

PRIMER ON THE PHILIPPINE FINANCIAL SYSTEM

I. Brief Overview of the International Financial System

The Philippine Financial System is part of a larger ecosystem in the global economy known as the international financial system. Unlike its other counterpart systems within the international order, e.g. the international trade system, the international financial system (IFS) does not have the substantive principles and hard law foundation that is the bedrock of these other systems that co-exist, work, and overlap with each other in facilitating globalization in the world economy today. Financial regulation and monetary affairs continue to be a soft law-based regime held together by what scholars like Brummer calls reputational, market, and institutional mechanisms but one that has far more coercive force¹ than other similarly-situated regulatory areas because of the operational dependence of domestic regulatory financial institutions and national monetary authorities in the IFS.

As it exists today, the IFS is a complex structure of regulatory rules, global standards, best practices, and guidance documents and commitments that lack formal legality but embody principles strongly persuasive to government institutions, the private sector, and other stakeholders of cross-border money and business transactions. It evolved out of the breakdown of the Bretton Woods System, its downfall historically marked by the beginning of the Petrodollar era when the United States dollar was taken off from the gold standard in the 1970s. Since then, technological developments in information and communication in the last half of the past century and the beginning of this century

¹ BRUMMER, C., “How International Financial Law Works (and How it Doesn’t)”, *The Georgetown Law Journal*, Vol. 99, 257 (2011).

revolutionized the conduct of international finance in much the same way that the explosion of inventions in maritime technology and navigation, such as the caravel and the Mercator projection, kickstarted and revolutionized international trade and commerce as we know it today. Those maritime and navigational technologies made the transition from coastal navigation to oceanic navigation possible, creating maritime trade routes that made movement of goods and people faster, more economical, and efficient than the more expensive, limited, time-consuming, and riskier land trade routes. 21st century information and communication technologies, in the same way that 15th century maritime and navigational technologies bridged the eastern and western parts of the world, connected capital to consumers of credit and accelerated the internationalization of finance.

The development of the existing IFS, however, is not only an outcome of the opportunities of modern technology. It is also a cumulative outcome of the risks posed by the increased interdependence of the economies of countries after World War II. As Giovanoli² would describe it, the IFS is a “child of crises”. The failure of the German bank, Herstatt, in the 1970s, the sovereign debt crisis and the global stock market collapse of the 1980s, the 1997 Asian financial crisis, and the global financial crisis of 2008-2009, among others, significantly changed the existing IFS. For example, the effects of the 1970s collapse of Herstatt bank raised awareness of cross-border risks of increasingly-connected domestic financial systems. Because of this, the Bank of International Settlements (BIS) in Basel, Switzerland, spearheaded the discussion of these cross-border risks among the leading countries of that period. The result is the establishment of the Basel Committee on Banking Supervision (BCBS) in 1974 which, since 1996, leads the Joint Forum of international financial regulators together with the

² GIOVANOLI, M., “The Reform of the International Financial Architecture after the Global Crisis”, *University of Pennsylvania Journal of International Law*, Vol. 29, No. 2 (2007).

International Organization of Securities Commissions (IOSCO) and the International Association of Insurance Supervisors (IAIS), comprise the Joint Forum of International Financial Regulators. The Committee on the Global Financial System of the BIS works with central monetary authorities in identifying and responding threats to domestic financial markets and the global financial system while the Committee on Payment and Settlement Systems, established in 1990, works with the same central monetary authorities in monitoring, developing, and setting the standards for payment, clearing, and settlement systems. In the aftermath of the global financial crisis of 2008-2009, the Financial Stability Forum was converted into the Financial Stability Board (FSB), an international body of finance ministries, central monetary authorities, and international financial institutions, with the sole mandate of monitoring risks and proposing recommendations for the global financial system. Together with the International Monetary Fund, the World Trade Organization, and the World Bank, the FSB is at the heart of rulemaking and standard setting in the IFS.

