on a system and its actions is made available and understood by participants. Ensuring that the differential premium system is as transparent as possible and disclosing information on a timely, consistent and accurate basis can enhance accountability, sound management and the functioning of the system.

The extent of public disclosure of premium categories or ratings can have a major impact on the system's effectiveness. Disclosing the results of a bank's differential premium category rating publicly can enhance discipline and provide additional incentives for banks to improve their future results. However, disclosure can have negative consequences such as those associated with disclosure of bank-specific information to the public and associated premium categories. In cases where a bank is encountering serious problems (and such are reflected in its differential premium assessment) such disclosure could exacerbate resolution efforts and erode confidence in the financial system. Although insured depositors may not have strong incentives to use such information, uninsured depositors and other creditors may withdraw funds from an institution suffering a poor rating. It should be recognized that the information used for assigning differential premiums is usually based on a specific point in time. Thus, it would be misleading to depositors and others, as well as unfair to the bank, to imply that a premium classification assigned perhaps months earlier is an accurate reflection on a bank that may have already taken steps to improve its premium classification in the next assessment cycle. Finally, disclosure could also increase the legal liability of the deposit insurance entity, and supervisory and regulatory authorities.

On the opposite end of the spectrum, highly rated banks may use the disclosure of their ratings to attract more deposits and other business to themselves. And, faced with the prospect that their rating (and individual components) may be disclosed; they may be reticent to support the introduction of such a premium scheme.[15]

In addition, many deposit insurance entities do not collect directly the information that is needed for the differential premium system and must rely on supervisors or regulators to provide them with this information. In these cases, decisions on disclosure will have to take into account the policies of the authorities and any confidentiality provisions related to the disclosure of information which has been received from banks.[16]

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[14] To facilitate the adoption of its differential premium system, CDIC (Canada) introduced a transitional mechanism for the first two years of its scheme. In the first year of the transition period, the total quantitative score of each bank was adjusted upward by 20 percent. In the second year, the total quantitative score of each bank was adjusted upward by 10 percent. In the third year and thereafter, there were no such adjustments.

[15] The use of coinsurance by a deposit insurance system has implications for disclosure and confidentiality. It can be argued that in situations where only a pre-specified proportion of deposits are insured, extensive information needs to be provided to the public regarding the financial condition of banks.

[16] It should be noted that in some countries securities regulators may require the disclosure of deposit insurance premium payments and any material increases in such payments. Thus, sophisticated individual investors and rating agencies may be able to surmise differential premium categories and changes in ratings from such disclosed information.

For these types of reasons, designers of differential premium systems need to determine the appropriate balance between the desire to promote accountability, discipline and sound management through disclosure and the need to ensure confidentiality. Some systems have sought a balance with a policy of partial transparency (e.g. Taiwan, the United States and Canada). That is, at a minimum the basic framework of the system and the factor criteria used are disclosed to the public but the actual ratings or premium categories are only disclosed to the board of directors and management of the bank. In such cases, banks are prohibited from disclosing their premium category and any rating (or rating component) on which that classification is based. At present, no deposit insurance system in existence publishes these ratings.

Review, updating and fine-tuning of a differential premium system

Given the potential financial impact of differential premium rates for banks, it would be expected that some banks may wish to provide amended information or even disagree with or contest their assigned categories or ratings. While ensuring that the system is transparent and well accepted by industry may lessen the potential for disagreements, a formal process to review potential disagreements should be implemented to resolve any disputes.

An approach used in some countries is for banks wishing to have their category reviewed to submit their requests for review. An administrative law process can be followed to formally review information and results. If a case can be made based on the evidence, then the category could be amended.[17] Other countries may choose to use informal approaches to review categories. The degree to which a formal or informal review process is used, and the nature of the process, will depend on the specific characteristics of the country and its legal system.

It should also be recognized that no differential premium system is ever perfect and experience gained operating the system can provide opportunities for improvement and fine-tuning. A differential premium system can benefit from the continuous and regular review of operational experiences. Some countries even conduct scenario testing.

Lastly, changes in the objectives of a differential premium system, industry structure, reporting requirements, approaches to supervision and examinations and international developments, may require a system to be updated and modified over time. For instance, indicators of risk can and do gain or lose significance over time and thus may be dropped, added or be weighted differently. As an example, changes in international standards in areas such as capital measurement (e.g. Basel II) can also lead to a reassessment and modification of differential premium systems employing such measures. Thus, differential premium systems need to be regularly re-assessed on their effectiveness and efficiency in meeting their objectives. If necessary, differential premium systems need to be up-dated and/or revised to meet changing conditions or requirements.

