



# Prospects for Philippine Investments and Financial Services

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# Why Invest in the Philippines

## International Monetary Fund

- ❖ The Philippines' macroeconomic fundamentals improved considerably during the past decade, closing the door on an era of recurrent balance of payment crises.

Public debt was nearly halved

Inflation has eased to low single digits

Growth has picked up and become more stable

External Vulnerabilities were reduced

Current Account consistently in surplus

Build-up stock of FX reserves

On the verge of achieving a net external asset position.

- ❖ Short-term market interest rates have fallen to exceptionally low levels.
- ❖ Main policy challenge - Safeguarding macroeconomic stability while building the foundations for stronger and more inclusive growth.

- April 2013 IMF Report

## Comparison of ASEAN CDS & Credit Ratings

	<b>5-Year CDS (In Basis Points)</b>	<b>Moody's Credit Rating</b>	<b>Moody's Credit Rating Outlook</b>
Philippines	93	Baa3	Positive
Indonesia	190	Baa3	Stable
Thailand	110	Baa1	Stable
Malaysia	109	A3	Stable

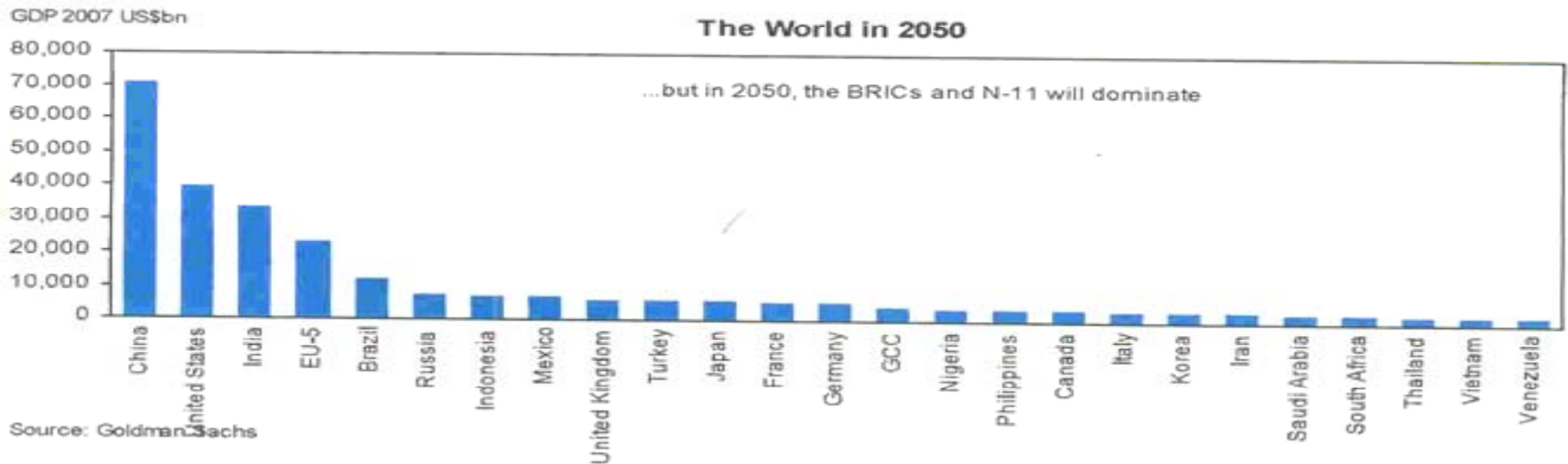
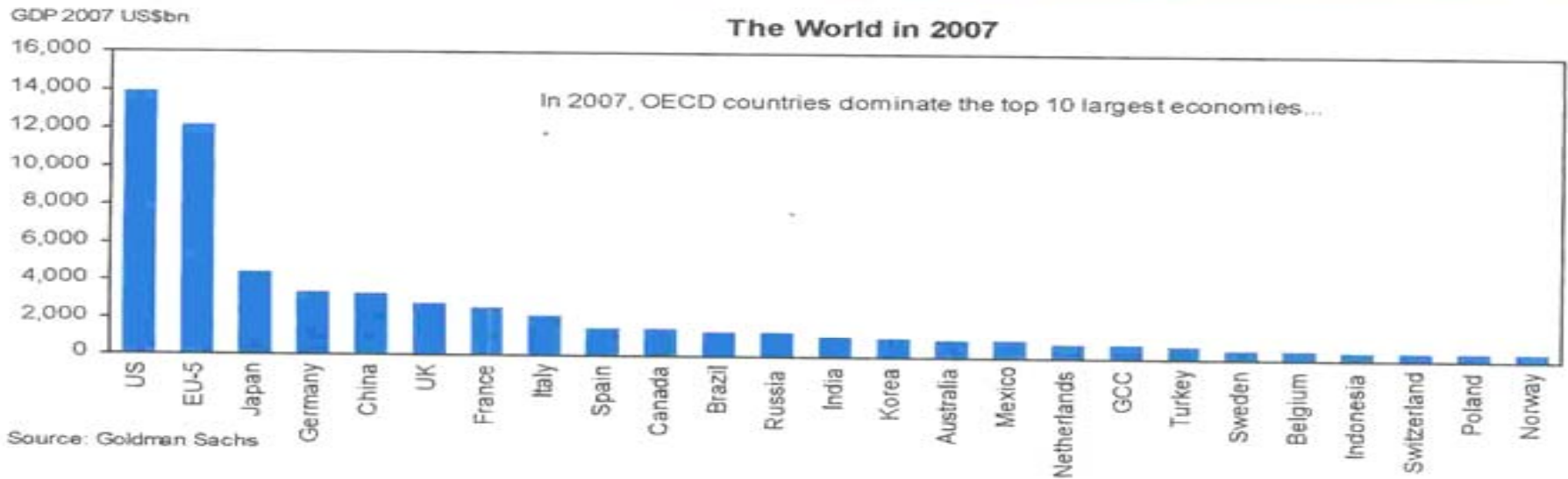
As of Oct. 29, 2013

Source: Bloomberg

# Why Invest in the Philippines

- ❖ Investment Grade Rating – Fitch; Standard and Poors; Moody's; Rating and Investment, Inc. (Japan-based rating agency)
- ❖ Demographic Dividend/Sweet Spot
- ❖ Bright Economic Conditions
- ❖ High GDP growth; Generally low interest rates; Fairly stable Peso; High FX reserves; Low deficit to GDP ratio; Manageable inflation.
- ❖ Fast Growth Economies (Next 16) Forecast – Goldman Sachs; HSBC; Citibank
- ❖ Preparing for ASEAN (2015) and ASEAN Banking Integration Framework (2020)

# Next 16



# Expanding Middle Class

## Exhibit 12: Tracking the rise of the middle class across the BRICs and N-11

Share of population with incomes between \$6,000 and \$30,000 (PPP terms)

%	Brazil	Russia	India	China	Korea	Bangladesh	Egypt	Indonesia	Iran	Mexico	Nigeria	Pakistan	Philippines	Turkey	Vietnam
2009	46	71	6	37	67	0	39	16	70	61	6	9	15	79	7
2015	52	71	16	59	46	1	57	29	77	65	9	13	23	81	20
2025	59	56	46	75	23	5	84	57	73	65	18	22	40	70	51
2040	57	29	89	53	7	38	82	87	41	49	42	49	69	35	84

Source: Goldman Sachs projections. In countries where the middle-class share declines over time (Russia, Korea, Iran, Mexico and Turkey), this reflects a shift into the higher-income category.