II. History of the Philippine Financial System

At the beginning of the American colonial period, two British banks, the Chartered Bank of India, China, and Australia and the Hongkong and Shanghai Banking Corporation which opened their branches in the Philippines in the 1870s, were the leading banks in the Philippines. Both were engaged in funding foreign trade. Another bank, the Bank of the Philippine Islands, which was established in 1851 as the Banco Español Filipino de Isabel II, mostly engaged in commercial and not agricultural lending. Its' largest shareholder at that time was the Church. The other major bank, an American bank, was founded in 1904 but was eventually bought out by the National City Bank of New York in 1914. For an economy reliant on agriculture, the 3% of total loans that was secured by agricultural land in 1904 was a questionable situation. Thus, the legislative branch of the US government sought to begin forming a private bank that is focused on agriculture but the effort failed. Hence, the

government created a government owned and controlled bank for agriculture. Its debtors were mostly farmers and sugar planters but its resources were becoming depleted, so, to take advantage of the greater demand for credit in 1916, the American Governor-General promoted the creation of a large, multipurpose national bank to handle the colonial government's development efforts. It is within this context that the Philippine's first publicly-funded bank, the Philippine National Bank (PNB), was born.³

It was also during that time that the trajectory of governance by a Democrat-led US government is to slowly turn over governance of the Philippines to the Filipinos. For this reason, the Philippine government was also slowly being taken over by the Filipino financial elite who, at that time, were mostly the landed oligarch. Hutchcroft observed that the financial resources provided by state institutions for business were drained by a predatory national oligarchy who occupied the positions of government power slowly being transferred by the Americans to the Filipinos and the classic example of this is the Philippine National Bank. After five years of its existence, its resources were already plundered to the point that the bank, the government, and the currency system were in utter breakdown and led to it being labeled as one of the most infamous moments of Philippine history.⁴

The draft bill for the PNB's creation that H.P. Willis, who became the first chairman and president of PNB, crafted turned the bank into a financial entity that was speculative, developmental, and characterized wildcat banking. PNB, like the national banks in the latter half of the 19th century in the US, were given the power to issue banknotes and perform exchange operations for the government. Hutchcroft pointed out that Willis resigned from PNB after a year because its initial PhP10 million capitalization went to loans made by bank officers who took them out without consultation and without limit as their amount.⁵

³ HUTCHCROFT, P.D., *Private Interests and Public Resources: The Historical Development of the Philippine Banking System* in *Booty Capitalism: The Politics of Banking in the Philippines*, New York: Cornell University Press (1998), pp. 65-80.

⁴ HUTCHCROFT, P.D., *Private Interests and Public Resources: The Historical Development of the Philippine Banking System* in *Booty Capitalism: The Politics of Banking in the Philippines*, New York: Cornell University Press (1998), pp. 65-80.

⁵ HUTCHCROFT, P.D., *Private Interests and Public Resources: The Historical Development of the Philippine Banking System* in *Booty Capitalism: The Politics of Banking in the Philippines*, New York: Cornell University Press (1998), pp. 65-80.

When the new president of the bank took over, credit was mostly extended to politically connected agricultural families who, by 1918, already owned two-thirds of the total assets in the Philippine banking system. Banking laws were violated by the bank. The bank's directors extended huge loans to themselves that amounted to heavy losses and when bank funds and government deposits were not enough, the bank began printing more money and used the currency reserve fund in the total amount of \$41,500,000.00 in New York. An audit of the bank in 1921 discovered that the capital stock of the government and half of its deposits in the bank had been depleted. Because of the abuse on the bank's power to print money and conduct currency operations, the insolvency of the bank affected the economy and the government almost became broke.⁶

Because of this, PNB was reorganized in 1924. Its loan portfolio, however, ended up becoming the leverage of the political groups in power in the government. Hutchcroft demonstrated how the regime of the first president of the Commonwealth government of the Philippines, Manuel Quezon, was able to use PNB loans as political leverage for or against the landholding elite, depending on the political objective. PNB's resources, as a result, ended up becoming the source of rent-seeking and plunder.⁷

PNB was the largest commercial bank during the American colonial period. However, there were also new banks that entered the Philippine financial system. Yokohama Specie Bank, a Japanese bank, was created in 1918 while three domestic banks owned by Americans, Chinese, and Filipino investors followed suit – China Banking Corporation in 1920, Philippine Trust Co., a commercial bank by the 1920s, Peoples Bank and Trust Company in 1926. By 1935, the Philippine financial system already consisted of nine commercial banks and two savings bank which were controlled by the government, foreign banks, the Chinese, the Americans, and the

⁶ HUTCHCROFT, P.D., *Private Interests and Public Resources: The Historical Development of the Philippine Banking System in Booty Capitalism: The Politics of Banking in the Philippines*, New York: Cornell University Press (1998), pp. 65-80.

