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Closing the Backdoor: Fintech License Strategies, Regulatory Reclassification, and the Architecture of Digital Bank Supervision in the Philippines

Marigold Geca¹; Cherry Ann Marie Espelita, MBA²; Andrea Gwyneth Atento³, Ramon George Atento, PhD⁴

¹Bank of the Philippine Islands, ²University of Cabuyao, ³Colegio de Santo Domingo de Silos, ⁴First Asia Institute of Technology and the Humanities

mcgeca@bpi.com.ph

Abstract

The rapid digitalization of banking in the Philippines created conditions under which fintech-affiliated firms could operate nationally active digital banking platforms (Pradipta et al., 2023). This paper examines this license-category arbitrage and the BSP's regulatory response — the Prudential Requirements for Digital-Centric Thrift Banks, Rural Banks, and Cooperative Banks — through a structured analytical and documentary review. Drawing on five thematic streams of scholarly and policy literature encompassing regulatory arbitrage theory, digital banking governance in emerging markets, tiered capital framework design, fintech–bank hybrid strategies, and the financial inclusion consequences of prudential tightening, the paper evaluates the BSP's framework against criteria of internal coherence, proportionality, competitive neutrality, and inclusion-sensitivity. The analysis finds that the framework's two principal instruments — a geographic customer concentration threshold of 30% and a tiered capital ladder linked to digital adoption rates — are analytically coherent and broadly consistent with established principles of proportionate banking regulation. The geographic threshold restores operational alignment between rural bank license classifications and their associated prudential standards; the tiered capital ladder compresses the residual arbitrage space below the formal reclassification trigger. However, the framework is found to be inadequately developed in terms of financial inclusion, lacking explicit inclusion-sensitive transition provisions that could mitigate short-run service contraction risks for underserved populations in island and rural communities. The paper further situates the Philippine case within the comparative Southeast Asian regulatory landscape, identifying the BSP's ex post reclassification approach as a model of potential relevance for regulators in markets facing analogous technology-enabled licence arbitrage dynamics. Recommendations are offered for regulatory implementation, supervisory data infrastructure, regional licensing framework design, institutional capital strategy, and future empirical research.

Keywords: *regulatory arbitrage; digital banking regulation; prudential capital requirements; Bangko Sentral ng Pilipinas; financial inclusion; fintech licensing; emerging-market banking regulation*

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1. Introduction

The digital transformation of banking in Southeast Asia has accelerated at a pace that has frequently outrun the regulatory frameworks designed to govern it (Jameaba, 2022). Across the region, fintech firms have pursued banking licences not merely as compliance obligations but as strategic assets — gateways to deposit-taking, lending, and

payment infrastructure that underpin scalable financial businesses (Pawlak, 2023). In the Philippines, this dynamic took a particularly instructive form. Rather than pursuing the designated digital bank licence established by the Bangko Sentral ng Pilipinas (BSP) in 2020, a number of fintech-affiliated entities chose an alternative path: the acquisition of rural bank licences, which carry substantially lower capitalization requirements, and the construction of nationwide digital platforms upon these sub-national institutional frameworks. The result was a category of institution that was, in regulatory terms, a community-based rural bank, but in operational terms, a nationally active digital lender or deposit-taking platform.

This divergence between licence classification and operational reality represents a textbook case of regulatory arbitrage in banking — a phenomenon in which firms exploit gaps between the regulatory burdens associated with different institutional categories to achieve market access at lower cost and with reduced oversight (Minto et al., 2021).

The prudential implications of this arrangement were significant. Rural bank regulatory standards — including capital adequacy ratios, governance expectations, risk management frameworks, and oversight intensity — were calibrated for community-level financial institutions serving geographically bounded populations with predictable and relatively contained risk profiles. When the same institutions began onboarding customers from across the Philippine archipelago through cloud-based platforms and mobile applications, the alignment between their licence-mandated risk management capacity and their actual operational risk exposure deteriorated materially. Cybersecurity obligations, fraud exposure, liquidity management complexity, and systemic interconnectedness all expand with scale in ways that rural bank prudential standards were not designed to absorb (Hassan et al., 2025; Uddin et al., 2023).

