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Bank Non-Performing Loans (NPLs) Management and Resolution: The Case of the Philippines

Workshop on NPL Resolution in Asia and Europe

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10 February 2020, Monday
ADB Headquarters Manila



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This Presentation

- 1 Bank Non-Performing Loans (NPL) Management and Resolution in the Philippines**
 - Legal Framework
 - Regulatory Framework
- 2 BSP Policies and Measures**
- 3 NPL Trends and Developments**
 - Bank NPL Level and Structure
 - Some Reasons Behind Recent Increase in Bank NPL
- 4 Conclusion**



Asian Financial Crisis

- crippled a number of banking systems in the region because of elevated NPLs
- NPL ratio of the Philippine banking system that ranged from 3.0 percent to 3.4 percent in the first half of 1997 peaked at 18.6 percent in 2001
- high levels of NPLs called for the enactment of critical legislative measures to clean up the balance sheets of banks



Special Purpose Vehicle (SPV) Law or Republic Act (R.A.) No. 9182

- Enacted into law on December 2002 and became effective on April 2003
- Provides regulatory framework for granting fiscal incentives to asset management companies (AMCs) or special purpose vehicles (SPVs) that purchase the non-performing assets (NPAs) of banks at a discount
- Incentivized NPA transfers via tax exemptions and fee privileges
- Prohibits banks themselves from owning more than 5% of any AMC that purchases bad loans and assets
- Powers of SPV:
 - i. Primary—Invest and acquire NPAs of financial institutions (Fis)
 - ii. Secondary—Engage 3rd parties to manage, operate, collect and dispose NPAs; Rent, lease, hire, pledge, mortgage, transfer sell, securitize, collect rents and profits concerning NPAs