⁷ HUTCHCROFT, P.D., *Private Interests and Public Resources: The Historical Development of the Philippine Banking System in Booty Capitalism: The Politics of Banking in the Philippines*, New York: Cornell University Press (1998), pp. 65-80.

Church with foreign banks owning only a quarter of the total banking resources, a far cry from their dominant position at the beginning of the American colonial period.⁸

The Insular Treasurer originally had jurisdiction over the banking sector. However, by 1929, a Bureau of Banking under the Finance Department of the colonial government was established to supervise the growing banking sector. The first Filipino owned bank, the Philippine Bank of Commerce, was established in 1938. Four other banks were also created during the Commonwealth period. A government-owned Agriculture and Industrial Bank was also formed in 1939. However, by the 1940s, World War II broke out and the Philippine financial system was in shambles. Only four Filipino banks continued to operate during the war but these banks had to be bailed out by the government after the war because the value of their assets plummeted during the war. The Agriculture and Industrial Bank was absorbed by the Rehabilitation Finance Corporation (RFC) in order to assist in the rehabilitation. However, corruption permeated the sale of surplus American war materiel intended for postwar reconstruction, the proceeds of which were supposed to be put in the AIB as bank funds. Hence, it ended up being short on funds. Its paid-in capital was also abused. Instead of industrial and agricultural loans, most of the capital went to residential loans.⁹

The idea of a central bank to regulate the Philippine financial system came about in the 1930s. At that time, the monetary policy of the country was administered by the Commonwealth government, the government of the Philippines that managed the country under American rule, through the Department of Finance and the National Treasury. The Philippines was using the US dollar on the exchange standard as its currency. The US dollar, at that time, was on the gold standard amidst the Great Depression. By the end of the 1930s, the idea of a central bank crystallized. The Tydings-McDuffie Act of the US, known in the Philippines as the Philippine Independence Act, provided for the ten-year transition period of the Philippines to become

⁸ HUTCHCROFT, P.D., *Private Interests and Public Resources: The Historical Development of the Philippine Banking System in Booty Capitalism: The Politics of Banking in the Philippines*, New York: Cornell University Press (1998), pp. 65-80.

⁹ HUTCHCROFT, P.D., *Private Interests and Public Resources: The Historical Development of the Philippine Banking System in Booty Capitalism: The Politics of Banking in the Philippines*, New York: Cornell University Press (1998), pp. 65-80.

independent. The law required the Philippine Commonwealth government's legislature to enact a law that will establish a central bank. As a colony of the US, monetary policy enacted by the Philippine legislature was ultimately subject to the approval of the president of the US. Franklin Roosevelt, the US president during that period, disapproved the central bank version in the bill due to strong opposition from certain sectors. A second version of it was passed in the mid-1940s but it was not implemented because the country was in the middle of a war and the Philippines was then fighting with the US against Japanese military occupation.¹⁰

After the US won against the Japanese, the Philippine President then, Manuel Roxas (Roxas), directed his finance secretary, Miguel Cuaderno, Sr. (Cuaderno, Sr.), to propose a charter for a central bank. Cuaderno, Sr. headed a commission called the Joint Philippine-American Finance Commission, that studied the financial, monetary, and fiscal issues of the Philippines. One of its recommendations was the transition from the dollar exchange standard to a managed currency standard and a central bank was crucial in implementing it.¹¹

To do so, Manuel Roxas formed a Central Bank Council to draft the charter of a monetary authority. This draft was submitted to the Philippine legislature on February 1948 and was passed by it as the Central Bank Act of 1948.¹² A Monetary Board was created to serve as the governing board of the central bank.¹³ The objectives of the central bank, through the Monetary Board, was to promote and maintain monetary stability in the country, preserve the value of the peso in its convertibility in the international market, and promote the pursuit of a higher level of production, employment and real income in the Philippines.¹⁴

¹⁰ Bangko Sentral ng Pilipinas, "*Creating a Central Bank for the Philippines*", available at <https://www.bsp.gov.ph/Pages/History.aspx> (last accessed 30 April 2022).