The significance of this regulatory development extends well beyond the Philippines. Across Asia, digital banking has expanded rapidly, and regulators in markets including Singapore, Malaysia, and Indonesia have grappled with analogous questions about how to design licensing frameworks that are permissive enough to support financial innovation and inclusion yet rigorous enough to ensure systemic resilience (Pradipta et al., 2023; Ehrentraud et al., 2020). The Philippine case offers a particularly clear example of what happens when these frameworks contain exploitable discontinuities — and of how a central bank can respond through structural regulatory redesign rather than through blanket restriction.

This paper examines the BSP's new prudential framework through the lens of banking regulation theory, comparative digital banking governance, and the broader policy tension between financial stability and financial inclusion in emerging-market contexts. It does so through a structured analytical and documentary review, drawing on regulatory literature, fintech governance scholarship, and comparative international experience. The paper is not an empirical evaluation of the policy's effects — which, given its recent nature, remain to be observed — but rather an analytically grounded assessment of its design logic, its institutional implications, and its relevance to the wider question of how regulators in developing economies should govern the boundary between traditional and digital banking.

The paper pursues four interconnected objectives. First, it traces the theoretical and empirical literature on regulatory arbitrage in banking, establishing the conceptual foundation for understanding the Philippine case. Second, it examines the international literature on digital banking regulation and tiered prudential frameworks, identifying the design principles that inform effective governance of hybrid and digital financial institutions. Third, it subjects the BSP's new framework to analytical scrutiny, assessing its internal logic, its likely competitive and structural consequences, and its alignment with established regulatory design principles. Fourth, it considers the implications of this policy episode for financial inclusion, market concentration, and the architecture of digital banking regulation in comparable emerging-market economies across Asia.

2. Review of Related Literature

2.1 Regulatory Arbitrage in Banking: Theory, Mechanisms, and Documented Cases

Regulatory arbitrage in banking refers to the deliberate exploitation of structural asymmetries in regulatory frameworks — across institutional categories, product classifications, or jurisdictions — to reduce compliance costs, minimize capital obligations, or gain market access under less stringent oversight conditions (Moles, 2022). The concept is embedded in the broader literature on regulatory economics, which holds that regulated entities, acting as rational actors, respond to differences in regulatory burden. In financial systems, this response manifests across a wide range of behaviors: the migration of activities from regulated banks to shadow banking entities (Moles, 2022), the use of off-balance-sheet structures to reduce capital charges (Papanikolaou & Wolff, 2014), the selection of booking

jurisdictions to minimize supervisory intensity, and — as the Philippine case illustrates — the strategic use of lower-tier licence categories to achieve market access ordinarily associated with more heavily capitalized and regulated institutional forms.

The theoretical foundations of regulatory arbitrage in banking draw on multiple traditions. Public choice theory frames arbitrage as an expected consequence of any regulatory regime that imposes differential costs on functionally equivalent activities, leading firms to seek the path of least regulatory resistance where doing so is economically rational and legally permissible (Frantz & Instefjord, 2018). The regulatory dialectic literature, associated in particular with work on the evolution of financial regulation following crises, describes a dynamic in which regulators close known arbitrage channels only for new ones to emerge as market participants adapt (Klapkiv & Ülgen, 2022). This cyclical dynamic has been documented extensively in the context of capital regulation under successive Basel frameworks, where innovations in securitization have at various points served as vehicles for regulatory capital relief that undermined the spirit of the underlying framework even while remaining within its formal boundaries (Scannella, 2012).

Empirical documentation of banking regulatory arbitrage exists (Boyer & Kempf, 2016). Studies of the pre-2008 financial system in the United States and Europe identified the growth of structured investment vehicles, conduits, and other off-balance-sheet entities as a systematic arbitrage of capital requirements, one that concentrated risk outside the perimeter of prudential supervision while maintaining implicit connections to regulated institutions (Papanikolaou & Wolff, 2014). The Basel II internal ratings-based approach similarly attracted criticism for enabling capital optimization strategies — particularly among large internationally active banks — that reduced reported capital ratios without commensurate reductions in actual risk exposure (Resti, 2016).