# Demographic Sweet Spot/ Dividend

## Emerging middle class amid large population

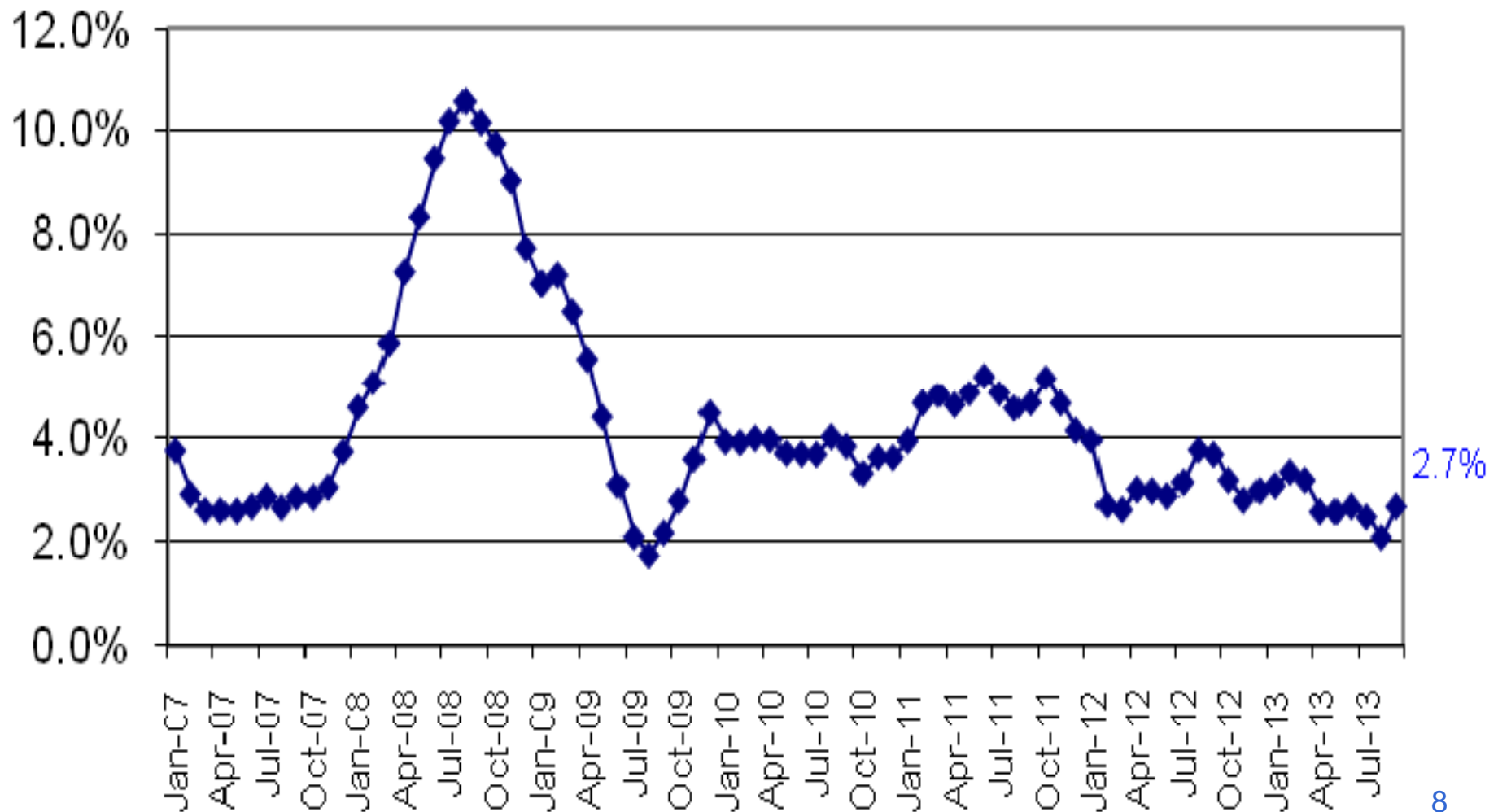
- ❖ 12<sup>th</sup> most populous nation in the world
- ❖ More than 95 million as of 2012
- ❖ 38<sup>th</sup> in the world in terms of GDP (as of 2012)

## Demographic sweet spot/ dividend (2015)

- ❖ Majority of the population will be of working age
  - Increased incomes, consumption, savings
  - Countries entering this phase have experienced relatively high growth for over two (2) decades

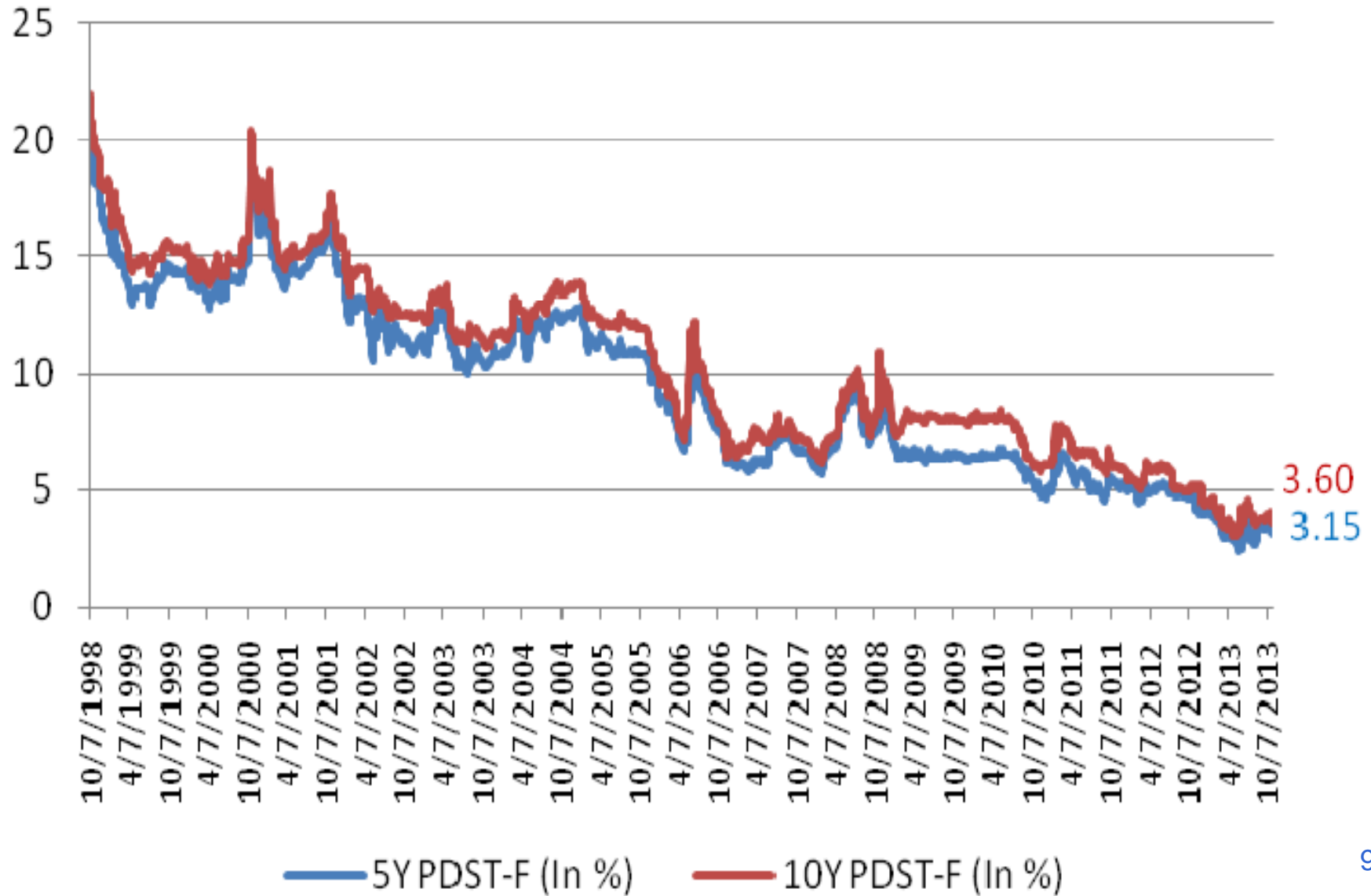
# Benign Inflation/CPI (Near 4-Year Lows)