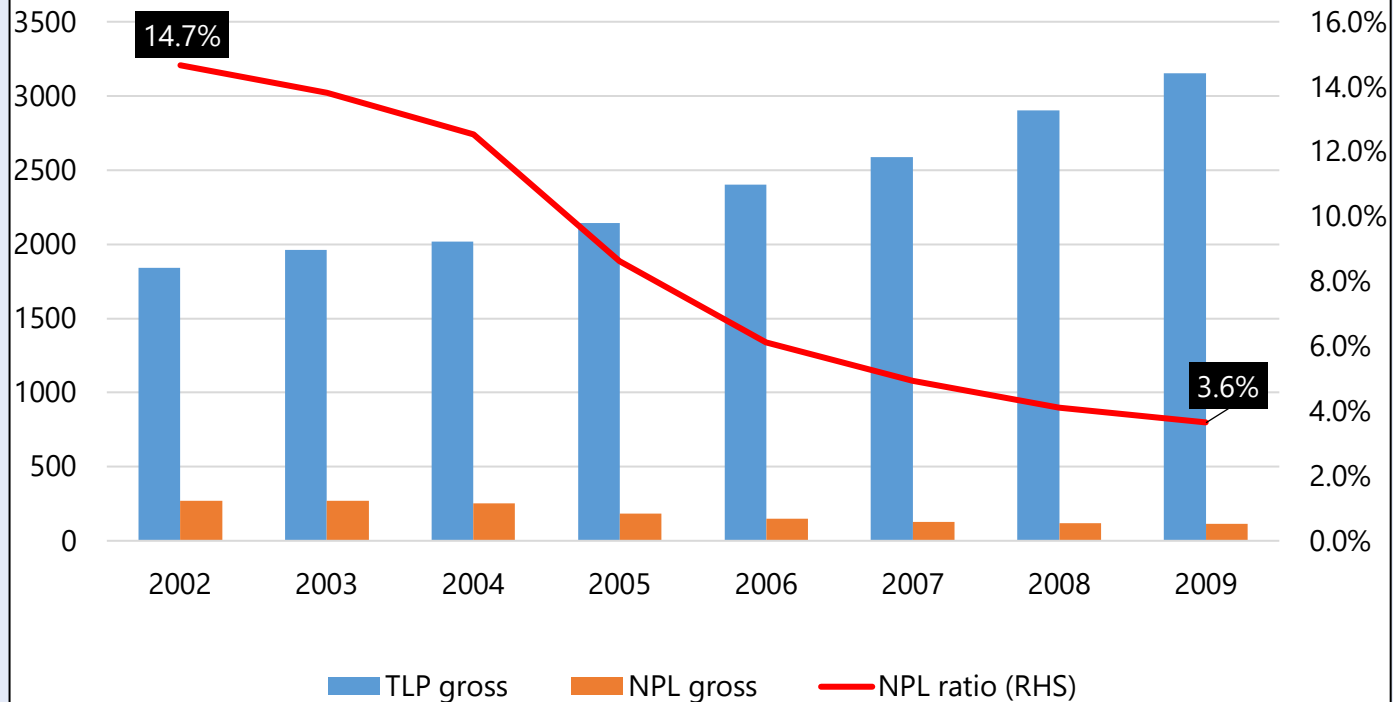


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NPL significantly improves amid continued credit expansion

Figure 1. Philippine Banking System: Total Loan Portfolio and Non-Performing Loans

From end-2002 to end-2009



Source: BSP Website

- *NPL ratio of the Philippine banking system showed remarkable improvement from 14.7 percent as of end-December 2002 down to 3.6 percent as of end-December 2009*
- *The BSP adoption of the Basel standards and continuous regulator reforms and initiatives on credit risk-taking activities of the banking system largely contributed in the significant decline in NPL ratio of the banking system*



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Securitization Act of 2004 (R.A. No. 9267)

- Provides legal and regulatory framework for securitization to implement the policy of the State to promote development of capital market by supporting securitization and creating favorable market environment for a range of asset-backed securities



The General Banking Law of 2000 (R.A. No. 8791)

- Provides legal ground for banking reforms including enhancement of supervisory capability of the BSP, improvement of prudential standards and regulatory standards, and competition in the industry



- **Circular No. 855 – Guidelines on Sound Credit Risk Management Practices**
 - A. Establishing an Appropriate Credit Risk Environment
 - Critical role of ***Board of Directors and Senior Management*** in promoting a prudent and sound credit environment
 - B. Operating Under a Sound Credit Granting Process
 - Emphasize ***“capacity-to-pay”*** in determining borrower’s creditworthiness
 - C. Maintaining an Appropriate Credit Administration, Measurement and Monitoring
 - ***Internal Risk Rating System***

