An assessment of the Philippine financial services sector

Dr. Rene E. Ofreneo
University of the Philippines, Quezon City
(With contributions from Trishia P. Octaviano and Carmina Angelica C. Valeroso)

This assessment report, prepared for the International Labour Organization by Dr. Rene E. Ofreneo, is intended to provide a rapid overview of the financial services sector in the Philippines and to stimulate discussions at the Tripartite Workshop to Promote Social Dialogue on Financial Services Reforms in Selected Asia and Pacific Countries (Jakarta, Indonesia, 5-6 August 2015).The views expressed in the report are not necessarily those of the ILO.

International Labour Office

Geneva

29 July 2015

Contents

1. Introduction: Overview of the financial sector

The Philippine financial sector has emerged from the 2007-2010 global financial crisis relatively unscathed (*Philippine Development Plan 2011-2016)*. One major explanation for this is the continuing effort of the government to strengthen the sector in the aftermath of the Greece-like financial crisis in the Philippines in 1980-85 and the Asian financial crisis in 1997-98. Among the reform measures instituted by the government were the higher reserves that banks must maintain, the cleaning up of the banks' books of their non-performing assets (NPAs) and the enactment in 1993 of a law establishing a stronger BangkoSentralngPilipinas (BSP) which exercises full supervisory powers over the different financial institutions.

Asset-wise, the financial system is dominated by the banking sector, which controls over 80 per cent of the resources of the financial system, with the non-bank financial institutions such as insurance companies accounting for the rest (*Philippine Development Plan 2011-2016).* On the other hand, the banking sector is largely in the hands of over 30 commercial banks. There are hundreds of rural banks and thrift banks; however, they account for only 11 per cent of the assets of the entire banking sector.

This short paper is a rapid scanning of the industrial relations adjustment issues in the globalizing Philippine commercial banking sector and assessment of the role of social dialogue in the adjustment process.

2. Liberalization, crisis and growth

The Philippine commercial banking sector has been opened up to competition, both local and overseas, largely through a series of government-initiated liberalization measures. In the post-war era (1940s-1960s), the sector catered largely to the domestic market and had limited role in the foreign exchange market.

In the 1970s, the government allowed foreign financial institutions to set up offshore banking units while the commercial banks were authorized to accept foreign currency deposits. In the early 1980s, the anti-usury law became obsolete with the deregulation of interest rates. On the recommendation of the International Monetary Fund (IMF), the interest rate deregulation was accompanied by programs allowing big commercial banks to go “universal”, that is, to undertake traditional banking functions (e.g., accept deposits, issue letters of credit, engage in foreign exchange transactions, etc.) alongside investment banking. The traditional “differentiation” of functions among banks (rural, savings, thrift, development and commercial) was removed, with the commercial and universal banks allowed to undertake any or all of these functions. A universal bank is also allowed to hold equity in a non-financial institution, or in virtually other area of the economy (Ofreneo, 1996).

The interest rate deregulation and universal banking policy coincided with the difficult decade of the 1980s. In 1980-83, the Philippine economy was in recession; in 1983-85, the recession became a full-blown depression, with the economy registering negative GDP growth (Ofreneo, 1996). The banking sector was badly hit by the recession-depression, with the Philippines' banks unable to issue letters of credit on behalf of the country's importers-exporters. Unable to service its debt, the government was forced to negotiate for a debt service moratorium.

The economy normalized only in the second half of the 1980s, after the 1986 People Power Revolt installed Corazon C. Aquino as the new President. The Corazon Aquino Administration also tried to strengthen the financial system. The huge liabilities accumulated by the two government banks – Philippine National Bank (PNB) and Development Bank (DBP) – were transferred to the government and became part of the bigger national debt. Subsequently, the PNB, then the country's premier bank, was put on the privatization auction block.

In 1994, the Philippines passed Republic Act (RA) 7721, which liberalized the entry and scope of operations of foreign banks. As a backgrounder, no foreign bank had been allowed entry under the 1948 General Banking Act, except the four foreign banks licensed during the Spanish and American colonial periods, namely: Hong Kong Shanghai Bank, Citibank, Standard Chartered Bank, and Bank of America. RA 7721 allowed the entry of foreign banks through any of the three modes: ownership of up to 60 per cent of the voting stock of an existing domestic bank, investment in a newly-incorporated banking subsidiary, and establishment of branches with full banking authority. Ten foreign banks were granted authority to operate in the country within five years from the date of the Act's entry into effect.