Inflation Rate (CPI)



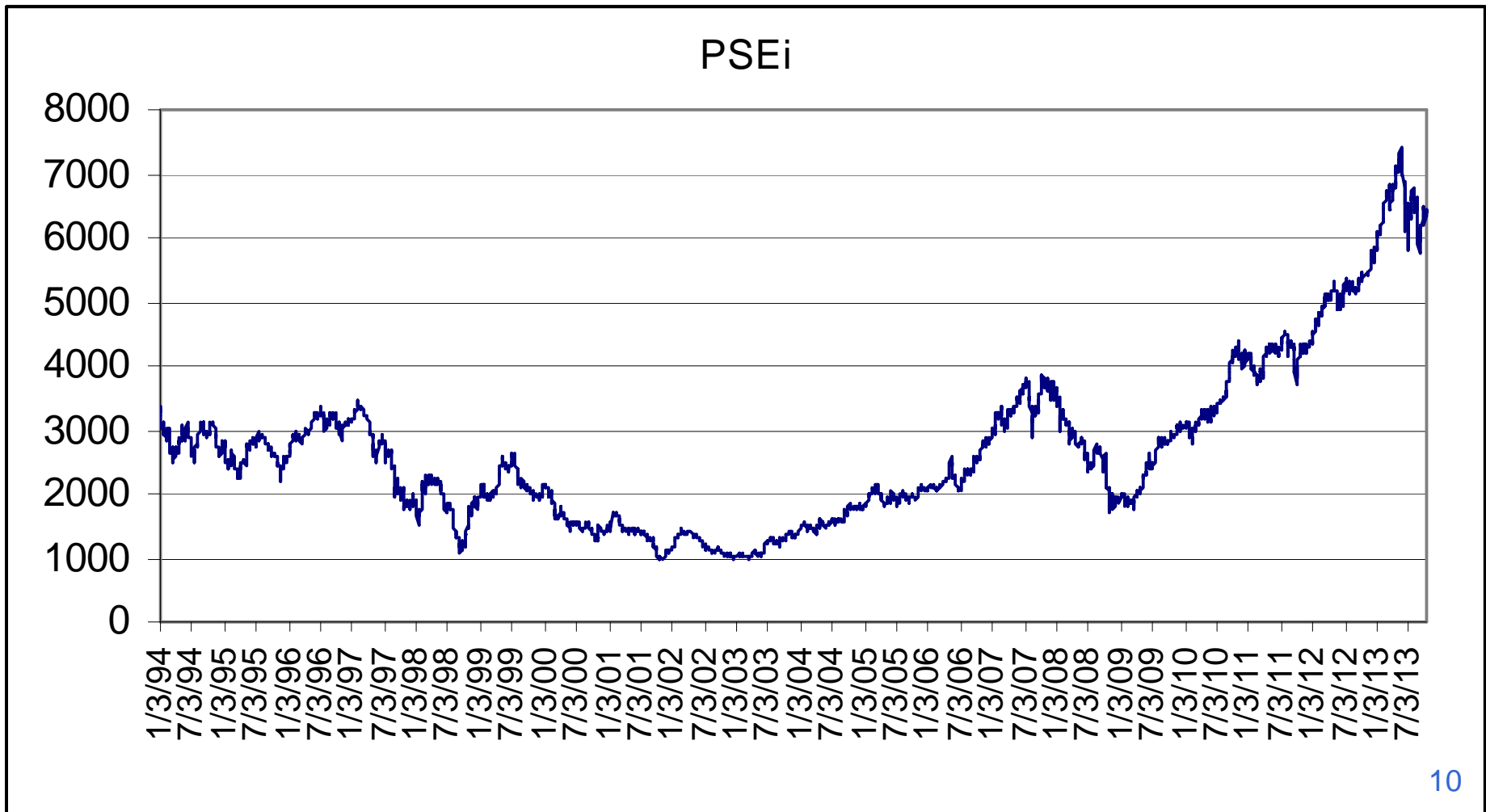


## 5- & 10-Year PDST-F Yields Again Near Record Lows Recently



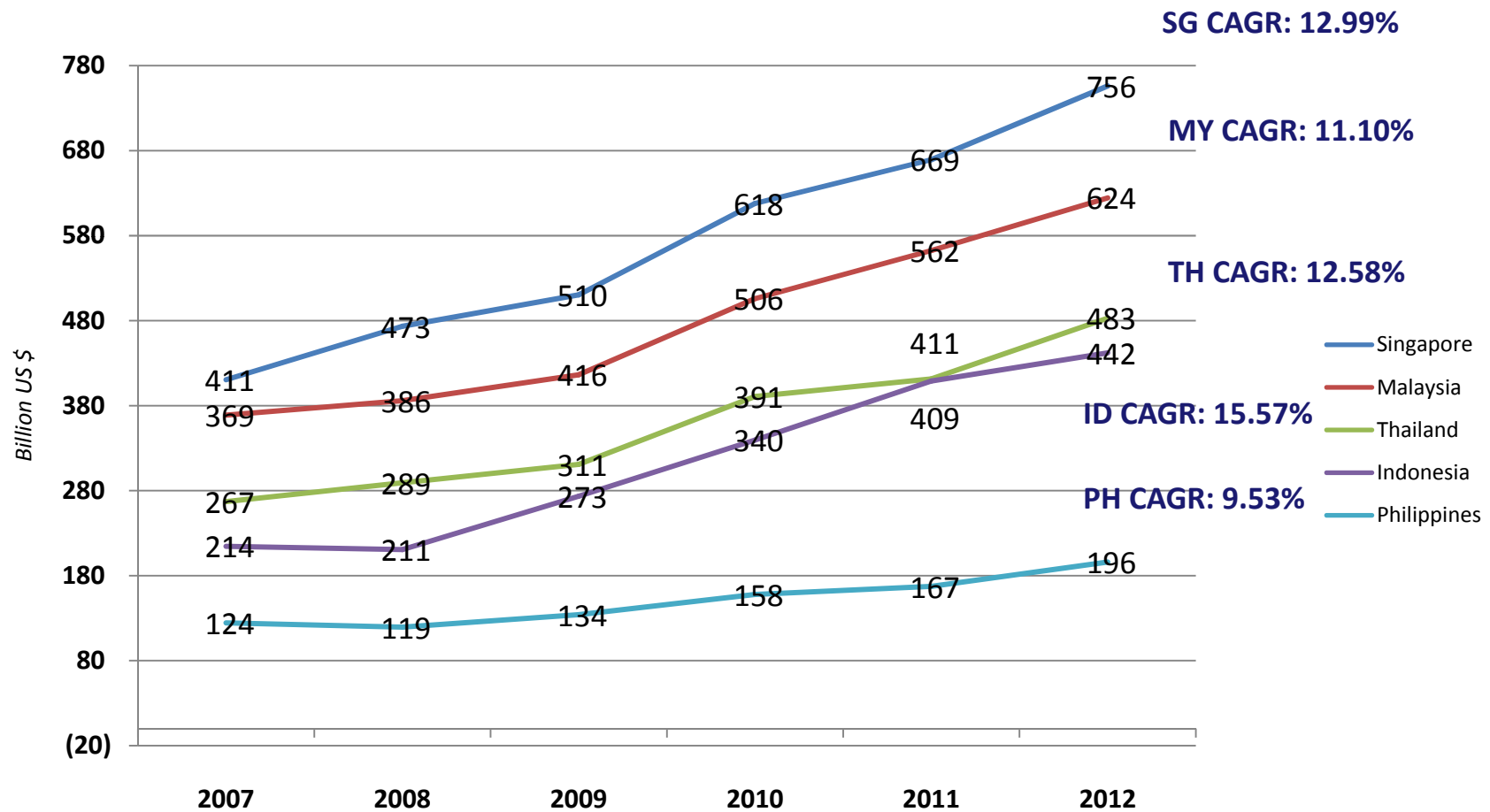
# Why Invest in the Philippines