In emerging-market contexts, the literature is less extensive but carries important insights. Research on financial systems in emerging economies has identified licence-category arbitrage as a phenomenon, particularly in banking systems that maintain multiple tiers of institutional classification with different capital minima, geographic operating restrictions, and supervisory regimes (Settlements, 2006). The coexistence of commercial banks, thrift banks, rural banks, cooperative banks, microfinance institutions, and savings and credit cooperatives within a single national financial system creates multiple points at which operational equivalence may be achieved under structurally different regulatory conditions (Yoshino & Morgan, 2016). Differences in capital requirements across financial institutions can create incentives for regulatory arbitrage (Freixas et al., 2007).

What distinguishes the Philippine digital banking case from earlier forms of institutional arbitrage is the role of technology as an enabler. In prior episodes, arbitrage typically required either physical infrastructure — the establishment of new entities, the booking of assets in different jurisdictions — or financial engineering — the construction of instruments or structures that fell outside the regulatory perimeter (Blinder, 2015; Friedrich & Thiemann, 2020). In the Philippine fintech-rural bank model, digital infrastructure performed this function. Cloud-based onboarding systems, mobile applications, and API-driven payment rails allowed institutions with minimal physical presence to serve a geographically dispersed national customer base at marginal cost (Chatterjee, 2024; Qi, 2023). The technology effectively collapsed the economic logic of geographic operating restrictions, which had previously served as a natural complement to sub-national licence categories by limiting the scale at which such institutions could realistically operate.

This interaction between digital infrastructure and licence arbitrage has not been extensively theorized in the existing literature, representing an important analytical gap. Conventional regulatory frameworks often emphasize addressing risks that are measurable and based on historical evidence (Gai et al., 2019).

2.2 Digital Banking Regulation and Prudential Frameworks in Emerging Markets

The regulatory governance of digital banking in emerging markets has evolved rapidly since approximately 2015, driven by the simultaneous expansion of mobile connectivity, the proliferation of fintech business models, and the policy imperative of financial inclusion (Kouam, 2025; Mashoene et al., 2025). Central banks and financial regulatory authorities across Asia, Africa, and Latin America have responded with a diverse array of licensing frameworks, sandbox mechanisms, and prudential standards — reflecting both the heterogeneity of national financial systems and the absence of a universally accepted international template for digital bank regulation (Igbinenikaro & Adewusi, 2024; Nnaomah et al., 2024).

In Southeast Asia, the divergence in regulatory approaches has been pronounced. Singapore's Monetary Authority of Singapore introduced a dedicated digital bank licensing framework in 2020, distinguishing between digital full bank licences — available to non-bank applicants — and digital wholesale bank licences, which carry narrower operating permissions (Asia Small and Medium-Sized Enterprise Monitor 2020, 2020; Han & Xu, 2022). The framework reflects a deliberate policy of managed market entry, with a limited number of licences issued and applicants subject to rigorous assessment of financial soundness, business model viability, and technology risk management. Malaysia's Bank Negara similarly established a digital banking licensing framework, awarding five licences under a foundational phase with constrained balance sheet exposure limits before transition to full operational status (Ehrentraud et al., 2020). Both frameworks share a common design principle: the acknowledgment that digital banks constitute a functionally distinct institutional category warranting purpose-built regulation, rather than adaptation of existing community or commercial bank standards.

Indonesia's approach has been more permissive and acquisition-oriented (Lathifah & Suyanto, 2022). The Financial Services Authority (OJK) has facilitated the digital transformation of conventional banks through the conversion of existing bank licences rather than the creation of new digital categories (Yuspin et al., 2023), and minimum capital requirements for digital banking operations (Kurniawan, 2022). A number of prominent Indonesian digital banks — including Bank Jago and Bank Aladin — emerged through acquisition and transformation of existing licences rather than greenfield digital bank applications (Shabri, 2022; Suharbi & Margono, 2022), a pattern closely analogous to the Philippine rural bank acquisition strategy, though operating within a different regulatory architecture (Lathifah & Suyanto, 2022).

The Philippines' central bank, Bangko Sentral ng Pilipinas (BSP), granted digital banking licences to six banks (Pradipta et al., 2023). The broader literature on digital banking regulation in emerging markets identifies several recurring design tensions (Innes & Andrieu, n.d.). The first is the trade-off between entry liberalization — which promotes competition and innovation — and prudential caution, which prioritizes systemic stability (Innes & Andrieu, n.d.). Evidence from early digital bank cohorts in Kenya and India suggests that digital banking accelerates financial inclusion (Nnaomah et al., 2024). The second tension concerns the treatment of hybrid institutions — entities that blend digital and physical operating models — which resist clean categorization under licensing frameworks designed for either traditional branch-based banks or purely digital players (Amstad, 2019).