- **Circular No. 855 – Guidelines on Sound Credit Risk Management Practices**

- D. Maintaining an Appropriate Credit Control Process

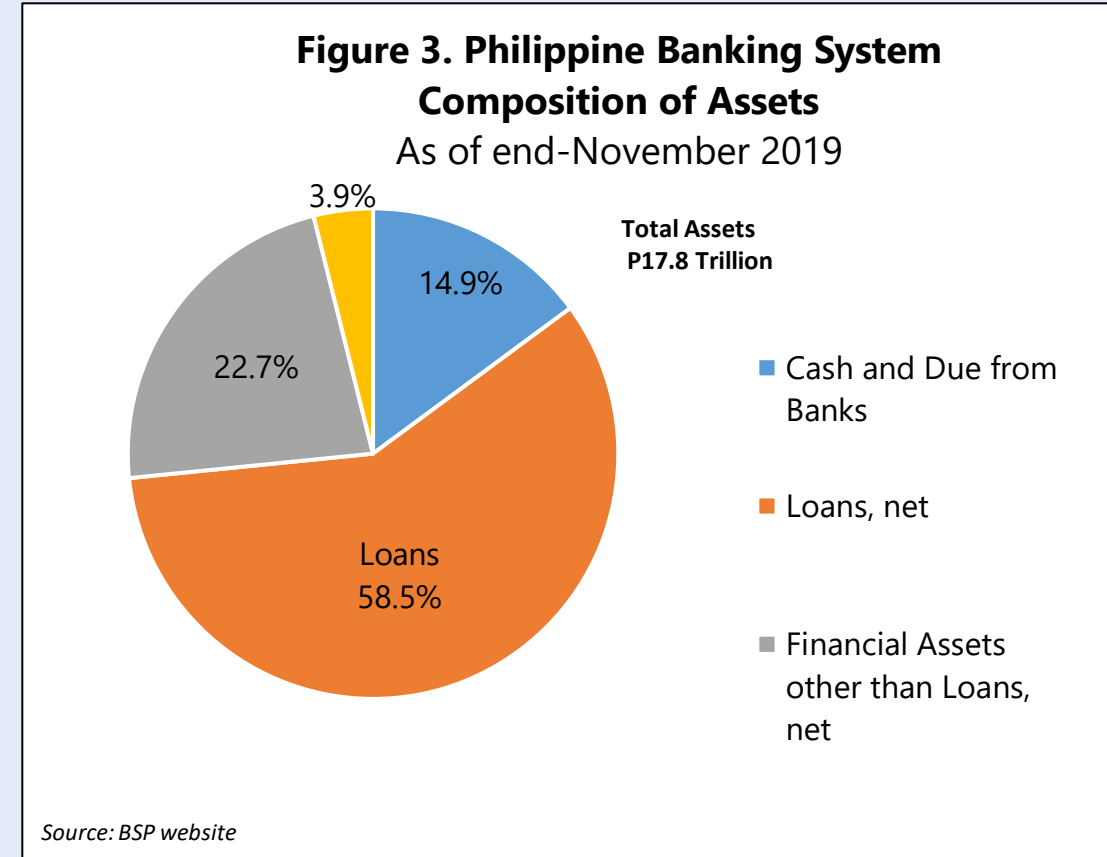
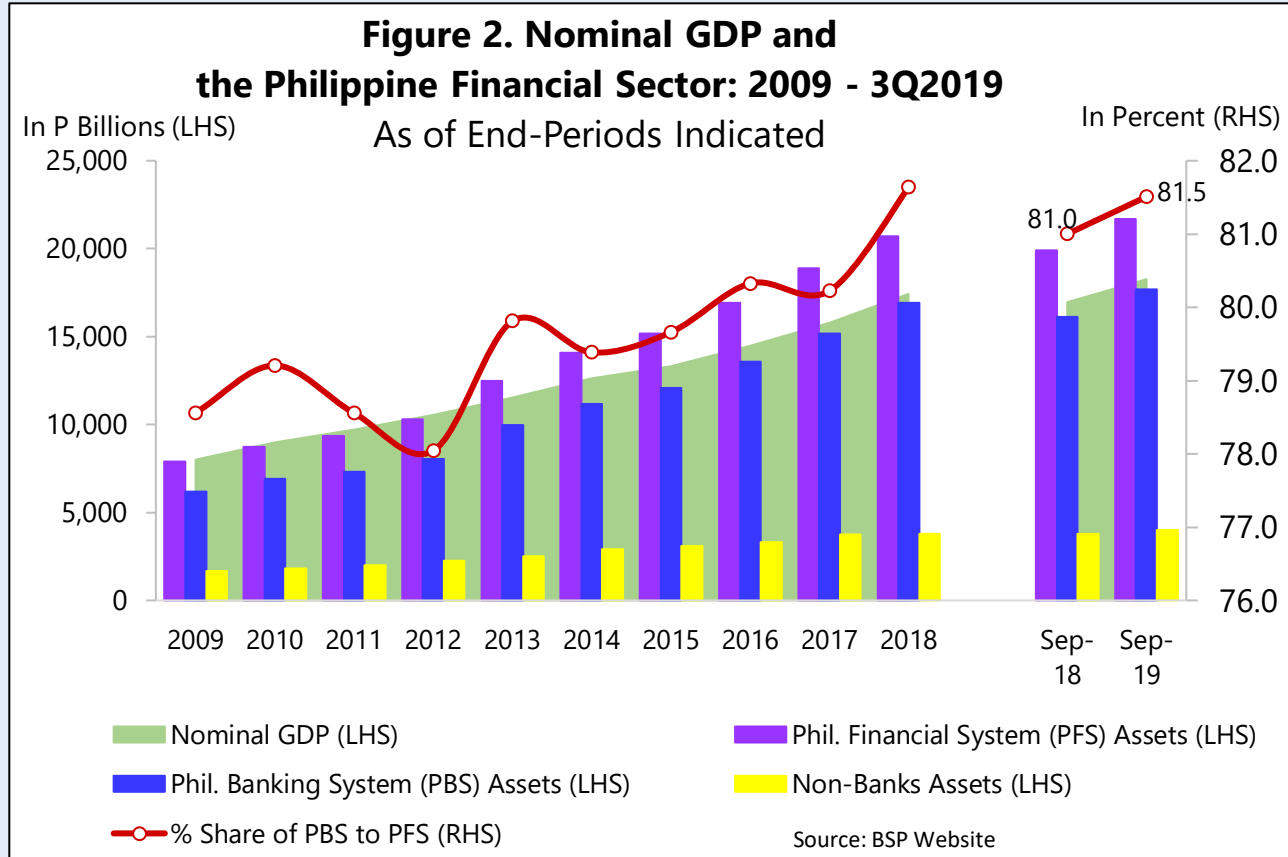
- Early identification and intervention to maintain quality of portfolio, prevent further deterioration and minimize losses
 - ***Sound Loan Loss Estimation Methodology***
 - Well-defined criteria for write offs