Economic Conditions favorable for the development of the Capital Markets



# Why Invest in the Philippines

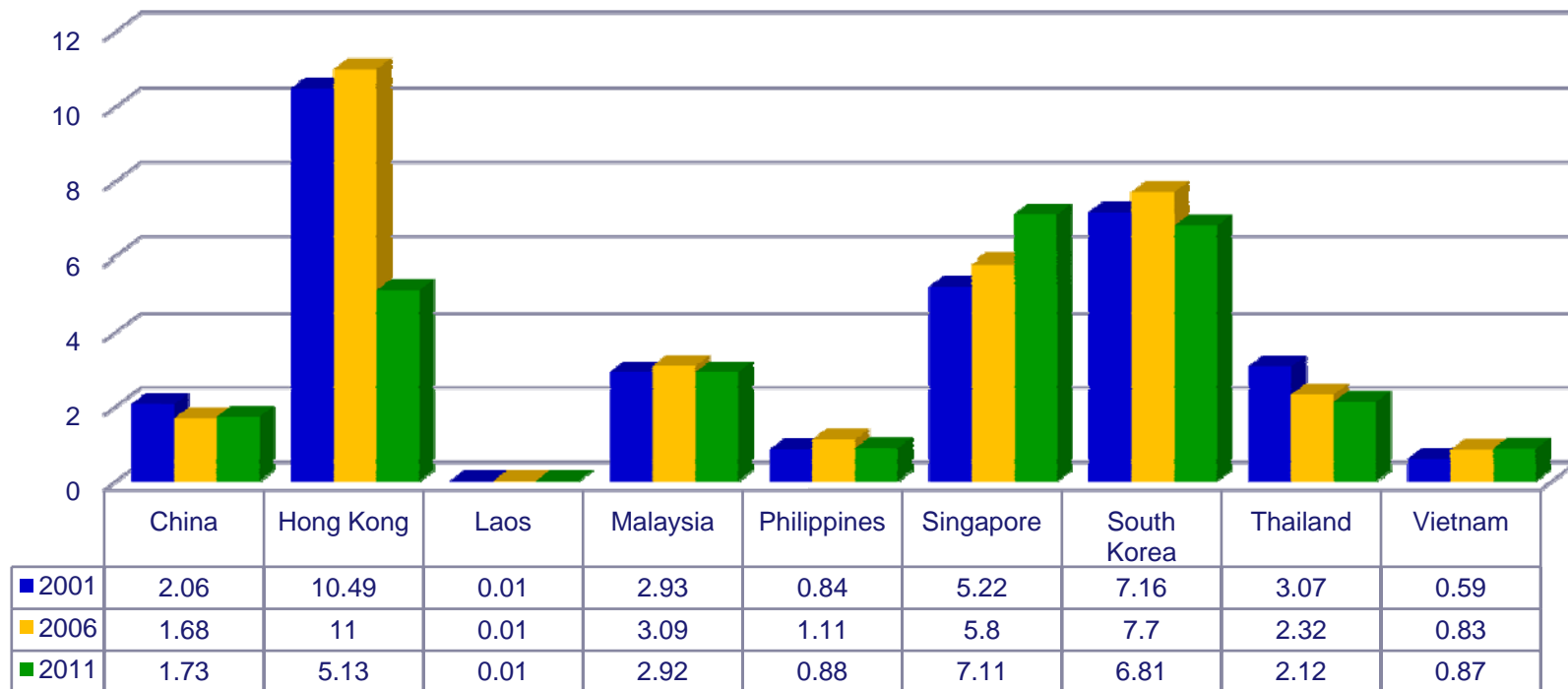
Philippine Banking System still has opportunity to grow