¹¹ Bangko Sentral ng Pilipinas, "*Creating a Central Bank for the Philippines*", available at <https://www.bsp.gov.ph/Pages/History.aspx> (last accessed 30 April 2022).

¹² Republic Act No. 265 (1948).

¹³ Republic Act No. 265 (1948), Sec. 5.

¹⁴ Republic Act No. 265 (1948), Sec. 64

The central bank was likewise required to maintain international reserves in gold and assets in foreign currencies.¹⁵ It was also given control of credit policy and was authorized by law to extend loans, rediscounts, discounts, and advances to banks and to provide them with liquid funds during crises.¹⁶ It was likewise given the authority to conduct open market operations¹⁷ and to prescribe reserves requirement to banks for peso and foreign currency deposits.¹⁸ The central bank created in 1948 basically served as the fiscal agent and banker of the Philippine government.¹⁹

The 1948 central bank law created the Philippine peso, for the first time, as the unit of monetary value of the Philippines, to be represented by the “P” sign, and divided into centavos, to be represented by a “c” sign.²⁰ The gold value of the peso was pegged to the US dollar parity of the peso.²¹ The Central Bank of the Philippines was given the sole right and authority to issue currency within the Philippines²² fully guaranteed by the Philippine government and considered as legal tender in the country.²³ This currency is considered as liabilities of the central bank and serves as a first lien on the assets of the Central Bank.²⁴ The Monetary Board determines the amount of notes and coins to be issued in circulation.²⁵

Notwithstanding the law, Hutchcroft pointed out that American control was still prevalent in the financial sphere. The 1946 Bell Trade Act disallows any change in the US dollar-peso exchange rate without the consent of the US president. After World War II, the Philippines is the only country in the world that continued its prewar exchange rate of PhP2 to \$1 despite extensive capital destruction during the war which led to balance of payment problems.²⁶

¹⁵ Republic Act No. 265 (1948), Sec. 68 and Sec. 69.

¹⁶ Republic Act No. 265 (1948), Sec. 86.

¹⁷ Republic Act No. 265 (1948), Sec. 96.

¹⁸ Republic Act No. 265 (1948), Sec. 102.

¹⁹ Republic Act No. 265 (1948), Sec. 115.

²⁰ Republic Act No. 265 (1948), Sec. 47.

²¹ Republic Act No. 265 (1948), Sec. 48.

²² Republic Act No. 265 (1948), Sec. 52.

²³ Republic Act No. 265 (1948), Sec. 54.

²⁴ Republic Act No. 265 (1948), Sec. 53.

²⁵ Republic Act No. 265 (1948), Sec. 56.

²⁶ HUTCHCROFT, P.D., *Private Interests and Public Resources: The Historical Development of the Philippine Banking System in Booty Capitalism: The Politics of Banking in the Philippines*, New York: Cornell University Press (1998), pp. 65-80.

In 1972, a joint International Monetary Fund-Central Bank Banking Survey Commission was made about the Philippine banking system. The commission issued a report outlining banking policy reforms to deal with persistent problems in Philippine financial institutions. Changes were made to the Central Bank of the Philippines in light of the problems besetting it and the emerging issues in the PFS. When a new constitution was promulgated in 1973 for the Philippines in light of the declaration of martial law, the new constitution required the establishment of an independent central monetary authority which, later on, was decreed by virtue of a presidential order.²⁷ The dictatorship was ended through a peaceful revolution and a new constitution, the 1987 Philippine Constitution, mandated the establishment of a central bank for the Philippines. In 1993, the New Central Bank Act was signed into law and took effect.²⁸

III. Institutions in the Philippine Financial System

a. *The Bangko Sentral ng Pilipinas (BSP) in the PFS*

Unlike the Federal Reserve whose existence is statutorily provided, the existence of a central monetary authority of the Philippines, its central bank, is constitutionally mandated.

The Philippine Constitution requires the Philippine Congress to establish an independent central monetary authority whose form and existence shall be established by law.²⁹ This monetary authority, today known as the *Bangko Sentral ng Pilipinas (BSP)*, is given the constitutional prerogative to provide policy direction over money, banking, and credit.³⁰ It has exclusive supervision over bank operations, finance companies, and other like

²⁷ Presidential Decree No. 1801 (1981).