The Philippines happened to be bullish in 1994. The country registered high GDP growth in 1994-97, which also saw the rapid liberalization of the banking and other sectors of the economy.

This growth was rudely interrupted by the 1997-98 Asian financial contagion that originated from Thailand. However, compared to the 1980-85 financial crisis, the Philippine financial sector survived this new crisis without any major bank closures, contrary to what happened in Indonesia and Thailand.

Twenty years after RA 7721, in 2014,, the government further liberalized the entry of foreign banks with the issuance of RA 10641. Under the new law, foreign banks may now own up to 100 per cent of an existing bank's voting stock (Uy, 2014). Foreign banks are given equal treatment to that accorded domestic banks under the new law, as they "shall perform the same functions, enjoy the same privileges, and be subject to the same limitations imposed upon a Philippine bank of the same category." Similarly, domestic banks under the new law also enjoy "any right, privilege or incentive granted to foreign banks or their subsidiaries or affiliates."

3. Social dialogue and industrial relations issues in the context of mergers, sectoral consolidation and business adjustments

As a result of the changes in the policy regime for the sector and in the overall economic environment, commercial banks have been undertaking different organizational and business adjustments to make their operations viable, efficient and profitable. Eventually, these adjustments are in turn being translated into personnel and industrial relations adjustments. An earlier study done by the author (Ofreneo, 1996) identified the following causes of major human resource and industrial relations adjustments by banks:

- Mergers and consolidations: weak banks merging with bigger banks;

- Right-sizing: banks looking for the optimum number of employees to be hired or retained or retired (usually facilitated by "early retirement programmes" or ERPs) based on some reengineering/streamlining exercises;

- Labour flexibility: banks categorizing jobs into regular and non-regular, and outsourcing the latter to minimize labour cost and reduce union's influence;

- Modernization of services: various technological innovations being adopted such as the ATM system, stand-alone cheque clearance, online banking, etc.;

- Diversification and expansion: banks expanding and diversifying services such as greater involvement in the remittance business for the overseas Filipino workers (OFWs) and setting up more branches nationwide; and

- Conduct of varied training programmes to attain higher employee productivity, versatility and engagement.

Based on interviews with bank unions and human resource personnel, these adjustments are more or less still continuing, although they take different forms on a bank-to-bank basis. The most difficult and painful ones are in relation to mergers, acquisitions and consolidations (MACs) because there are unavoidable employee dislocations (for example, the successor/surviving bank cannot afford to maintain all the branches of the merging banks if these branches happen to be in the same place or location), different union and collective bargaining benefits, clashes in management cultures and so on. Another painful and contentious adjustment measure is job outsourcing for it erodes job and union security.

There were waves of MACs in the 1980s (crisis decade) and in the 1990s (liberalization decade capped by the Asian crisis of 1997-98). The processes for MACs have not stopped since then, for they are officially encouraged by the BSP itself as part of the regulatory body's post-crisis response.[1]A researcher wrote: "Banks merged as they tried to reap economies of scale advantages and positioned themselves against a more intense threat of domestic competition and across borders."[2]

Data from the BSP shows that for 2004-2014, there were 31 merger cases, 25 of acquisitions among banks and non-bank financial institutions (NBFIs), and 21 of consolidations. Table 1, below, is a summary of the more significant MACs for that period.

[1]Gochoco-Bautista, M.S. (1999). The Past Performance of the Philippine Banking Sector and Challenges in the Postcrisis Period. In: Rising to the Challenge in Asia: A Study of Financial Makets: Volume 10—Philippines. Asian Development Bank, 30-78.

[2] Supra note 7, at 4. pp. 1.