Key BSP Policies and Measures

- **Circular No. 941 – Redefinition of Past Due and Non-Performing Exposures**
 - ***Past Due*** – accounts that does not pay on contractual due date
 - FIs may provide cure period
 - ***Non-Performing*** – accounts that are deemed impaired, classified as doubtful/loss, in litigation and/or full repayment is unlikely without foreclosure of collateral
 - even without any missed payments
- **Circular No. 1011 – Philippine Financial Reporting Standards (PFRS) 9**
 - **ECL Model** – early recognition of allowance for credit losses even before default or non-payment of the borrower
 - considers historical information and future economic conditions

- **Enforcement Action** – early intervention to address supervisory concerns and issues
 - A. Corrective Actions**
 - BSP directives – to be undertaken within a prescribed timeline
 - Letter of Commitment – written commitment by the Board of Directors
 - B. Sanctions** – proportionate to gravity of the offense
 - C. Other enforcement actions such as:**
 - Initiation to Prompt Corrective Action (PCA) framework
 - Issuance of Cease and Desist Order (CDO)
 - Conservatorship
 - Placement under Receivership

3 Philippine banking system sustains its growth alongside a growing economy



➤ The country's growth momentum was supported by the Philippine Financial System

➤ Bank assets were mostly deployed to lending activities, as loans continue to hold a sizeable share at 58.5 percent of the banking system's total assets, followed by investments at 22.7 percent