# Why Invest in the Philippines

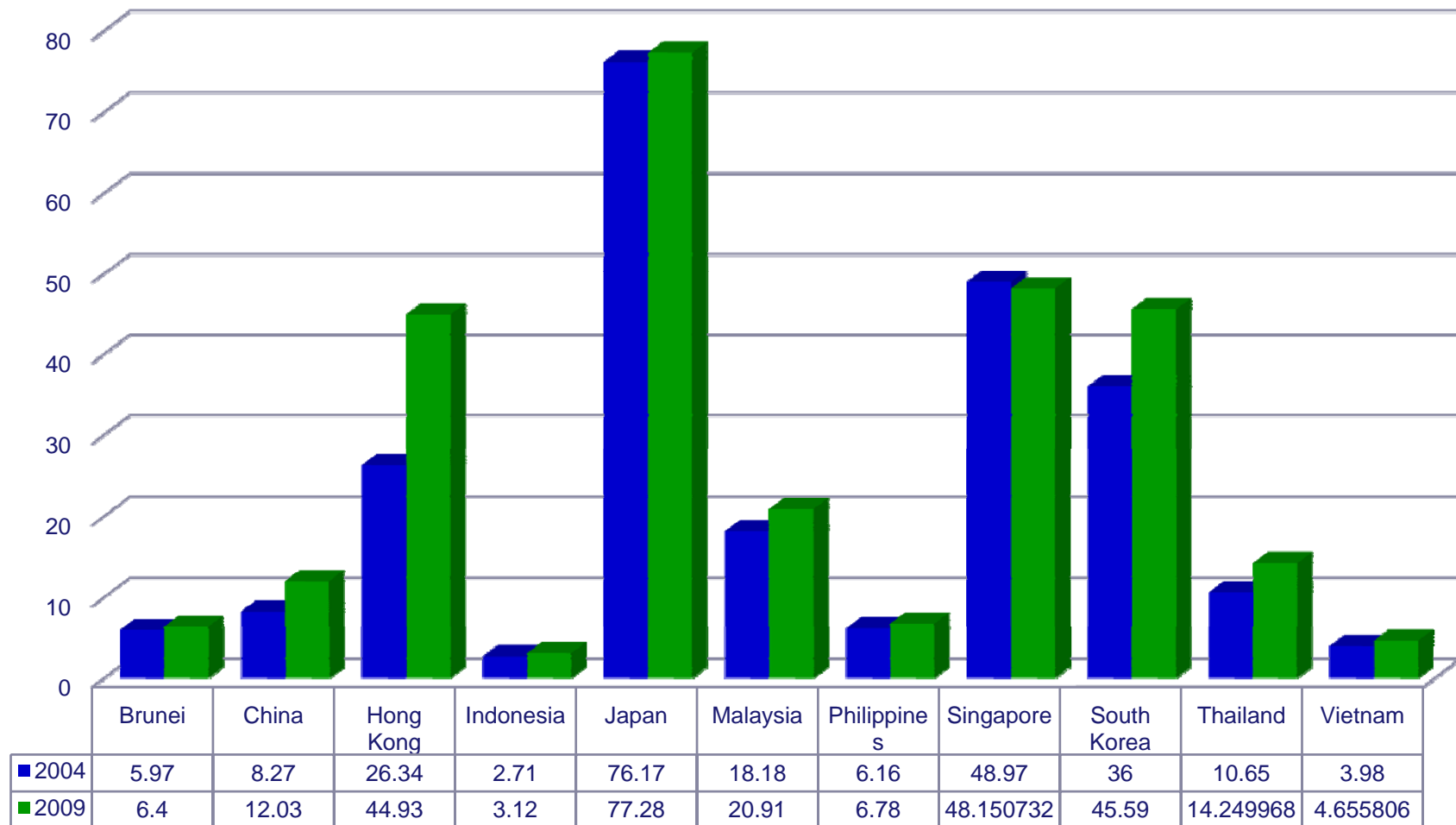
In the Philippines, Insurance Companies, Pension Funds, Mutual Funds and other investment management Companies will also grow

Life insurance premium volume to GDP (%)



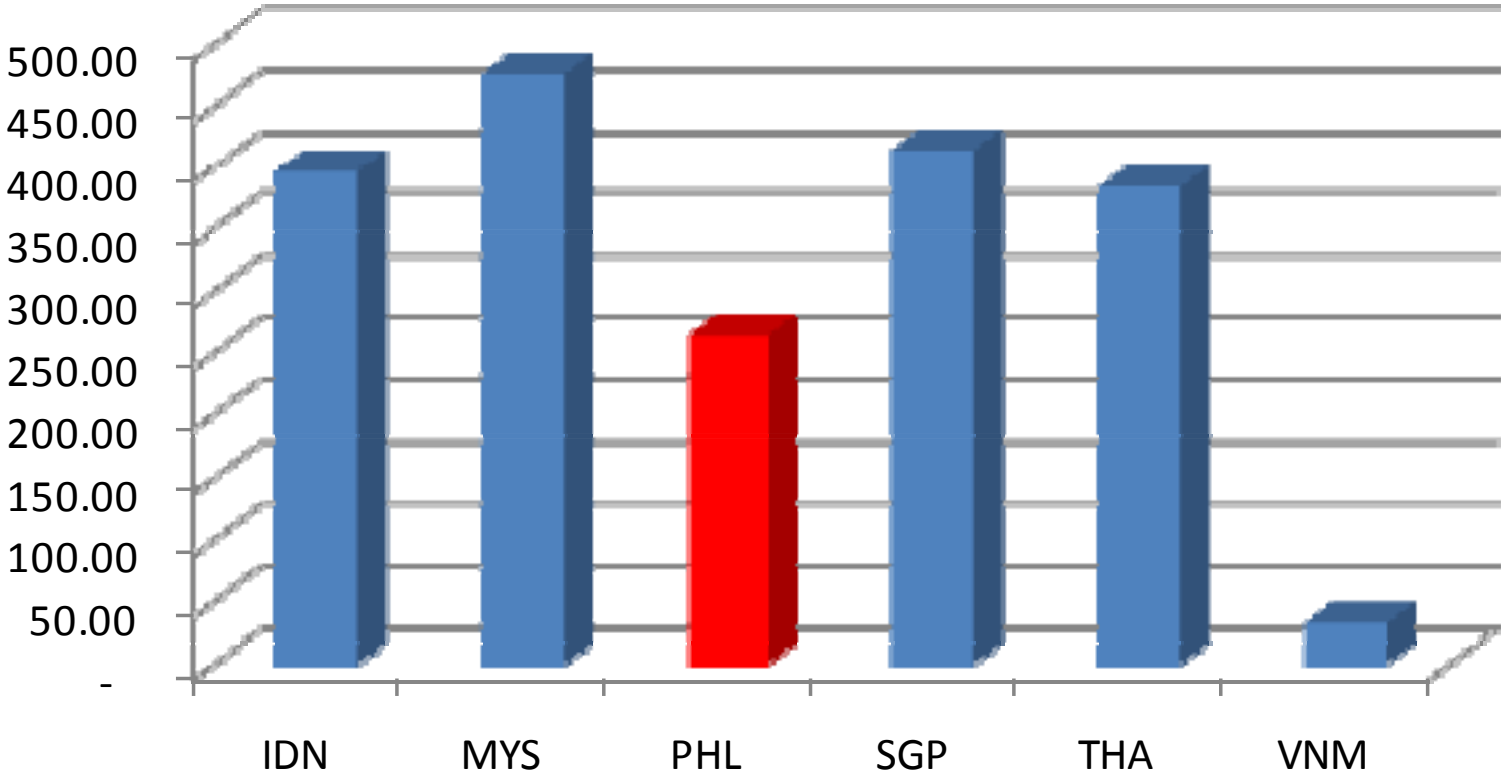
# Why Invest in the Philippines

Insurance company assets to GDP (%)

