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Regulatory framework

1 What are the principal governmental and regulatory policies that govern the banking sector?

The government recognises the vital role of banks in providing an environment conducive to the sustained development of the country's economy. Accordingly, it is the government's policy to promote and maintain a stable and efficient banking system that is globally competitive, dynamic and responsive to the demands of a developing economy.

2 Summarise the primary statutes and regulations that govern the banking industry.

The General Banking Law governs not only universal banks but also commercial banks. Section 71 thereof provides that the organisation, ownership, capitalisation and powers of thrift banks (composed of savings and mortgage banks, stock savings and loan associations, and private development banks), rural banks, cooperative banks, and Islamic banks, as well as the general conduct of their businesses are governed by the Thrift Banks Act, the Rural Banks Act, the Philippine Cooperative Code and the Charter of Al-Amanah Islamic Investment Bank of the Philippines respectively. However, the General Banking Law applies to thrift banks and rural banks, insofar as it is not in conflict with the provisions of the special laws governing such banks. On the other hand, the Philippine Cooperative Code recognises the primacy of the General Banking Law in the regulation of cooperative banks.

The rules implementing the above statutes are embodied in the Manual of Regulations for Banks issued by the Bangko Sentral ng Pilipinas (BSP), the Philippine central bank. From time to time, additional circulars and other issuances are promulgated by the BSP to cover new matters, if not to amend, repeal, supplement, or otherwise modify existing rules.

3 Which regulatory authorities are primarily responsible for overseeing banks?

The BSP, through its Monetary Board, is primarily responsible for overseeing banks. The Philippine Deposit Insurance Corporation (PDIC) can also conduct examination of banks, with the prior approval of the Monetary Board, provided that no examination can be conducted by the PDIC within 12 months of the last examination date.

4 Describe the extent to which deposits are insured by the government. Describe the extent to which the government has taken an ownership interest in the banking sector and intends to maintain, increase or decrease that interest.

Banks must insure their deposit liabilities with the PDIC. Each depositor is a beneficiary of the insurance for a maximum amount of 500,000 Philippine pesos or its foreign currency equivalent.

There are very few remaining government-owned or controlled banks, owing to the government's privatisation programme.

5 Which legal and regulatory limitations apply to transactions between a bank and its affiliates? What constitutes an 'affiliate' for this purpose? Briefly describe the range of permissible and prohibited activities for financial institutions and whether there have been any changes to how those activities are classified.

The grant of loans and other credit accommodations by a bank to its DOSRI (directors, officers, stockholders and their related interests) is regulated. Corporations in which the lending bank owns at least 20 per cent equity are considered as affiliates, which are deemed 'related interests' of such bank. DOSRI loans must be approved by the board of directors of the lending bank and granted upon terms not less favourable to the bank than those offered to non-DOSRI borrowers. Core banking consists of deposit taking and lending. In particular, commercial banking includes:

- accepting drafts;
- issuing letters of credit;
- discounting and negotiating promissory notes, drafts, bills of exchange, and other evidence of debt;
- accepting or creating demand deposits;
- receiving other types of deposits, as well as deposit substitutes;
- buying and selling foreign exchange, as well as gold or silver bullion;
- acquiring marketable bonds and other debt securities; and
- extending credit – all subject to pertinent rules promulgated by the Monetary Board.

Universal banking includes the above functions and two additional powers, namely the capacity to invest in enterprises not allied to banking and to underwrite securities. However, no bank in the Philippines can engage in insurance business as insurer.

6 What are the principal regulatory challenges facing the banking industry?

Apart from the regulatory challenge posed by the Basel II and III-based capital adequacy requirements, the constant challenge to the banking industry is to be more dedicated in providing loans and other credit accommodations (including microfinancing) that will foster national development and eradicate poverty.

7 How has regulation changed in response to the recent crisis in the banking industry?

The regulations have not changed significantly but the enforcement thereof has been further reinforced in response to the recent crisis in the banking industry. However, the PDIC charter was amended to increase the insurance coverage from 250,000 to 500,000 Philippine pesos per depositor.

8 In what ways do you anticipate the legal and regulatory policy changing over the next few years?

Over the next few years, the BSP will reinforce its policy of encouraging mergers or consolidations between and among banks. The BSP will increasingly align its regulatory policy with applicable internationally accepted standards, including those of the Bank for International Settlements and the Basel Committee on Banking Supervision. Enhanced compliance by banks with prudential measures prescribed by the BSP will be uppermost in the agenda of the BSP, to promote safer and more sound banking practices.