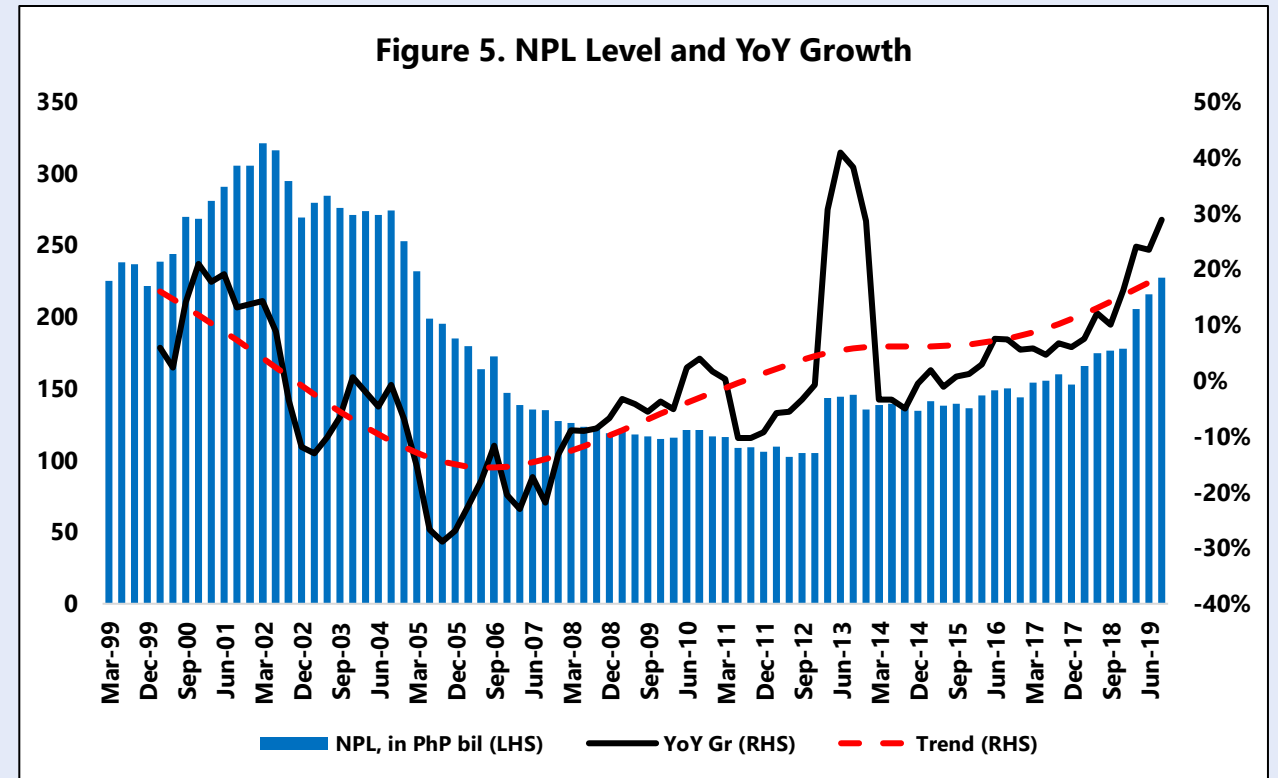
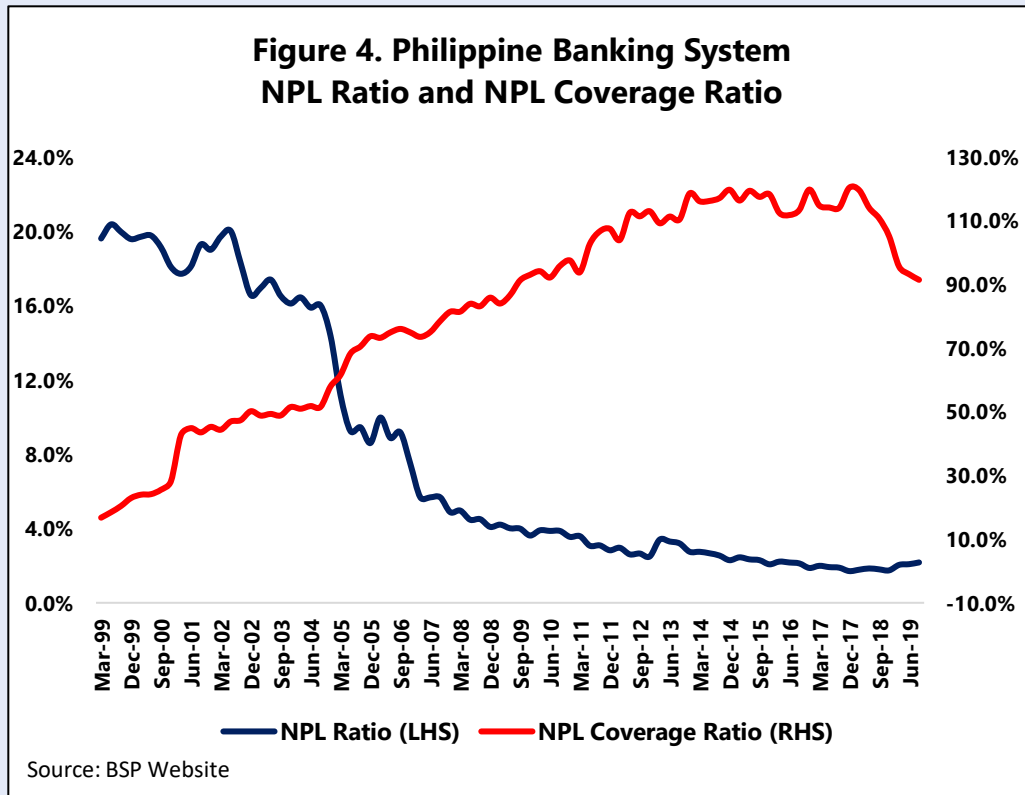