²⁸ Republic Act No. 265 (1948), Sec. 64

²⁹ 1987 CONSTITUTION OF THE REPUBLIC OF THE PHILIPPINES, Article XII, §20.

³⁰ 1987 CONSTITUTION OF THE REPUBLIC OF THE PHILIPPINES, Article XII, §20.

institutions.³¹ The Philippine Congress is given the statutory prerogative to provide for other powers of the central monetary authority over this area.³² It has done so through Republic Act No. or the New Central Bank Act of 1993.³³

The composition of the Philippine monetary authority's main governing body, the Monetary Board, is outlined in the Philippine Constitution. Its members must be natural-born Filipino citizens, must be known for their probity, integrity, and patriotism, and the majority of them must hail from the private sector. The Philippine Constitution allows other qualifications of its members to be statutorily provided by the Philippine Congress³⁴ who has outlined them in the New Central Bank Act.³⁵

The Philippine Congress has likewise enumerated the powers of the Monetary Board in the New Central Bank Act. Under the law, the Monetary Board has the power to issue rules and regulations for the discharge of its functions and the functions of the BSP.³⁶ It has the sole prerogative to direct the management, operations, and administration of the BSP,³⁷ to reorganize the central bank's workforce³⁸ and to establish its human resource management system and its compensation structure,³⁹ and to determine and approve the BSP's budget.⁴⁰ The legal department of the BSP is under the exclusive control and supervision of the Monetary Board.⁴¹

The BSP, as the central monetary authority of the Philippines, was also created under the New Central Bank Act.⁴² Its primary mandate is to maintain price stability in the economy, promote

³¹ 1987 CONSTITUTION OF THE REPUBLIC OF THE PHILIPPINES, Article XII, §20.

³² 1987 CONSTITUTION OF THE REPUBLIC OF THE PHILIPPINES, Article XII, §20.

³³ Republic Act No. 7653 (1993), Art. II.

³⁴ 1987 CONSTITUTION OF THE REPUBLIC OF THE PHILIPPINES, Article XII, §20.

³⁵ Republic Act No. 7653 (1993), Art. II.

³⁶ Republic Act No. 7653 (1993), Sec. 15(a).

³⁷ Republic Act No. 7653 (1993), Sec. 15(b).

³⁸ Republic Act No. 7653 (1993), Sec. 15(b).

³⁹ Republic Act No. 7653 (1993), Sec. 15(c).

⁴⁰ Republic Act No. 7653 (1993), Sec. 15(d).

⁴¹ Republic Act No. 7653 (1993), Sec. 15(b).

⁴² Republic Act No. 7653 (1993), Sec. 2.

monetary stability and maintain peso convertibility.⁴³ Consistent with the constitutional directive, BSP is given the power to regulate the money, banking, and credit sector. It also regulates the non-banking financial sector composed of quasi-banks, trust entities, and other financial institutions created by the Philippine Congress through special law,⁴⁴ such as non-bank financial institutions with quasi-banking functions (NBQBs), non-stock savings and loans associations (NSSLAs), and Pawnshops and Money Service Businesses (MSBs). It is empowered to exercise supervisory and examination powers over these banks and non-banking financial sector as well as their subsidiaries.⁴⁵ This supervisory and examination powers include the issuance of rules and the establishment of standards of operation for the uniform application of these rules.⁴⁶ These rules are outlined in the Manual of Regulations for Banks. BSP likewise regulates foreign banks. Republic Act No. 7721⁴⁷ regulates the entry of foreign banks into the PFS.

BSP is also given the authority to conduct a regular investigation of all banks⁴⁸ and to inquire into their solvency and liquidity.⁴⁹ Monitored by the BSP, bank deposits are protected by the Secrecy of Bank Deposits Law.⁵⁰ Under this law, bank deposits may not be examined or looked into by any person, private or working for the government, without the permission of the depositor subject to certain exceptions e.g. when it is the subject of a litigation or any legal proceeding such as an impeachment case, a bribery case, or a case involving the dereliction of duty by a public official,⁵¹ or any of the corrupt practices enumerated under the Anti-Graft and Corrupt Practices Act,⁵² or a case involving a violation of certain crimes defined under the Anti-Money Laundering Act.⁵³ It may also only be looked into or examined if it is the subject of a regular or periodic examination of a bank by BSP, if the disclosure is made by the

⁴³ Republic Act No. 7653 (1993), Sec. 3.