Supervision

9 How are banks supervised by their regulatory authorities? How often do these examinations occur and how extensive are they?

The BSP examines the books of every bank once every 12 months, and at such other times as the Monetary Board may deem expedient. An interval of at least 12 months is required between annual examinations.

The BSP examiners are authorised to administer oaths to any director, officer or employee of any bank and to compel the presentation of all books, documents, papers or records necessary to ascertain the facts relative to the true condition of such bank.

The PDIC may also examine banks, with the prior approval of the Monetary Board, to determine whether they are engaging in unsafe and unsound banking practices. No examination can be conducted by the PDIC within 12 months of the last examination date. To avoid overlapping of efforts, the PDIC examination considers the relevant reports and findings of the BSP pertaining to the bank under examination.

10 How do the regulatory authorities enforce banking laws and regulations?

Violations of any of the provisions of the General Banking Law are subject to the penalties and other sanctions under the New Central Bank Act.

Any owner, director, officer or agent of a bank who, being required in writing by the Monetary Board or by the head of the supervising and examining department of the BSP, wilfully refuses to file the required report or refuses to permit a lawful examination into the affairs of such bank, will be punished by a fine of between 50,000 and 100,000 Philippine pesos or by imprisonment of not less than one year or no more than five years, or both, at the discretion of the court.

On the other hand, the wilful making of a false or misleading statement on a material fact to the Monetary Board or to the BSP examiners will be punished by a fine of between 100,000 and 200,000 Philippine pesos or by imprisonment of not more than five years, or both, at the court's discretion.

In turn, any person who is responsible for wilful violation of the General Banking Law or any order, instruction, rule, or regulation issued by the Monetary Board will, at the court's discretion, be punished by a fine of between 50,000 and 200,000 Philippine pesos or by imprisonment of not less than two years or no more than 10 years, or both. Whenever a bank persists in carrying on its business in an unlawful or unsafe manner, the Monetary Board may take action for the receivership and liquidation of such bank, without prejudice to the penalties provided in the first sentence of this paragraph and the administrative sanctions provided in the next paragraph.

Without prejudice to the foregoing criminal sanctions against culpable persons, the Monetary Board may impose administrative sanctions for any of the above violations, wilful violation of the charter or by-laws of the bank, any commission of irregularities, or conducting business in an unsafe or unsafe manner as determined by the Monetary Board. These administrative sanctions are as follows:

- fines in amounts as may be determined by the Monetary Board to be appropriate, but in no case to exceed 30,000 Philippine pesos a day for each violation, taking into consideration the attendant circumstances, such as the nature and gravity of the violation or irregularity and the size of the bank;
- suspension of rediscounting privileges or access to the BSP credit facilities;
- suspension of lending or foreign exchange operations or authority to accept new deposits or make new investments;
- suspension of interbank clearing privileges; and
- revocation of quasi-banking licence.

In addition, the Monetary Board can suspend or remove the offending director or officer of a bank. In this respect, the termination (or even the resignation) from office of such director or officer will not exempt him from administrative or criminal sanctions.

Moreover, the erring corporation may be dissolved by quo warranto proceedings instituted by the solicitor general. In this connection, an original quo warranto proceeding may be commenced with the Supreme Court of the Philippines.

11 What are the most common enforcement issues and how have they been addressed by the regulators and the banks?

Enforcement issues mostly relate to compliance by banks with BSP regulations on safe and sound banking practices in connection with the offering and provision of bank services and products.

12 How has bank supervision changed in response to the recent crisis?

See question 7. The BSP has further strengthened its supervision of the banking sector. PDIC deposit insurance coverage was increased from 250,000 to 500,000 Philippine pesos per depositor.

Resolution

13 In what circumstances may banks be taken over by the government or regulatory authorities? How frequent is this in practice? How are the interests of the various stakeholders treated?

As noted in question 20, the Monetary Board may appoint a conservator for a bank that is in a 'state of continuing inability or unwillingness to maintain a condition of liquidity deemed adequate to protect the interest of depositors and creditors'. The conservator will have such powers as the Monetary Board deems necessary to take charge of the assets and liabilities of the bank, manage it or reorganise its management, collect all monies and debts due it and restore its viability. If, based on the report of the conservator or its own findings, the Monetary Board determines that the continuance in business of the bank would involve probable loss to the depositors and other creditors of the bank, the bank would be placed under receivership and eventually liquidated. The PDIC is usually the designated receiver. If the bank notifies the BSP or publicly announces a bank holiday, or in any manner suspends the payment of its deposit liabilities continuously for more than 30 days, the Monetary Board may, summarily and without prior hearing, close the bank and place it under receivership of the PDIC.