Table 1. Selected Mergers, Acquisitions and Consolidation, 2004 to 2014

Date	Activity
2004	Consolidation of Mindanao-based Network Rural Bank, Inc., Rural Bank of Panabo, Inc. and Provident Rural Bank of Cotabato into One Network Rural Bank, Inc.
2005	Citibank NA acquired Insular Savings Bank for roughly P1 billion
2005	Banco de Oro Universal Bank acquired 66 of the 67 Philippine branches of Singapore's United Overseas Bank for P600 million
2005	Bank of the Philippine Islands acquired a controlling stake in Prudential Bank
2005	Banco de Oro Universal Bank purchased the Go family's 24.76% stake in Equitable PCI Bank for P10.2 billion
2006	UCPB Savings Bank absorbed UCPB Rural Bank, raising the former's capital to P800 million from P400 million
2006	UnionBank of the Philippines purchased 98.84% of The International Exchange Bank shares
2007	Banco de Oro Universal Bank merged with Equitable PCI Bank, resulting in combined assets of P613 billion and combined deposits of P435 billion
2007	Rizal Commercial Banking Corp. acquired 30-year old thrift bank Merchants Savings and Loan Association for P520 million
2009	Rizal Commercial Banking Corp. acquired JP Laurel Rural Bank in Batangasfor P375 million, paving the way for the former's entry into the microfinance business
2009	East West Banking Corp. absorbed AIG Philam Savings Bank and its two subsidiaries, PhilAm Auto Finance and Leasing, Inc. and PFL Holdings, Inc.
2009	Banco de Oro Unibank. Inc. acquired GE Money Bank worth P1.3 billion
2011	East West Banking Corp. acquired Butuan City-based Green Bank, Inc. which added nearly P3 billion to the former's consolidated assets
2011	Asia United Bank Corp. acquired Cooperative Bank of Cavite, which was renamed Cavite United Rural Bank, for P400 million
2012	Asia United Bank Corp. acquired the banking business of Asiatrust Development Bank, Inc., giving the former additional 28 branches
2012	BDO Unibank, Inc. acquired Rural Bank of San Juan, Inc.
2012	East West Banking Corp. purchased Pasig City-based FinMan Rural Bank, Inc. for P42 million.
2013	Philippine National Bank merged with Allied Banking Corp., creating the Philippines' fifth largest lender
2013	BDO Unibank, Inc. signed an agreement to acquire 99.99% of Citibank Savings, Inc., Citi's thrift banking arm in the Philippines
2014	China Banking Corp. paid P1.579 billion for the 84.77% of Planters Development Bank's capital stock
2014	BDO Unibank, Inc. signed a deal to acquire the thrust business of Deutsche Bank AG, Manila Branch, which adds P70 billion to BDO's P770 billion assets under management
2014	Philippine Bank of Communications bought Laguna-based Rural Bank of Nagcarlan, Inc., adding six branches to the former's 64
2014	Philippine Bank of Communications acquired a majority stake in Mindanao-based BancoDipolog, Inc.

Compiled by Octaviano, T.P. for BusinessWorld First Quarter Banking Report, May 29, 2014

With the Association of Southeast Asian Nations (ASEAN) accelerating the processes of economic integration under its Economic Community Blueprint, more MACs are bound to happen in the Philippine banking sector. This is particularly true in the period 2016-2020, the period that the ASEAN is projecting to be the realization period for its Financial Integration programme.

4. Trade unions concerns, Banking Industry Tripartite Council (BITC) and the outsourcing consensus

The commercial banking sector is highly unionized. Labour relations were understandably tumultuous in the 1980s, when a number of banks had to lay off large number of workers due to the economic and financial crisis. Although bank strikes are rare and non-existent in the commercial banking industry, a number of bank unions filed strike notices in the 1980s and 1990s. These notices were promptly transformed by the Department of Labor and Employment (DOLE) into preventive mediation cases given the critical importance of banking in the economy.

Today, the unions are still worried about the preservation of job security in a liberalizing financial sector because liberalization and competition engender more MACs, increased outsourcing of jobs that are classified as non-regular, endless reengineering of work, automation of bank services and pressures on employees to adapt to the changing nature of bank jobs. Because of the foregoing concerns and the sad conflict-ridden bank-union relations in the 1980s, bank unions led by the National Union of Bank Employees (NUBE) pushed for the formation of the BITC, a tripartite body.

DOLE responded positively to the unions' demand by recommending for the formation of the BITC in 2000. The BITC, whose establishment document was attested to by then President Joseph Estrada, has representatives from the unions (NUBE and non-NUBE affiliates), banks (Bankers' Association of the Philippines and representatives of bank HR managers) and the government (DOLE, BSP and the Ministry of Finance).

The BITC had been meeting on and off since the 2000s and been conducting tripartite consultations on varied industrial relations and human resource concerns. One of the issues raised in the BITC meetings was the establishment of a special fund to help displaced workers affected by MACs. No concrete evidence exists, however, whether the fund was ever established.