Research on central bank approaches to these tensions suggests that regulatory responses tend to cluster around two broad models, which involve a graduated approach to licensing and reclassification based on operational maturity (Allen et al., 2020; Ehrentraud et al., 2020).

2.3 Tiered Capital Frameworks and Licence Architecture in Banking Regulation

The design of capital requirements in banking regulation has shifted considerably since the introduction of the original Basel Accord in 1988 (Furfine, 2000; Haron et al., 2020). Early frameworks applied relatively uniform capital ratios across institutions, reflecting a regulatory philosophy that common standards were necessary to ensure competitive neutrality and prevent supervisory races to the bottom (Haron et al., 2020; Karacadag & Taylor, 2000). Subsequent iterations — particularly under Basel II — introduced greater differentiation, distinguishing between institution types and risk model sophistication in ways that acknowledged the heterogeneity of the banking sector while attempting to maintain the overall integrity of the capital framework (Choi et al., 2018).

The principle of proportionality in prudential regulation — the idea that regulatory obligations should be calibrated to the size, complexity, and risk profile of the regulated institution rather than applied uniformly across all entities — has gained significant traction in both academic and policy discourse (Castellano, 2024; Francesco & Maggetti, 2017). The Basel Committee on Banking Supervision has endorsed proportionality as a design principle in its guidance for national supervisors, particularly in the context of simplified approaches for non-complex institutions (Boss et al., 2018). The Financial Stability Board has similarly emphasized proportionality in the application of resolution and recovery frameworks (Restoy, 2019). In practice, proportionality takes many forms: simplified capital calculation approaches for smaller institutions, reduced disclosure obligations, lighter-touch supervisory engagement, and — most relevant to the Philippine case — differentiated minimum capital requirements across institutional tiers (Boss et al., 2018; Gai et al., 2019).

Tiered capital frameworks, in which minimum capitalization requirements vary by licence category and institutional complexity, are standard features of banking systems in both developed and emerging economies

(Martino et al., 2017; Settlements, 2006). Where tiers are defined by criteria — geographic scope, customer base concentration, product range, balance sheet size — that are genuinely correlated with risk (Demsetz & Strahan, 1997; Farnè & Vouldis, 2019; Jonghe, 2009), tiered capital requirements can efficiently allocate regulatory burden without creating arbitrary competitive distortions (Martino et al., 2017). Where tiers are defined by criteria that diverge from risk profiles, tiered frameworks can inadvertently create or preserve arbitrage opportunities (Scannella, 2012; Efinger, 2015).

The literature on capital requirement design in emerging-market banking systems emphasizes several additional considerations. Capital adequacy in these contexts is not merely a function of formal minimum requirements but of the quality of capital instruments recognized under national frameworks, the reliability of asset valuation and provisioning standards, and the supervisory capacity to enforce compliance. Studies of banking systems in South and Southeast Asia have found that formal capital ratios can be misleading indicators of actual resilience where loan classification standards are weak, provisioning is inadequate, or related-party lending is prevalent (Şengül, 2023). This suggests that tiered capital frameworks must be evaluated not only in terms of their numerical thresholds but also in terms of the broader supervisory infrastructure within which they operate.

A specific challenge in designing tiered frameworks for digital banking is the identification of appropriate scale metrics. Traditional banking supervision has used balance sheet size — total assets or total deposits — as the primary indicator of institutional scale and, by extension, systemic importance. Digital banking complicates this metric in two ways. First, digital banks may accumulate large customer bases and transaction volumes while maintaining relatively lean balance sheets (Koont, 2023; Mbama, 2018). Second, the rate of growth can be substantially faster in digital models than in branch-based banking, meaning that a balance-sheet-based threshold may lag the institution's operational scale by a significant period (Nagy et al., 2023). The BSP's choice of digital customer adoption rate as the primary scaling metric for its tiered capital ladder represents a conceptually sound response to this challenge — customer reach is a meaningful proxy for operational exposure in a digital context — though it introduces its own definitional and measurement complications around what constitutes a digitally onboarded customer and how that population is consistently measured and reported.