The assets of a bank under liquidation are held in trust for the equal benefit of all creditors. The receiver must first pay the costs of the proceedings, before paying the debts of the bank, in accordance with the rules on concurrence and preference of credit under the Civil Code of the Philippines. The shareholders last to receive payment, if any funds remain. The depositors can claim from the PDIC the amount of their insured deposits (see question 12).

14 What is the role of the bank's management and directors in the case of a bank failure? Must banks have a resolution plan or similar document?

The directors and officers of a failing bank must cooperate with the regulators, including the conservator and receiver. The following acts of a director or an officer of such bank are subject to criminal penalties:

- refusal to turn over bank records and assets to the designated receiver;
- tampering with bank records;
- appropriating bank assets for himself or another party;
- causing the misappropriation and destruction of bank assets;
- receiving or permitting or causing to be received in the bank any deposit, collection of loans, or receivables;
- paying out or permitting or causing to be paid out any fund of the bank; and
- transferring or causing to be transferred securities or property of the bank.

In addition, erring directors and officers will be included in the list of persons disqualified by the Monetary Board from holding any position in any bank or financial institution.

No voluntary dissolution and liquidation of a bank can be undertaken without the prior approval of the Monetary Board. For this purpose, a request for Monetary Board approval must be accompanied by a liquidation plan.

15 Are managers or directors personally liable in the case of a bank failure?

The bank's directors and officers who knowingly assent to patently unlawful acts of the bank or who are guilty of gross negligence or bad faith in directing the affairs of the bank or acquire any personal or pecuniary interest in conflict with their duties as such directors or officers, will be liable jointly and severally for all resulting damages suffered by the bank and its shareholders.

16 How has bank resolution changed in response to the recent crisis?

Bank resolution has not changed in response to the recent crisis. There is a legislative bill that seeks to amend the BSP charter by giving the BSP more flexibility in dealing with banking crises, but it is still pending in the Philippine congress.

Capital requirements

17 Describe the legal and regulatory capital adequacy requirements for banks. Must banks make contingent capital arrangements?

The BSP prescribes the minimum level of capitalisation for banks. For instance, a universal bank must have a minimum capital of 4.95 billion Philippine pesos while that of a commercial bank is 2.4 billion Philippine pesos.

In addition, the BSP adopted Basel II-based capital adequacy requirements for universal banks and commercial banks. Thrift banks and rural banks that are not subsidiaries of universal banks or commercial banks continue to be subject to Basel I-based guidelines. In any case, the daily risk-based capital ratio of a bank, expressed as a percentage of qualifying capital to risk-weighted assets, must not be less than 10 per cent for both a solo basis (ie, head office plus branches) and a consolidated basis (ie, parent bank plus subsidiary financial allied enterprises, excluding an insurance company). The qualifying capital is the sum of Tier I (core) capital and Tier II (supplementary) capital, less required deductions. In turn, Tier II capital is the sum of upper Tier II capital and lower Tier II capital, net of required deductions.

Universal and commercial banks have their respective internal capital adequacy assessment process that supplements the BSP's risk-based capital adequacy framework. These banks are responsible for setting internal capital targets consistent with their risk profile, operating environment and strategic plans.

The BSP has targeted the adoption by universal and commercial banks by 2014 of Basel III capital adequacy standards.

18 How are the capital adequacy guidelines enforced?

In case of non-compliance by a bank with the prescribed minimum ratio, the Monetary Board may, until that ratio is met or restored by such bank:

- limit or prohibit the distribution of net profits by such bank, and require that such profits be used, in full or in part, to increase the capital accounts of such bank;
- restrict or prohibit the acquisition of major assets by such bank; and
- restrict or prohibit the making of new investments by such bank, with the exception of purchases of readily marketable evidence of indebtedness of the Philippines and the BSP, and other evidence of indebtedness or obligation to the servicing and the repayment of which are fully guaranteed by the Philippines.