The BITC character changed in 2010-2014, with a deepening of social dialogue. First, NUBE and the other unions in the BITC proposed and insisted that the BITC, as a tripartite body, should promulgate rules on responsible outsourcing in the banking sector. A 2010 trade union-drafted resolution stated that sub-contracting or outsourcing "must not result to the termination of employment of regular employees, reduction of work hours or reduction or splitting of the bargaining unit". The resolution also called for a BITC mechanism on how to resolve disputes and the establishment of a "Livelihood Bridging Program" for employees affected by MACs and bank reorganizations.

The draft resolution naturally generated a year-long discussion and debate among the three parties in the BITC, eventually resulting in a historic BITC Resolution No. 1 on December 1, 2011. The resolution, "Adopting the Banking Industry Voluntary Code of Good Practice on Dispute Settlement and Outsourcing/Subcontracting of Certain Bank Functions", provides, among others, for the following:

- Formation of a BITC's Committee of Five to act as a special mediation-conciliation body to resolve disputes; and

- Rules on responsible outsourcing of certain bank functions such as dialogue on the rationale for any outsourcing measure, proactive bank consultation with the union and employees before any outsourcing is done ("most especially if said subcontracting or outsourcing would result in the termination of regular employees or reduction or splitting of an organized bargaining unit"), best efforts to retain services of affected employees, assistance to affected employees through livelihood and other programs, and strict compliance with existing laws on outsourcing.

The resolution was a historic one because it is the first industry tripartite agreement on the divisive and contentious issue of outsourcing. It was historic because it was signed by the leadership of the BSP, DOLE, NUBE and non-NUBE union leaders, and the heads of the three bankers groups: Bankers Association of the Philippines, Chamber of Thrift Banks and the Rural Bankers Association of the Philippines.

Credit to the adoption of the resolution goes to all the above-named institutions. However, special credit goes to the BSP and DOLE officials who shepherded the three parties in a healthy social dialogue in over a year of debates and discussions. In particular, the BSP, through Assistant Governor Dr. Noe Ravalo, was able to clarify what is "outsourceable" or not in the banking industry by helping define "what are the inherent bank functions" and why performing those functions cannot be outsourced. Those functions include deposit-taking, lending, executive management functions, compliance, internal audit, risk management and certain activities covered by specific guidelines. An authoritative clarification of what is outsourceable or not is central in any discussion on outsourcing; hence, a healthy resolution of what is outsourceable requires clarity of definitions in accordance with accepted legal parameters in a country.

5. Conclusion

MACs and other adjustment issues are bound to crop as the economic integration processes deepen. Labour and industrial relations disputes can be handled in a proactive and healthy manner through more, not less, social dialogue. However, a *sine qua non* in the dialogue process is the healthy respect that each party accords to each other's rights. With social dialogue, everybody wins.

6. References

BangkoSentralngPilipinas, p. 1. Retrieved from: http://www.bsp.gov.ph/regulations/key/MergersandConsolidation.pdf on September 4, 2014

Bank Industry Tripartite Council, 2011. "Resolution No. 1, Series of 2011 – Adopting the Banking Industry Voluntary Code of Good Practice on Dispute Settlement and Outsourcing/Subcontracting of Certain Bank Functions". Downloadable at: http://blr.dole.gov.ph/blr_files/vcgp/national/banking_itc_reso_1_s2011.pdf.

Dacanay, S. J. O. (2007). Profit and Cost Efficiency of Philippine Commercial Banks Under the Periods of Liberalization, Crisis and Consolidation. A paper presented at The International Business & Economics Research Conference, Beverly Hilton, Los Angeles, California. p. 1

Gochoco-Bautista, M.S. (1999). The Past Performance of the Philippine Banking Sector and Challenges in the Postcrisis Period. In: Rising to the Challenge in Asia: A Study of Financial Makets: Volume 10-Philippines. Asian Development Bank, 30-78.

National Union of Bank Employees, 2010. "Banking Industry Tripartite Council Resolution No. 1, Series of 2010", handout produced for BITC discussion. (unpublished)

Ofreneo, R. E., 1996. "Evolving IR/HR Practices in Philippine Commercial Banking", in Lee, J. and Verma, A., eds., *Changing Employment Relations in Asian Pacific Countries*, Taipei: Chung-Hua Institution for Economic Research, pp. 345-366.

Ravalo, N., 2010. "What Makes a Bank a Bank? Defining what are inherent bank functions", handout produced for BITC discussion. (unpublished)

Republic of the Philippines, 2011. "Towards a Resilient and Inclusive Financial Sector", *Philippine Development Plan 2011*-2016, Mandaluyong: National Economic Development Authority, pp. 181-204.