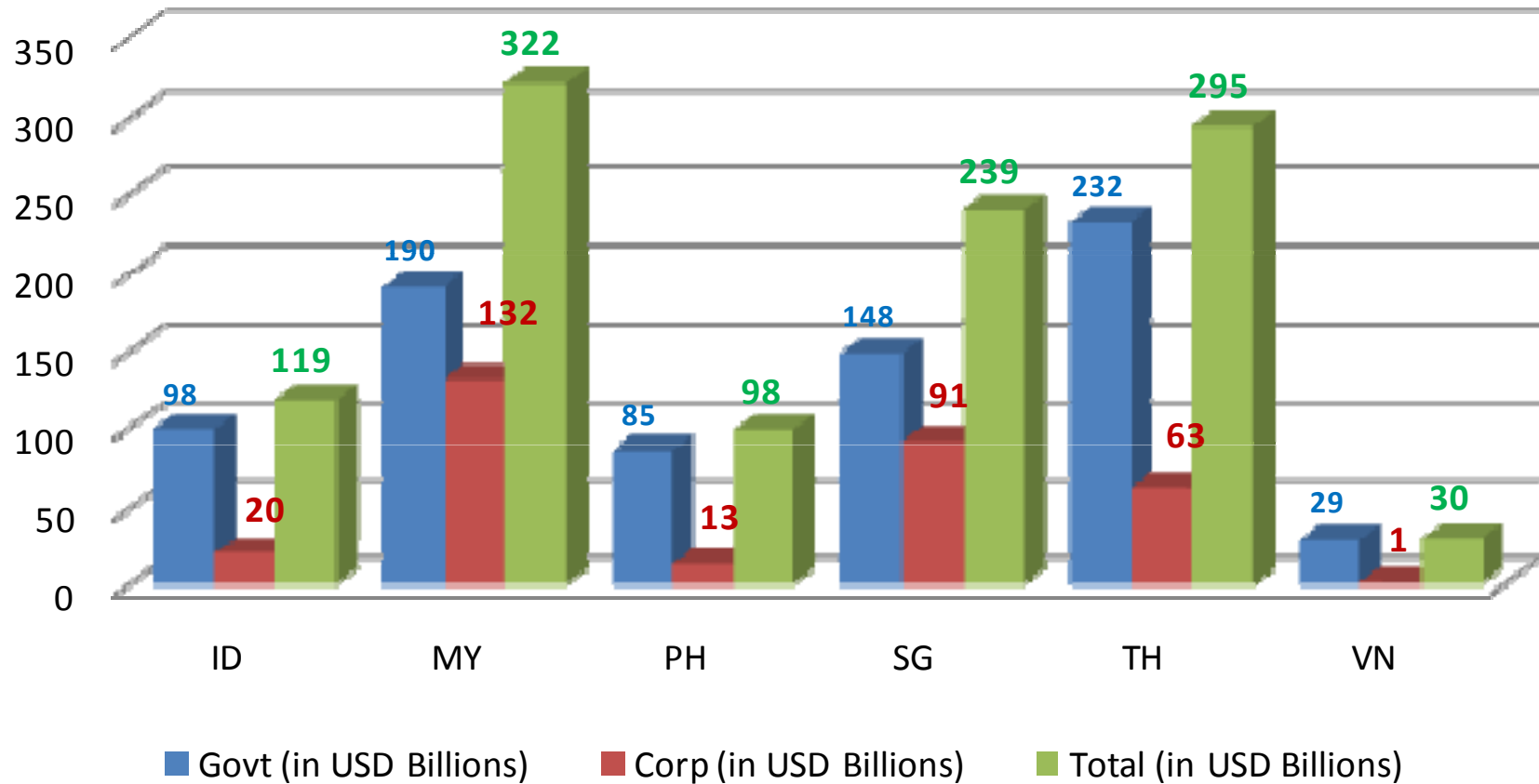




**Market Cap of Listed Cos. -ex US, CN, JP (in US\$): 2012**

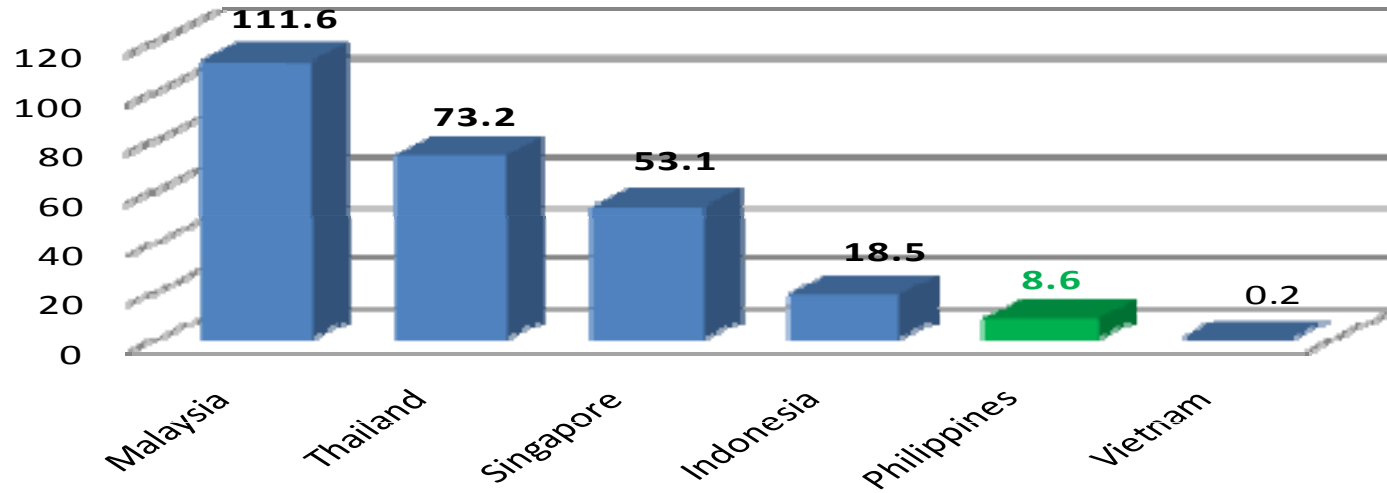


## Size of Local Currency Bond Market ex-JP, CN (US\$ Bil): Mar. 2013

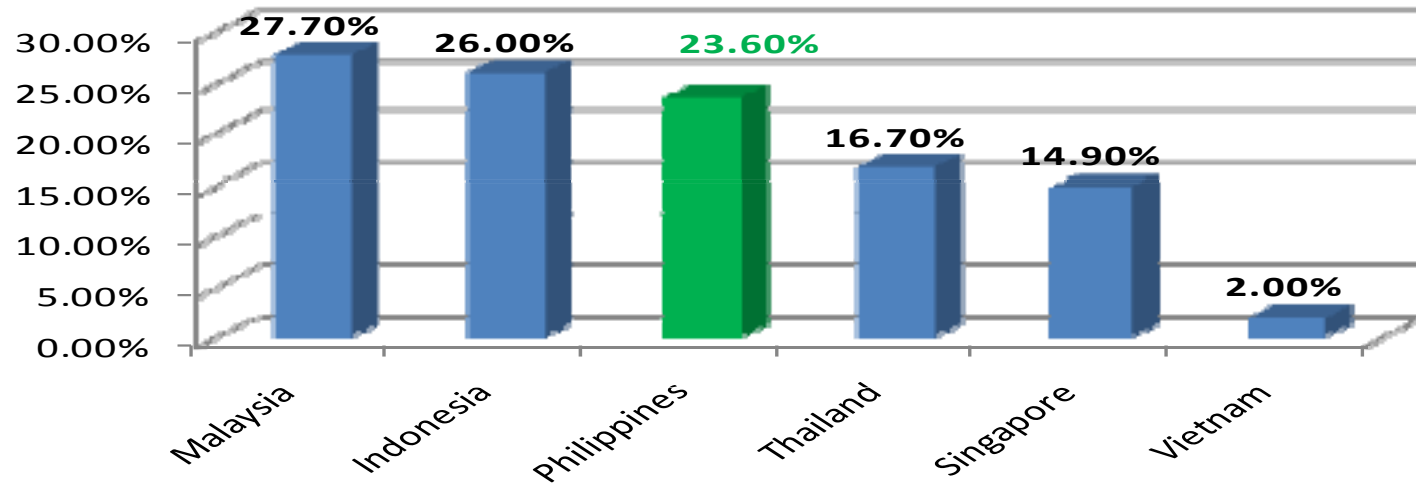


Source: Asian Development Bank

**Mutual fund AUM: 2012 (in US\$ Bil)**

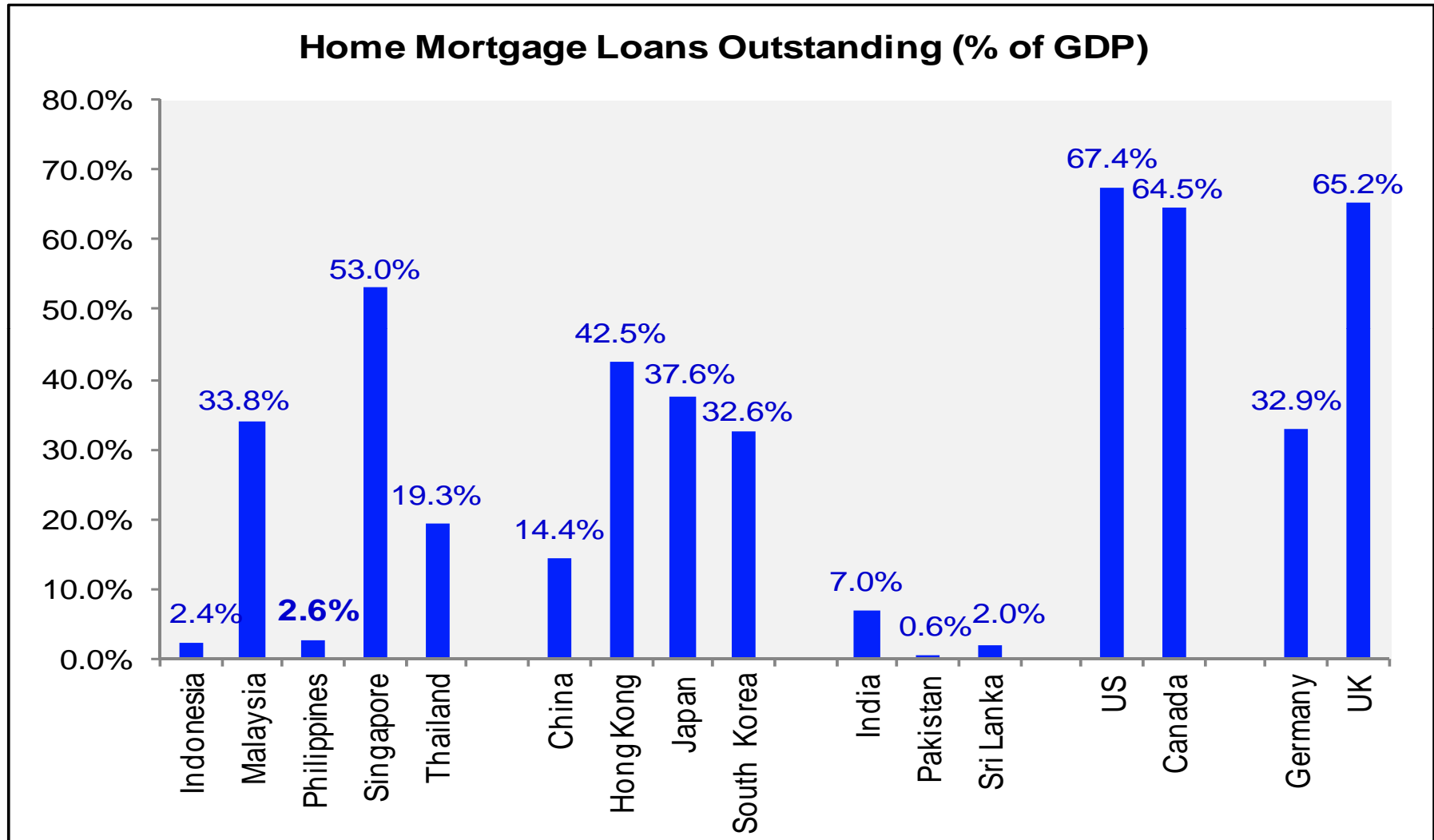


**Mutual fund AUM CAGR: 2008-2012**





# Comparison Mortgage-to-GDP Ratios For Different Countries



Source: Housing Finance Information Network (HOFINET)--Wharton, IFC, World Bank, FMO

# Challenges and Opportunities

Risks and Challenges

Governance and Regulatory complexity

Operations and Technology

Growth Challenges

Human Capital



A photograph of a dense forest with many tall, thin trees and a dirt path leading through them. The trees are mostly deciduous with green leaves. The path is in the center, leading away from the viewer. The lighting is bright, suggesting a sunny day.

# Think Big Picture

“Don’t look at the trees,  
Look at the forest.”



A blue-tinted image of a hand holding a globe. The globe shows continents and is held in a cupped position. The text is overlaid on the globe.

**Risks and Challenges**  
**in a BORDERLESS**  
**INTERCONNECTED**  
**GLOBAL ECONOMY**

# Risks and Challenges

Date	Crisis	Type of Risk	Measures/Regulations
1980s	LDC Crisis	Sovereign, Default Risk	Fiscal/Structural Reforms, Governance
Oct. 19, 1987	Black Monday (US Stock Market Crash: -23%)	Market Risk; Iran Fired Missiles to Two US Ships in Persian Gulf	Market Circuit Breakers; Stricter Disclosure, Transparency