Conclusions and key points of guidance

The following points of guidance summarize the main conclusions and suggestions arrived at by IADI to help policymakers design, implement and continually assess differential premium systems. These points are reflective of, and adaptable to, a broad range of circumstances, settings and structures.

1. Objectives of a differential premium system

The first step in designing a differential premium system is to identify the objectives that it is expected to achieve. The primary objectives of differential premium systems should be to provide incentives for banks to avoid excessive risk taking and introduce more fairness into the premium assessment process.

Differential premium systems are most effective at achieving these objectives when they provide good incentives for banks to manage their risks and when they are accompanied by effective early warning systems and prompt corrective supervisory action to deal with problem banks.

2. Situational analysis against conditions

Before establishing a differential premium system it is important to undertake a situational analysis to self-assess the state of the economy, current monetary and fiscal policies, the state and structure of the banking system, public attitudes and expectations, the strength of prudential regulation and supervision, the legal framework,

[17] *This process would typically include the deposit insurance entity and may include the supervisory or regulatory authority depending on the role they play (e.g. the provision of examination ratings or information) in the differential premium system.*

and the soundness of accounting and disclosure regimes.

Policymakers have a wider range of options available for designing a differential premium system if these regimes are sound. In some cases, conditions may not be ideal and, therefore, it is important to identify gaps between existing conditions and more-desirable situations and thoroughly evaluate available options, since the establishment of a differential premium system is not a remedy for dealing with major deficiencies.

3. Approaches used to differentiate bank risk

The approach used to differentiate risk among banks and assign premiums should be: (1) effective at differentiating banks into appropriate risk categories; (2) utilize a wide variety of relevant information; (3) be forward looking; and, (4) be well accepted by the banking industry and financial safety-net participants.

4. Authority, resources and information requirements

a) The adoption of differential premium systems requires policymakers to ensure that the deposit insurance authority has the necessary authority, resources and information (i.e. consistent, accurate and verifiable) in place to administer the system appropriately.

b) A balance needs to be struck between requiring necessary information for the classification of banks into premium categories and concern that the demands of the system not be unduly burdensome to banks.

c) In cases where the deposit insurance entity does not directly gather information but relies on the supervisor, formal agreements need to be in place to ensure that information required for administering the differential premium system is collected, verified for accuracy, and transmitted on a timely basis.

d) The information used for differential premiums needs to be validated to ensure that it is accurate and consistent among banks and over time. This may require that reporting standards be established and that information be verified through on-site means. The use of previously audited information can also help contribute to the accuracy of the differential premium system and reduce unnecessary administrative and reporting burdens on member banks.

e) The period for premium assessment should reflect the most current bank risk profile.

5. Premium categories and assignment of premium rates

a) With respect to deciding on the number of premium categories, the objective should be to have different premium categories - given the size and number of banks - to ensure there is a meaningful distinction between premium categories to act as an incentive for banks to improve their risk profile.

b) In determining premium rates to apply to categories, rates should be set to ensure that the funding requirements of the deposit insurance system are met and to provide effective incentives for the sound risk management of banks.

6. Transition issues

a) A well-managed transition process can help contribute to the success and acceptance of a differential premium system. An effective transition plan should set out the transitioning objectives, responsibilities, resource requirements, timetable and deliverables. The plan should be communicated to all interested parties prior to the beginning of the process.

b) The use of a transition period for banks and the deposit insurance entity can help facilitate the transition process. Generally, the more complex the differential premium system assessment criteria and the more demanding its information requirements are, the greater the adjustment period required.

7. Transparency, disclosure and confidentiality

a) The bases and criteria used in a differential premium system should be transparent to banks and all other participants.

b) Designers of differential premium systems (as well as all other financial safety-net participants) need to determine the appropriate balance between the desire to promote accountability, discipline and sound management through disclosure and the need to ensure confidentiality of information.

8. Review, updating and fine-tuning of a differential premium system

a) Given the potential financial impact of differential premium rates for banks, it would be expected that banks might wish to provide amended information or even disagree with or contest their assigned scores. Therefore, a formal process to review potential disagreements should be implemented to resolve any disputes.

b) Differential premium systems need to be regularly re-assessed on their effectiveness and efficiency in meeting their objectives. If necessary, they should be up-dated and/or revised to meet changing conditions or requirements.

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How can your bank serve you better?