⁴⁴ Republic Act No. 8791 (2000), Sec. 4.6.

⁴⁵ Republic Act No. 7653 (1993), Sec. 25.

⁴⁶ Republic Act No. 8791 (2000), Sec. 4.

⁴⁷ Republic Act No. 7721 (1994).

⁴⁸ Republic Act No. 8791 (2000), Sec. 4.4.

⁴⁹ Republic Act No. 8791 (2000), Sec. 4.5.

⁵⁰ Republic Act No. 1405 (1955).

⁵¹ Republic Act No. 1405 (1955), Sec. 2.

⁵² Republic Act No. 3019 (1960), as amended.

⁵³ Republic Act No. 9169 (2001).

Treasurer of the Philippines in compliance with the law,⁵⁴ or if it is the subject of an inquiry by the Bureau of Internal Revenue, the Philippine tax authority, of a dead depositor for the purpose of determining the estate tax to be imposed.⁵⁵

Foreign currency deposits in the PFS, on the other hand, are subject to the Foreign Currency Deposit Act.⁵⁶ Like deposits in Philippine or peso currency, foreign currency deposits may be examined with the written permission of the depositor⁵⁷ subject to almost the same exceptions as Philippine currency deposits. Both peso and foreign currency deposits may be looked into or examined if the BSP and the PDIC investigates or examines bank deposits due to unsafe or unsound banking practices.⁵⁸ Although formed as a government-owned corporation, BSP is given fiscal and administrative authority.⁵⁹

BSP exercises quasi-judicial functions in connection with its authority to regulate the banking and non-banking financial sector. It has the authority to obtain data and information from any government office and instrumentalities or government-owned and controlled corporations as well as the banking and non-banking financial sector that is necessary for the discharge of its functions. Refusal without justifiable cause of such authority subjects them to the subpoena and contempt powers of the BSP.⁶⁰

The principal representative of the Monetary Board and the BSP is the BSP Governor. In this capacity, the BSP Governor has the authority to sign contracts, notes, and securities, and other documents of the BSP, to represent it in any legal proceeding or action, and to delegate any power, including the power to negotiate with multilateral banking or financial institutions within and outside the Philippines.⁶¹ In times of emergencies like financial crises, the BSP

⁵⁴ Presidential Decree No. 679 (1975).

⁵⁵ Republic Act No. 8424 (1997), Sec. 6(f).

⁵⁶ Republic Act No. 6426 (1974).

⁵⁷ Republic Act No. 6426 (1974), Sec. 8.

⁵⁸ Republic Act No. 8791 (2000) and Republic Act No. 3591 (1963).

⁵⁹ Republic Act No. 8791 (2000), Sec. 1.

⁶⁰ Republic Act No. 7653 (1993), Sec. 23.

⁶¹ Republic Act No. 7653 (1993), Sec. 19.

Governor can call a meeting of the Monetary Board and can, with the concurrence only of two out of seven members of the Monetary Board, decide on any matter within the authority of the BSP.⁶²

The President of the Philippines cannot contract or guarantee foreign loans for the country without the prior concurrence of the Monetary Board under guidelines provided for by law.⁶³ Learning from the experience of the country during its martial law period when foreign loans contracted burdened the treasury and caused the country's debt to balloon, foreign loans must now comply with the law and the regulatory standards set by the monetary authority.⁶⁴ These foreign loans are also required to be available to the public.⁶⁵ The Monetary Board is constitutionally mandated to submit a quarterly report to Congress about the loans it contracted or guaranteed on behalf of the government or any of its instrumentalities that would affect the country's foreign debt.⁶⁶ To ensure strict compliance with these constitutional requirements, the Philippine Constitution declares acts that are contrary to them as inimical to the national interest and mandates the Philippine Congress to enact criminal and civil sanctions for their punishment.⁶⁷

b. Private Philippine Banks and Non-Bank Financial Institutions and the PFS

Private Philippine banks are classified as universal banks, commercial banks, thrift banks, rural banks, cooperative banks, Islamic banks, and such other kinds of banks that are provided for by the Monetary Board.⁶⁸ Universal banks are banks that can operate as a commercial bank and an investment house.⁶⁹ It can invest in the equities of allied enterprises that are financial or non-financial, in non-allied enterprises, and, to a certain extent, in quasi-banks.⁷⁰ A

⁶² Republic Act No. 7653 (1993), Sec. 19.