2.4 Fintech–Bank Hybrid Models, Acquisition Strategies, and Licensing Tensions

The strategy of acquiring an existing bank licence rather than applying for a new one has been documented across multiple jurisdictions as a preferred market entry route for fintech firms seeking to offer deposit-taking, lending, or payment services at scale, as documented in some jurisdictions (Bömer & Maxin, 2018). The motivations are broadly consistent: existing licences carry established regulatory relationships, operational infrastructure, and — in some cases — deposit insurance membership, all of which reduce the cost and time to market compared with greenfield licence applications. In markets where regulatory authorities have imposed explicit limits on new licence issuance, acquisition may also be the only available path to entry.

The literature on fintech acquisition of bank licences distinguishes between two broad strategic archetypes. The first is the full-conversion model, in which the acquiring firm substantially replaces the operations of the acquired institution — retaining the licence but rebuilding the business model, technology stack, customer base, and risk management infrastructure. This model is resource-intensive but produces an institution more coherently aligned with the acquirer's digital operating philosophy. The second is the platform-overlay model, in which the acquired institution's existing infrastructure is maintained while a digital distribution layer is constructed on top, using the licence's regulatory permissions to reach customers through channels and at scale that the original institution never contemplated. The Philippine fintech-rural bank cases correspond more closely to the second archetype: the acquired rural bank's physical infrastructure remained largely intact, while cloud-based onboarding and digital lending platforms were built above it to serve a national customer base (Velez, 2025).

The regulatory tensions in the financial sector, especially concerning FinTech, are significant and challenging (Anagnostopoulos et al., 2025). Because the acquiring firm does not fundamentally transform the chartered institution, the licence characteristics — and their associated regulatory obligations — remain formally applicable. The bank continues to be examined under rural bank standards, supervised by rural bank examination units, and capitalized at rural bank minimums. Yet the economic activity occurring within the institution — the volume of digital transactions, the geographic distribution of customers, the fraud and cybersecurity risk profile — may have shifted substantially toward the parameters of a digital bank. This creates what the literature on regulatory classification calls a type

mismatch: the institutional label governs the regulatory treatment, but the label no longer accurately reflects the institutional reality.

Banking-as-a-Service (BaaS) models introduce a further layer of complexity. In a BaaS architecture, a licensed bank provides the regulated banking infrastructure — account issuance, payment processing, regulatory permissions — to non-bank platform partners who distribute banking products to their own customer bases (Ilnytskyy et al., 2024). The bank may have limited direct customer relationships, with most customer interaction occurring through the platform partner's interface. This arrangement can produce rapid expansion of the bank's effective customer footprint without commensurate expansion of its direct operational visibility over those customers — a configuration that raises distinct questions about compliance responsibility, consumer protection obligations, and the adequacy of the bank's risk management relative to its end-customer exposure (Enriques & Ringe, 2020).

Regulators across multiple jurisdictions have responded to BaaS-related risks with varying degrees of urgency. The United States Federal Reserve and Office of the Comptroller of the Currency issued guidance for banks operating in fintech partnerships from approximately 2023 onward (Dopamu et al., 2024), amidst increased regulatory scrutiny and enforcement actions against financial institutions (Olatinsu, 2024). The United Kingdom's Prudential Regulation Authority has similarly scrutinized operational resilience in financial services and issued requirements effective from 2025 (Chanon et al., 2025). In the Southeast Asian context, regulatory guidance on BaaS has been less systematically developed (Pradipta et al., 2023).

2.5 Financial Inclusion, Access Costs, and the Unintended Consequences of Prudential Tightening

Financial inclusion — broadly defined as the access of individuals and businesses to affordable, appropriate formal financial services (Desello & Agner, 2023) — has been a major goal and policy tool in the Philippines in recent years (Desello & Agner, 2023; Espelita et al., 2025; Menez & Atento, 2026). The BSP's National Strategy for Financial Inclusion, first articulated in 2015 (Tetangco, 2015) and periodically updated (Park et al., 2023), frames expanded financial access as a core development objective intertwined with poverty reduction, household resilience, and productive investment (Asia Small and Medium-Sized Enterprise Monitor 2020, 2020). In the Philippine context, the inclusion imperative is particularly acute given the archipelagic geography of the country, which creates physical access barriers for rural populations in island provinces (Yoshino & Morgan, 2016), and compounded by historically high rates of financial exclusion — particularly among agricultural households, informal sector workers, and remote communities (PULVERA, 2025).