Late 1970s- Early 1990s	Savings & Loans (S&L) Crisis; High US Int. Rates	Collapse of Some S&Ls	Scrapped interest rate ceilings on deposits
1990-1991	Iraq invasion of Kuwait; Persian Gulf War (Desert Storm)	Sharp Increase in Oil Prices, Inflation; Market Risk	Tighter Monetary Policy; Renewable Energy
Summer of 1997	Asian Financial Crisis (Started in Thailand; baht depreciated from 25 to 58)	Currency, Market Risk	Floating Currencies; Currency Swaps Among Central Banks
Aug. 1998	Russian Default (sharp sell-off in global financial markets)	Credit/Default Risk, Market Risk	IMF/World Bank financial rescue; Fiscal Reforms
Sep. 1998	LTCM Crisis	Market Risk	Hedges/Diversification

# Risks and Challenges

<b>Date</b>	<b>Crisis</b>	<b>Type of Risk</b>	<b>Measures/Regulations</b>
Sep. 11, 2001	Sep. 11 Terrorist Attacks (stock markets closed until Sep. 17, 2001)	Security, Operational Risk	Tighter Anti-Money Laundering Laws
2002	US Corporate Malfeasance Crisis (Enron, WorldCom, among others)	Governance Risk; Integrity of Financials	Sarbanes-Oxley; Stronger Corporate Governance Standards
2007	US Subprime Crisis (sell-off in global financial markets)	Credit, Liquidity, Leverage Risk	Tighter Lending Standards
Sep. 2008	Lehman Bankruptcy; Washington Mutual Collapse; Merrill Lynch merged with Bank of America (worst sell-off since Great Depression; forced liquidations)	Credit, Liquidity, Leverage, Market Risk	Basel 3; Dodd-Frank; Sovereign Support of Banks; Creation of Bank Holding Companies; TARP; Economic Stimulus
Nov. 2009	Greece/Euro Zone Crisis (sell-off in global markets)	Default Risk	IMF Assistance ; Deposit Guarantees