⁶³ 1987 CONSTITUTION OF THE REPUBLIC OF THE PHILIPPINES, Article VII, §20.

⁶⁴ 1987 CONSTITUTION OF THE REPUBLIC OF THE PHILIPPINES, Article XII, §21.

⁶⁵ 1987 CONSTITUTION OF THE REPUBLIC OF THE PHILIPPINES, Article XII, §21.

⁶⁶ 1987 CONSTITUTION OF THE REPUBLIC OF THE PHILIPPINES, Article VII, §20.

⁶⁷ 1987 CONSTITUTION OF THE REPUBLIC OF THE PHILIPPINES, Article XII, §21.

⁶⁸ Republic Act No. 8791 (2000), Sec. 3.2(a) to (g).

⁶⁹ Republic Act No. 8791 (2000), Sec. 23.

⁷⁰ Republic Act No. 8791 (2000), Sec. 24.

commercial bank does not have the powers of an investment house⁷¹ and can only invest in financial allied enterprises such as thrift banks and rural banks⁷² and non-financial allied enterprises.⁷³ Thrift banks, rural banks, cooperative banks, Islamic banks, and other banks created by the Philippine Congress are defined and governed by their special laws.

Non-bank Financial Institutions refer to quasi-banks, trust entities and other financial institutions created by special law.⁷⁴ Quasi-banks are financial entities engaged in the business of borrowing funds by issuing, endorsing, or assigning with recourse or acceptance of deposit substitutes.⁷⁵ Trust entities are banks or non-bank financial institutions who perform trust functions through its trust business unit, trust corporations authorized by the BSP to engage in trust and other fiduciary business or to perform investment management services under the GBL.⁷⁶

To date, there are six non-bank financial institutions with quasi-banking functions (NBQBS) made up of one investment house, four financing companies with a total of 121 branches, and one NBQB. The total assets of these NBQBs is PhP168.3 billion as of 2021. On the other hand, 60 Non-stock Savings and Loans Associations (NSSLAs) made up of 138 branches are licensed in the Philippines with a combined total assets of PhP283.3 billion as of 2021. Pawnshops and Money Service Businesses (MSBs), which gives access to immediate liquidity to borrowers, is made up of 15,388 pawnshop offices broken down into 1,152 head offices and 14,236 branches and 7,449 offices broken down into 748 head offices and 6,701 branches.⁷⁷

⁷¹ Republic Act No. 8791 (2000), Sec. 29.

⁷² Republic Act No. 8791 (2000), Sec. 30.

⁷³ Republic Act No. 8791 (2000), Sec. 30.

⁷⁴ Republic Act No. 8791 (2000), Sec. 4.6.

⁷⁵ The term "deposit substitutes" is defined as an alternative form of obtaining funds from the public, other than deposits, through the issuance, endorsement, or acceptance of debt instruments for the borrower's own account, for the purpose of relending or purchasing of receivables and other obligations. These instruments may include, but need not be limited to, bankers acceptances, promissory notes, participations, certificates of assignment and similar instruments with recourse, and repurchase agreements. Republic Act No. 7653 (1993), Sec. 95.

⁷⁶ Manual of Regulations for Banks (MROB), Sec. X403(a).

⁷⁷ Bangko Sentral ng Pilipinas, "*Recent Trends in the Philippine Financial System*", available at https://www.bsp.gov.ph/Media_And_Research/Publications/ReportonRecentTrends2022-03.pdf (last accessed 4 March 2022).