Digital financial services have emerged as a critical instrument through which the Philippines has pursued its financial inclusion strategy in recent years (Asia Small and Medium-Sized Enterprise Monitor 2020, 2020). The rapid growth of e-money accounts, mobile payment platforms, and digital lending has extended the reach of formal financial services into communities where branch banking remained economically unviable (Okoth et al., 2017). This expansion highlights the transformative potential of FinTech in addressing persistent barriers to financial access (Basri, 2022; Bernards, 2019).

The concern raised in the literature — and surfaced explicitly in the BSP's consultative process around the new framework — is that prudential tightening may impose access costs disproportionately borne by previously underserved populations (Amornsiripanitch & Ricks, 2025). This concern operates through two channels. The first is the direct channel: mobile-first customers in rural and peri-urban areas often lack alternative access to formal banking services due to uneven availability and access to digital devices and high internet costs (Ozili, 2024). The second is the indirect channel: if the capital requirements associated with digital adoption create financial pressure that causes smaller institutions to slow their digital expansion or exit the market, the competitive landscape may shift toward larger, better-capitalized institutions whose business models are oriented toward urban and middle-income markets (Liu, 2021).

The literature on the distributional consequences of banking regulation in emerging markets is somewhat divided on the net effects of prudential tightening on financial access (Frost & Stralen, 2017). A strand of the literature emphasizes that weak prudential standards create fragile institutions that, when they fail, cause disproportionate harm to low-income depositors who lack the financial literacy and legal resources to seek redress — arguing that robust prudential frameworks ultimately protect the most vulnerable financial consumers (Mak & Braspenning, 2012). An opposing strand emphasizes that the fixed compliance costs associated with elevated prudential standards are regressive in their incidence, imposing burdens that larger institutions can absorb more easily than smaller community-

oriented ones, and thereby shifting the market toward institutional forms less naturally aligned with low-income and rural customer segments (Minetti et al., 2020).

The evidence from banking market consolidation in the Indian banking sector is similarly mixed (Bhat et al., 2025). Consolidation can improve efficiency, strengthen governance, and produce institutions more capable of sustaining investment in digital infrastructure and risk management (Yu & Liu, 2025). It can also reduce competitive diversity, eliminate institutions with strong local knowledge and community orientation, and concentrate market power in ways that are ultimately adverse to low-income consumers (Berger et al., 1998). The Philippine rural banking sector has historically comprised a large number of small, community-rooted institutions (Meslier-Crouzille et al., 2011); consolidation pressure driven by capital requirements in the digital domain represents a structural shift whose access consequences for underserved populations merit careful monitoring even if they cannot yet be empirically measured.

The broader literature on regulatory design and financial inclusion suggests that effective frameworks maintain prudential standards proportionate to institutional risk to increase financial inclusion and encourage innovation for specific clients and products (Sanchez et al., 2013). Whether the BSP's tiered framework achieves this balance, or whether its geographic threshold and capital ladder inadvertently compress the institutional diversity of the Philippine banking sector in ways that ultimately narrow financial access, is a question that future empirical research will need to address.

2.6 Synthesis of Literature

The five thematic streams reviewed in the preceding sections converge on a set of interconnected analytical conclusions that collectively frame the Philippine digital banking regulatory episode as both a specific policy problem and an instance of a broader, recurring tension in the governance of financial systems undergoing rapid technological transformation (Carandang et al., 2026).

Across the literature on regulatory arbitrage, digital banking governance, tiered capital frameworks, fintech–bank hybrid models, and financial inclusion, a common structural dynamic emerges: regulatory frameworks designed for a particular institutional context tend to generate arbitrage opportunities when the economic and technological environment shifts faster than the regulatory architecture can adapt (Lee, 2024). The Philippine rural bank acquisition strategy is, in this reading, neither anomalous nor uniquely Philippine. It is a locally specific expression of a globally documented pattern in which the pace of financial innovation consistently outpaces the adjustment capacity of regulatory classification systems calibrated to a prior technological and market reality (Ahern, 2025).