19 What happens in the event that a bank becomes undercapitalised?

If a bank becomes undercapitalised, it may be placed under conservatorship by the BSP, with a view to rectifying the capital deficiency. It may be possible to correct this condition, and the threatened insolvency of the bank may be averted by effective management reforms and infusion of additional capital.

20 What are the legal and regulatory processes in the event that a bank becomes insolvent?

The Monetary Board may first appoint a conservator for a bank that is in a 'state of continuing inability or unwillingness to maintain a condition of liquidity deemed adequate to protect the interest of depositors and creditors'. If conservatorship is not successful or not deemed proper by the Monetary Board, the Monetary Board may summarily forbid the bank from doing business and designate the PDIC as its receiver. If the receiver determines that the bank cannot be rehabilitated or permitted to resume business, the Monetary Board may instruct the receiver to liquidate the bank.

21 Have capital adequacy guidelines changed, or are they expected to change in the near future?

See question 17. The capital adequacy requirements will continue to be based on Basel II guidelines for universal and commercial banks. Eventually, thrift and rural banks must observe those guidelines.

Ownership restrictions and implications

22 Describe the legal and regulatory limitations regarding the types of entities and individuals that may own a controlling interest in a bank. What constitutes 'control' for this purpose?

Control is defined as ownership of more than 50 per cent of the voting stock of a bank.

Update and trends

Universal and commercial banks operating in the Philippines, including local branches of foreign banks, are now bracing themselves for the eventual implementation of Basel III-based capital adequacy requirements of the BSP (see question 17).

Foreign individuals and non-bank corporations controlled by foreign nationals can collectively own up to 40 per cent of the voting stock of a universal or commercial bank. However, Philippine citizens and non-bank corporations controlled by Philippine citizens can collectively own up to 100 per cent of the voting stock of such bank. However, foreign banks may be allowed by the Monetary Board to own 100 per cent of the voting stock of a universal or commercial bank. Up to 60 per cent of the voting stock of a thrift bank may be foreign-owned, but the capital stock of a rural bank is required to be wholly-owned by Philippine nationals. On the other hand, the series 'C' shares of Al-Amanah Islamic Investment Bank of the Philippines, comprising 40 per cent of its capital stock, may be foreign-owned.

23 Are there any restrictions on foreign ownership of banks?

See question 22.

24 What are the legal and regulatory implications for entities that control banks?

Apart from being subject to DOSRI rules, entities controlling a bank are expected to see to it that such bank observes the BSP rules on corporate governance, which are anchored on the principle of transparency, accountability and fairness or equity.

25 What are the legal and regulatory duties and responsibilities of an entity or individual that controls a bank?

See question 24. In respect of transparency, the controlling entity or individual, as a 'principal stockholder' of a bank classified as a 'public company', must disclose the changes in its or his stockholding in such bank, under the Securities Regulation Code.

26 What are the implications for a controlling entity or individual in the event that a bank becomes insolvent?

The controlling entity or individual will not be liable to the creditors of the insolvent bank beyond the amount of its or his equity contribution to such bank.

Changes in control

27 Describe the regulatory approvals needed to acquire control of a bank. How is 'control' defined for this purpose?

Any sale or transfer, or series of sales or transfers, which will result in the ownership or control of more than 20 per cent of the voting stock of a bank by any person, whether natural or juridical, will require the prior approval of the Monetary Board.

28 Are the regulatory authorities receptive to foreign acquirers? How is the regulatory process different for a foreign acquirer?

The regulatory process is not different for a foreign acquirer.

29 What factors are considered by the relevant regulatory authorities in an acquisition of control of a bank?

The BSP will want to know the organisational and financial profile of the acquirer. For instance, a foreign bank acquiring a local bank may be required to be among the top 150 foreign banks in the world or the top five banks in its country of origin. The Monetary Board may also:

- ensure geographic representation and coverage;
- consider strategic trade and investment relationships between the Philippines and the country of incorporation of the foreign bank;
- study the demonstrated capacity, global reputation for financial innovations and stability in a competitive environment of the applicant;
- see to it that reciprocity rights are enjoyed by Philippine banks in the applicant's country; and
- consider the willingness of the applicant to fully share its technology.

30 Describe the required filings for an acquisition of control of a bank.

A written application (together with supporting documents) is to be filed with the BSP for the purpose of acquisition of control of a bank.

31 What is the typical time frame for regulatory approval for both a domestic and a foreign acquirer?

The approval process can be completed within one month.

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