I have often wished that my bank had enough seats for the elderly like myself or that they have a courtesy lane where senior people don't have to line up with the very many people who pay their bills. I heard from my sister that other banks have Senior Citizen lanes. I hope this becomes mandatory for all banks as my feet are no longer as strong as they used to be.
- Libertad Canlas, 61, Senior Citizen, Mexico, Pampanga

I hate wasting so much time cueing in banks. I think if certain banks normally expect a huge influx of clients, they should have more tellers. I particularly get so irked when bank tellers get gossipy that they delay transactions. Also, I think it would be best if people who are there to pay bills have separate lines from those who need to do actual bank transactions. Banks nowadays are just too crowded for comfort. ***- M. Remir Macatangay, 26, Law Student, University of the Philippines***

How can my bank serve me better? By being more generous on the rewards points especially for clients who regularly update their accounts or for clients who pay their credit card bills regularly. Also by making their online transactions more secure (because I feel it it's not that secure) and for giving assistance to clients if they are going through system upgrade and maintenance. A two to three day notice that ATM machines will be inaccessible will be very helpful to customers (note to BPI).
- Celeste dela Torre, 27, Assistant Editor, Dempa Philippines

"Sana may sariling pila para sa senior citizen. *Nahihirapan ako mag-withdraw pag maraming tao. Sumasakit ang likod ko sa kahihintay."* (I wish that my bank has a teller solely for senior citizens. When I make a withdrawal on "peak hours," or when the bank is jam packed with depositors, waiting in a long line is very stressful for me. It's taking a toll on my back")
- Remedios Tondo, 68, senior citizen, Antipolo City

"Sana itaas ng kaunti 'yung interes. Napakaliit ng interes. Hindi nga maramdaman eh. Kung itataas and interes palagay ko ma-e- encourage ang mga tao na magdeposito sa bangko." (I hope they increase their interest rates. Prevailing interest rates are so low you could hardly feel its effect on your savings. If banks would raise interest rates, then I think this will encourage the public to save their money in banks.) ***- Danilo Talamisan, 54, Church Worker, Antipolo City***

"Tanggalin dapat 'yung ATM charges. *Mag* balance inquiry *ka, sisingilin ka ng* P5.00 o P8.00. *Mag* withdraw *ka, panibagong* P5.00 o P8.00. *Sana tanggalin na 'yung pag*-charge *sa* ATM *kasi maliit na nga sweldo ko babawasan pa nila."* (It would definitely help if banks do away with ATM charges. If you inquire on your balance, the ATM automatically deducts P5 or P8 from your account. If you make a withdrawal afterwards, the ATM will deduct another P5 or P8. I hope banks do away with ATM charges. My salary could hardly make ends meet. ***- Mark Caña, 41, Filshutters Pilipinas***

I hope my bank can develop loans with depositor-friendly interest rates. Plus, I am thinking it would be interesting if new types of loans will be offered aside from the usual housing and auto loans; probably something leaning towards medical/ healthcare. On a lighter note, I hope bank tellers don't have favorite clients. I have seen tellers attend to their friends first despite the long lines. This can be very annoying. ***- Ma. Edelita Gino, 27, Information Officer, Civil Service Commission***

My concerns are mainly related to credit cards. First, I hope they impose reasonable penalty charges. Second, I hope they give a grace period after the payment due date- of say three more days. Third, I want protection against credit card fraud. I've been charged with stuff that I did not purchase and all the bank could tell me is that I should be more careful next time. Finally, I hope they can give freebies to those with lower credit card points.
- Mary Ann S. Fabila, 31, Public Relations Officer, Civil Service Commission

Better financial instruments that allow would-be entrepreneurs to loan out for small-scale industries at the same time offering packages for small-scale savings. There is a need to encourage a savings culture instead of easy-consumer-credit-facilities. ***- Jane Buenaventura, 26, South East Asia Market Analyst, London***

Well, for starters, extend operating hours. I think some banks are open from 9am until 7pm... It would be nice if banks were open until 5pm... Specially if your signatories are hard to find... another would be to add more tellers... usually there are only two tellers open and when one goes on break, the line gets so long...
- Christine Eleosida, 27, Administration Officer, Quezon City

Banks should at least send the depositors an updated bank statement and inform us if our balance fell below the minimum requirements. This way, we would not get shocked knowing our accounts deducted of penalties and surcharges. Depositors must be to be informed of any deductions in our accounts. ***-Generosa Jimenez, 68, Karuhatan, Valenzuela***

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