A further point of convergence across the thematic streams concerns the distributional dimension of prudential regulation. The literature consistently finds that the costs and benefits of regulatory tightening are not evenly distributed across institutional sizes, market segments, or customer populations (Busch, 2017). In digital banking markets in particular, where entry by smaller and more agile fintech-affiliated institutions has been a primary driver of access expansion for underserved populations (Nnaomah et al., 2024), the competitive consequences of capital requirement increases deserve analytical attention independent of their systemic stability effects.

Finally, the literature on tiered capital frameworks and proportionate regulation underscores that the effectiveness of such frameworks is underpinned by tailoring rules that ensure criteria used to define regulatory tiers are appropriately aligned with the actual risk differentials that justify differential treatment (Bowman, 2024). The BSP's use of digital customer adoption rate as the primary scaling metric for its capital ladder represents a conceptually defensible departure from asset-based approaches, but its practical effectiveness will depend on the precision of the metric's definition, the robustness of reporting and verification mechanisms, and the regulator's capacity to identify institutions that approach thresholds without breaching them in ways that circumvent the framework's intent (Atento et al., 2025).

2.7 Gaps in the Literature

Despite the breadth and policy relevance of the thematic streams reviewed, several significant gaps constrain the analytical depth with which the Philippine case — and comparable regulatory episodes — can be fully assessed.

The most substantive gap concerns the intersection of digital technology and licence-category arbitrage in emerging-market banking systems. While the general phenomenon of regulatory arbitrage is well documented (Boyer

& Kempf, 2016), the specific mechanism by which digital infrastructure enables the decoupling of operational scale from physical presence — and thus renders geographic licence restrictions economically inoperative — has not been systematically theorized in the banking regulation literature.

A second gap concerns the comparative analysis of threshold-and-reclassification mechanisms as a regulatory design instrument. There is limited comparative research on whether threshold-based reclassification is more or less effective than alternative instruments — such as graduated licensing, activity-based regulation, or supervisory intensity scaling — in achieving regulatory objectives without producing excessive compliance costs or unintended market structure consequences.

A third gap is geographic. The literature on digital banking regulation is disproportionately concentrated on Singapore, India, China, and to a lesser extent Kenya and Nigeria (Gaviyau & Godi, 2025; Pradipta et al., 2023). The Philippines, despite being one of the more dynamic and institutionally complex digital banking markets in Southeast Asia (Department, 2022), is substantially underrepresented in the peer-reviewed regulatory governance literature (Velez, 2025).

A fourth gap concerns the financial inclusion consequences of regulatory-driven consolidation in digital banking. Empirical studies that specifically trace the access effects of capital requirement increases on digital banking market structure — particularly in archipelagic, low-income, and geographically fragmented markets — remain limited (Abbasi & Weigand, 2017).

Finally, the literature on BaaS regulatory governance in Southeast Asia remains underdeveloped relative to the rapid growth of BaaS-adjacent business models in the region. The regulatory challenges posed by institutions serving as banking infrastructure providers to non-bank distribution platforms have been more extensively analyzed in the North American and European contexts than in the ASEAN regulatory environment.

2.8 Contribution of the Present Paper

Against the backdrop of these thematic convergences and identified gaps, the present paper makes several contributions to the scholarly and policy literature on digital banking regulation in emerging markets.

First, it offers a theoretically grounded analytical account of the Philippine fintech–rural bank arbitrage mechanism — tracing its origins in the capital differential between licence categories, its enablement by digital distribution technology, and its prudential implications for the stability and governance of the banking system. By situating this mechanism within the broader literature on regulatory arbitrage, the paper connects a locally specific policy episode to a conceptual framework of wider applicability.

Second, it provides a structured analytical assessment of the BSP's Prudential Requirements for Digital-Centric Thrift Banks, Rural Banks, and Cooperative Banks — examining the internal logic of the geographic threshold, the tiered capital ladder, and the reclassification mechanism, and evaluating their design coherence against established principles in the comparative banking regulation literature.