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3

Loan quality continues to be satisfactory amid growth

Post-Asian Financial Crisis, banking system NPL ratio declined significantly, loan loss provisions increased



- *NPL ratio stable in past years, allowance for credit losses saw a sharp decline starting 2018*
- *Increases in NPLs in recent periods can be attributed to the "stricter" definition of past due and non-performing loans beginning 1 January 2018 and adoption of PFRS 9**

- *NPL level remained well-below pre-2005 levels, albeit YoY growth above trend since Dec 2019*

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Loans remain broad-based across industry and borrowers

Loans to Individuals comprise the majority of NPLs, followed by manufacturing and real estate activities

Figure 6. Composition of NPL by Economic Activity

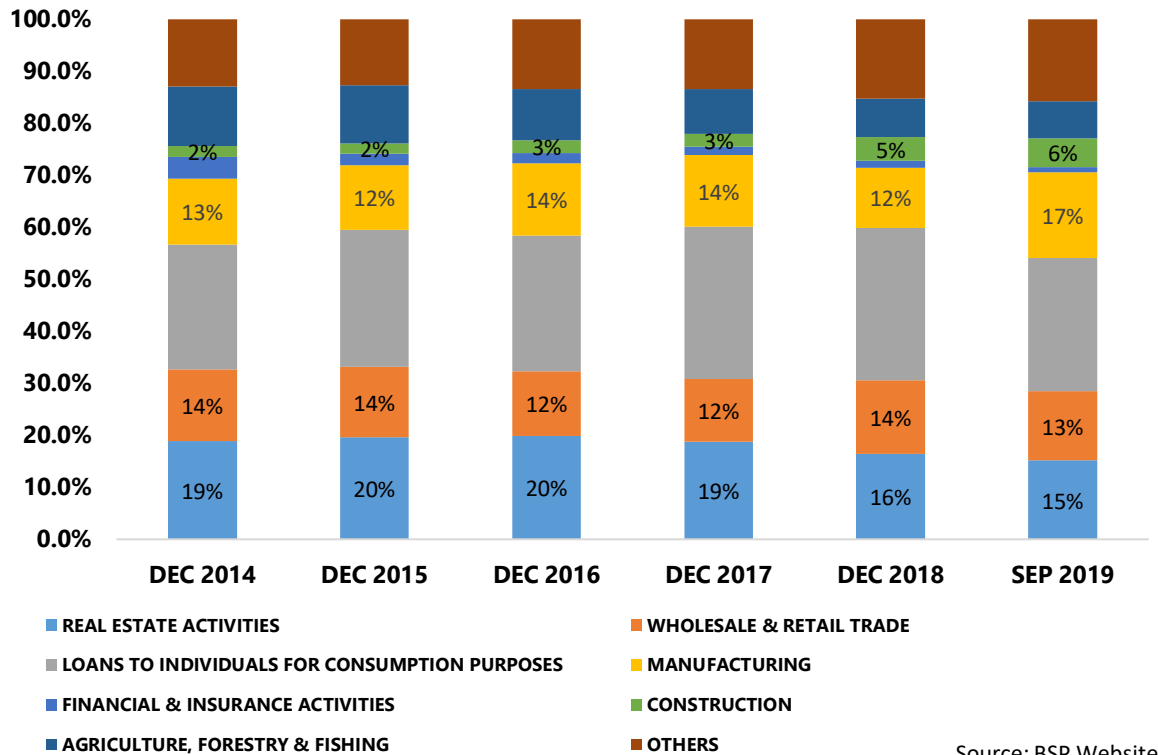
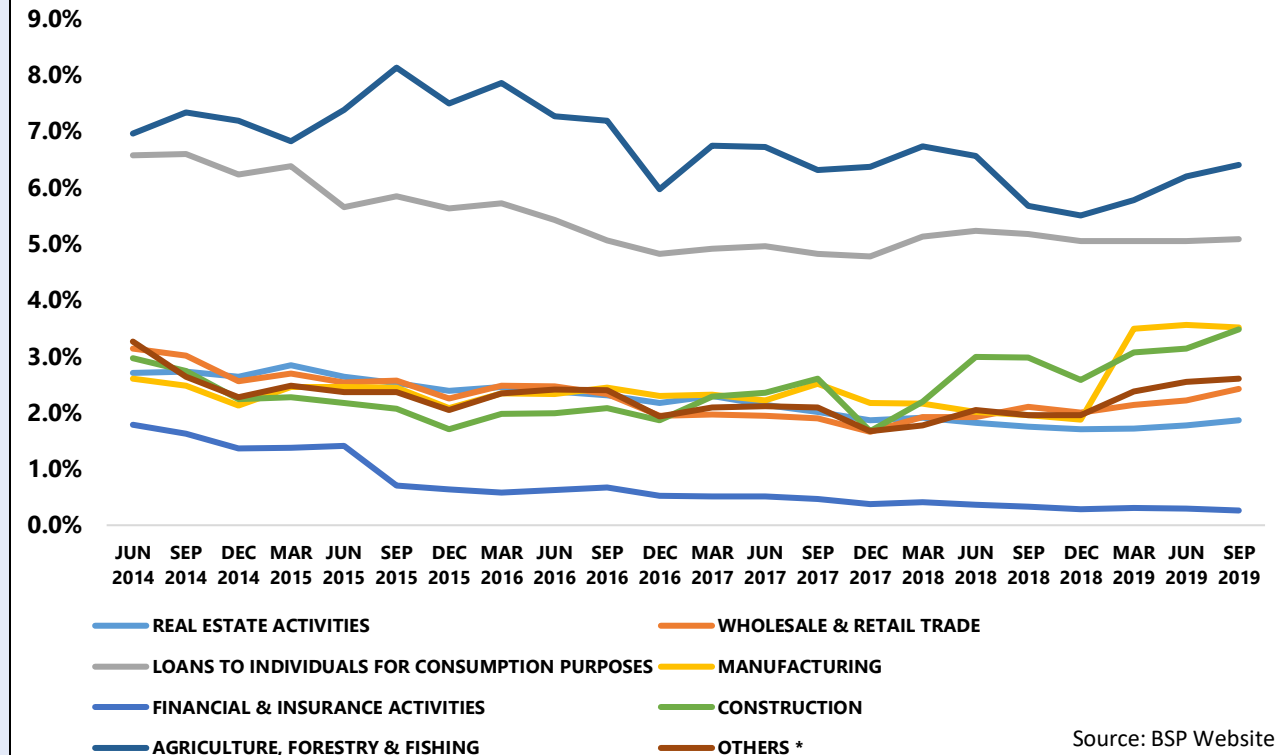
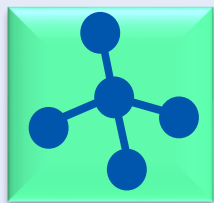


Figure 7. NPL Ratios by Economic Activity

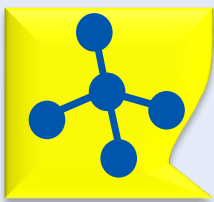


- Construction in a steady increase in share, while manufacturing saw an uptick in 2019.
- Real estate activities steadily declined in share

- Agriculture and Loans to Individuals register the highest ratios, construction and manufacturing saw an uptrend in 2019
- Increases in NPLs were largely driven by the upticks in the manufacturing sector as well as loans for household consumption of UBs/KBs



- The process of bringing down the level to within manageable range likewise entails structural reforms banking industry and in the regulatory and supervisory frameworks.



- The passage of the General Banking Law of 2000 has equipped the BSP with a range of supervisory tools to proactively address potential build-up of problem accounts in the industry.



- The adoption of an effective end-to-end credit risk management system underpins the effective management of non-performing assets.



- Asset quality of the Philippine Banking System remains satisfactory. Nonetheless, the BSP shall continue to remain vigilant in monitoring the asset quality of the banking system.



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