c. The Regulatory Regime of the PFS

The legal framework for financial regulation in the Philippines is governed by the Philippine Constitution with the Philippine's central monetary authority, the BSP, as the main regulatory authority. As discussed in the previous sections, BSP regulates private banks and the non-banking sector such as NBQBs, NSSLAs, and MSBs. It regulates these banks within the framework of Republic Act No. 8791, commonly known as the General Banking Law of 2000 or GBL.⁷⁸ As mentioned earlier, the GBL classifies banks as universal banks, commercial banks, thrift banks, rural banks, cooperative banks, and Islamic banks.⁷⁹ It gives the Monetary Board the authority to add and classify other kinds of banks in the exercise of its regulatory authority.⁸⁰ Specific banks are created and governed by certain special laws. Thrift Banks are created and governed by the Thrift Banks Act of 1995,⁸¹ Rural Banks by the Rural Banks Act of 1992,⁸² Cooperative Banks by the Cooperative Code of the Philippines of 1990,⁸³ and Islamic Banks by the Charter of the Al-Amanah Islamic Investment Bank of the Philippines.⁸⁴

The regulatory framework of the PFS rests on the legal infrastructure created by the Philippine Constitution, the GBL, the New Central Bank Act, the other special laws creating the non-banking financial institutions, the laws on currency deposits and other laws designed to maintain the stability of the PFS, the Manual of Regulations for Banks and other administrative rules and regulations issued by the BSP. These laws, rules, and regulations provide for the management of banks and other non-banking financial institutions, the regulatory capital and liquidity of these financial entities including the handling of their liquidation or recovery in case of liquidity problems. They also provide for the regulation of the reserve requirements of banks in relation to deposit and deposit-substitutes to ensure that the PFS is protected from

⁷⁸ Republic Act No. 8791 (2000).

⁷⁹ Republic Act No. 8791 (2000), Sec. 3.2(a) to (g).

⁸⁰ Republic Act No. 8791 (2000), Sec. 3.2 (g).

⁸¹ Republic Act No. 7906 (1995).

⁸² Republic Act No. 7353 (1992).

⁸³ Republic Act No. 6938 (1990).

⁸⁴ Republic Act No. 6848 (1990).

bank runs. They also regulate the allocation of single borrower's limit to different entities within the PFS to ensure that banks do not fail by overconcentrating credit to one borrower and prescribes loan-loss provisioning⁸⁵ and equity investment limits.

They also regulate the PFS through the directors, officers, stockholders and related interests (DOSRI) limit. The DOSRI limit is intended to put directors, officers, stockholders and their related interests on equal footing with the public when it comes to obtaining financing with a bank. This rule requires that loans and other credit accommodations extended to the directors, officers, stockholders and their related interests should be the same as those offered to the public.⁸⁶

The GBL, together with the Manual of Regulations for Banks are the main regulatory references for banks and non-banking financial institutions within the PFS. For foreign banks, as stated earlier, R.A. 7721⁸⁷ liberalizes the entry and scope of operations of foreign banks in the Philippines. Under this law, foreign banks can enter and operate in the Philippine financial system by acquiring or owning 60% of the voting stock of an existing bank or investing 60% of voting stock in a new banking subsidiary incorporated under Philippine law, or by establishing branches with full banking authority.⁸⁸ A foreign bank may only choose one mode of entry and can only own 60% of the voting stock of one Philippine bank or a new banking subsidiary.⁸⁹ They are also subject to certain capital requirements.⁹⁰ The head office of these foreign banks are required to provide a guarantee of prompt payment for the liabilities incurred by its Philippine branches.⁹¹

⁸⁵ Instituted through Appendix 15 of the Manual of Regulations for Banks on the guidelines for allowances for credit losses and Republic Act No. 11523 or the Financial Institutions Strategic Transfer Act of 2021.

⁸⁶ Republic Act No. 8791 (2000).

⁸⁷ Republic Act No. 7721 (1994).

⁸⁸ Republic Act No. 7721 (1994), Sec. 2.

⁸⁹ Republic Act No. 7721 (1994), Sec. 2.

⁹⁰ Republic Act No. 7721 (1994), Sec. 4.

⁹¹ Republic Act No. 7721 (1994), Sec. 5.

To protect Philippine depositors during financial crises and avoid bank panics, the Philippine Congress created the Philippine Deposit Insurance Corporation (PDIC).⁹² Like the Federal Deposit Insurance Corporation, the PDIC insures the deposit liabilities of all banks operating within the PFS, considering the financial history and condition of the bank, its capital structure adequacy, future earnings prospects, its management, and the convenience and needs being served by the banks. With the approval of the BSP, PDIC can examine banks at least once a year.

⁹² Republic Act No. 3591 (1963), as amended.