# Risks and Challenges

<b>Date</b>	<b>Crisis</b>	<b>Type of Risk</b>	<b>Measures/Regulations</b>
2011	Arab Spring Crisis (sell-off in global financial markets)	Market Risk (Higher Oil Prices)	Greater Drive For Renewable Energy
Aug. 2011	First US Credit Rating Downgrade by S&P After Fiscal Deadlock in Congress (US stock markets declined by at least -10% from highs)	Default Risk; Dysfunctional Bipartisanship in US Congress	Temporary Extension of US Funding/Debt Ceiling
May 22, 2013	Market sell-off after Bernanke signalled possible tapering of bond purchases (major stock markets declined by as much as -20% from highs)	Market Risk (Risk of Bubble Conditions)	Easy Monetary Policy; Record Low Interest Rates
Oct. 1-16, 2013	US Gov't. Shutdown (Partial); Could Cut US GDP Growth by -0.25	Market Risk, Credit Risk	Temporary Extension of US Funding/Ceiling; Hedging US Treasuries

# Asian Financial Crisis

- Excessive investment in property which caused property bubble.
- Over reliance on foreign investments to fund corporate debt, which began to taper off after the Federal Reserve raised interest rates. Asian economies attracted investment foreign inflows though high interest rates, which lost some of their attractiveness after the US Fed raised rates.
- Devaluation of the Chinese Yuan led Asian exports to become more expensive, thus reducing their competitiveness
- GDP growth in SEA economies was due to increases in investment rather than increases in total factor productivity.
- Fixed exchange rate led to Asian companies borrowing in foreign currencies.



# Liquidity Risk

## ❖ Write-downs/Credit losses of major global banks: US\$1.5tn

- Sept. 15, 2008: Bankruptcy of Lehman Brothers – largest bankruptcy in US History.
- Sept. 16, 2008: US gov't. bailout for AIG – largest bailout.
- Sept. 21, 2008: Goldman Sachs & Morgan Stanley became banks.
- Sept. 25, 2008: Washington Mutual seized by FDIC - biggest bank to ever fail.
- Nov. 23, 2008: US gov't. bailout for Citigroup - biggest ever for a bank.
- Credit/freeze/Risk aversion

- Troubled Asset Relief Program or TARP (US\$700bn),
- US economic stimulus (US\$787bn),
- US gov't. buyback of long-term Treasuries (US\$300bn)
- Operation Twist to extend bond maturities (US\$ 667 bn)
- QE3 (US\$85 mn monthly bond purchases)
- Fed Funds rate kept at record low 0.0% to 0.25% since Dec 2008

# Credit Risk

## The Largest U.S. Bankruptcies

1.	Lehman Brothers Holdings (09/15/08)-	\$691 billion
2.	Washington Mutual (09/26/08) -	\$327.9 billion
3.	WorldCom (07/21/02) -	\$103.9 billion
4.	General Motors (06/09) -	\$91 billion
5.	CIT (11/01/09) -	\$71 billion
6.	Enron (12/02/01) -	\$65.5 billion
7.	Conseco (12/18/02) -	\$52.3 billion
8.	Pacific Gas & Electric (04/06/01) -	\$49.75 billion
9.	Chrysler (04/30/09) -	\$39 billion
10.	Thornburg Mortgage (05/01/09) -	\$36.5 billion

**Global Recession**

**Almost Systemic Collapse**

# Operational Risks

## Bernard Madoff

- Fraudulent investment operation- Ponzi scheme
- Actual net fraud estimated to be between \$50 and \$64.8 billion

## Morgan Stanley

- Morgan Stanley mortgage bond trader Howie Hubler lost in 2008 about \$ 9 billion on subprime bets.



**SOCIETE  
GENERALE**

- Soc Gen claims that Bank trader Jerome Kerviel was engaged in trades of as much as EUR4.9bn (bigger than the bank's market capitalization), stating that "had taken massive fraudulent directional positions in 2007 and 2008 far beyond his limited authority.
- Kerviel received a 3-year prison sentence for unauthorized trades which cost the bank EUR4.9bn.



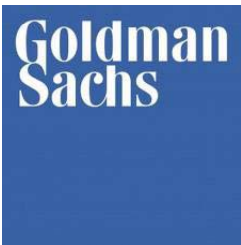
**JPMorgan**

- In 2012, large trading losses occurred at JPMorgan's Chief Investment Office, based on transactions booked through its London branch. A series of derivative transactions involving credit default swaps(CDS) were entered, reportedly as part of the bank's "hedging" strategy.
- Trader Bruno Iksil nicknamed the "London Whale", accumulated outsized CDS positions in the market. An estimated trading loss of \$5.8 billion was announced, with the actual loss expected to be substantially larger.

# Operational Risks



- Collapsed in Mar. 1995 and bought by Dutch company ING for one British pound.
- Collapse caused by employee Nick Leeson in the bank's Singapore office.
- Losses amounted to more than US\$1bn, which caused the failure of Britain's oldest investment bank



- Fabrice Tourre, former Goldman Sachs bond trader was found liable for fraud for his role in a failed mortgage deal that cost investors US\$1bn in a debacle that foreshadowed the financial crisis.
- Tourre and Goldman allegedly misled investors in an investment called Abacus 2007-AC1, otherwise known as a synthetic collateralized debt obligation.



- The plaintiffs alleged that the former Fannie executives, including CEO Franklin Raines, manipulated Fannie Mae's earnings to artificially inflate its stock price
- In 2011 the SEC charged Fannie Mae executives with fraud, indicating that they 'knew and approved of' misleading statements claiming the companies had minimal exposure to subprime loans at the height of home mortgage bubble

# Governance and Regulatory Complexity



Sarbanes-Oxley Act of 2002

Dodd-Frank Act of 2010



BASEL III



Anti-Money Laundering Act



Strengthening Corporate Governance in BSP Supervised Financial Institutions



Revised code of Corporate Governance

Annual Corporate Governance Report



Corporate Governance Manual



ASEAN Corporate Governance Manual

# Operations and Technology



To address:

Greater volume

Need for speed

Cost efficiency

Customer convenience/reach

Improved/real time reporting

Data analytics

Decision support tools

Big Data

Cognitive banking

# Growth Challenges

## **Alternatives:**

Organic or M&A

To be Global or Regional or Local

- Difficult to find growth in mature markets
- Scale becomes more important
- Organic growth through:

Branding/Brand equity

Improved distribution and distribution analytics

Customer segmentation and analytics

# Human Capital

Recruiting  
and Training

Trust and  
Transparency

Integrity  
Screening

Invest in Talent



# Human Capital



“Somebody once said that in looking for people to hire, you look for three qualities: **INTEGRITY**, **INTELLIGENCE**, and **ENERGY**. And if they don’t have the first the other two will kill you.”

Warren Buffett

# Experience

## “The best teacher of Governance”

1. You don't become a good lender until you've done some bad loans.
2. You don't become a good trader until you've done some bad trades.
3. You don't become a good operations head until you've experienced operational losses.
4. You don't become a good asset manager until you've made some bad investments.
5. You don't become a good CEO, until you've seen all of the above.



END