Third, the paper contributes to the comparative literature on digital banking governance in Southeast Asia by adding a detailed Philippines case study to a body of scholarship that has been disproportionately focused on Singapore, Malaysia, and Indonesia. The Philippine experience — combining a deliberate digital bank licence cap, a large and diverse rural banking sector, archipelagic access challenges, and a dynamic fintech acquisition market — offers distinctive insights that enrich comparative understanding.

Fourth, the paper explicitly connects the regulatory design question to the financial inclusion dimension, identifying the distributional risks embedded in the BSP's framework and articulating the monitoring and complementary policy questions that arise from the consolidation pressure it is likely to generate.

3. Methodology

3.1 Research Design

This paper adopts a structured analytical and documentary review design. It is a non-empirical, qualitative study that synthesizes regulatory policy documents, scholarly literature, and publicly available institutional information to

examine the design logic, regulatory context, and potential implications of the BSP's Prudential Requirements for Digital-Centric Thrift Banks, Rural Banks, and Cooperative Banks. The study does not generate or analyze primary quantitative data, conduct econometric estimation, or employ statistical inference. Its analytical contribution derives from the rigorous synthesis and structured interpretation of existing scholarly knowledge and regulatory documentation, organized around the central policy problem of licence-category arbitrage in Philippine digital banking.

The design is most accurately classified as a comparative policy review with elements of integrative qualitative synthesis. The comparative dimension arises from the paper's engagement with regulatory frameworks and empirical experiences across multiple jurisdictions — including Singapore, Malaysia, Indonesia, and broader emerging-market contexts — against which the Philippine regulatory episode is assessed. The integrative synthesis dimension arises from the paper's effort to draw together five distinct but interconnected thematic streams of scholarly literature into a coherent analytical framework for evaluating the BSP's regulatory response.

This design is appropriate for the paper's objectives. The core analytical questions posed by the paper are properly addressed through regulatory analysis and comparative institutional reasoning rather than through econometric estimation.

3.2 Source Orientation and Material Selection

The paper draws on three categories of source material. The first category comprises peer-reviewed scholarly literature in the fields of banking regulation, financial economics, fintech governance, digital banking policy, and financial inclusion. Sources were identified through systematic keyword searches across major academic databases, including Google Scholar, JSTOR, SSRN, and EconLit. Priority was given to studies published in internationally recognized peer-reviewed journals in finance, economics, and banking regulation, as well as to working papers from credible institutional sources such as the Bank for International Settlements, the International Monetary Fund, the World Bank, and the Asian Development Bank.

The second category comprises official regulatory and policy documentation. This includes BSP circulars, memoranda, and policy statements relevant to digital banking licensing and prudential regulation in the Philippines, specifically BSP Circular No. 1105 (2020). Comparable regulatory documentation from the Monetary Authority of Singapore, Bank Negara Malaysia, and Indonesia's Financial Services Authority (OJK) was also reviewed.

The third category comprises credible industry and financial journalism sources, used selectively and with explicit acknowledgment of their status as secondary and interpretive, rather than primary, regulatory sources. These materials were employed specifically to establish factual context regarding the market behavior of fintech firms operating through rural bank licences in the Philippines, where formal regulatory documentation does not provide granular institutional detail.

3.3 Thematic Grouping and Analytical Logic

The literature and policy materials assembled were organized into five thematic clusters. Thematic organization was guided by the principle of logical sequencing from conceptual foundation to applied policy analysis: the review moves from general theory on regulatory arbitrage, through the specific empirical and policy landscape of digital banking regulation in emerging markets, through the design principles of tiered capital frameworks, through the specific dynamics of fintech–bank hybrid strategies, and finally to the financial inclusion and access implications of the regulatory response under examination.

Within each thematic cluster, the analytical criterion applied was synthetic rather than enumerative. The objective was not to catalogue individual studies but to identify patterns of agreement and disagreement across the literature, note methodological tendencies and their limitations, and draw out the implications of the accumulated scholarly evidence for the specific regulatory problem under examination.

3.4 Geographic and Institutional Focus

The paper's primary geographic focus is the Philippines, with the BSP's regulatory framework and the Philippine digital banking market serving as the central object of analysis. Comparative reference is made to regulatory developments in Singapore, Malaysia, Indonesia, and — where analytically instructive — broader emerging-market

contexts in South Asia and Sub-Saharan Africa. The institutional focus is on the regulatory boundary between rural bank and digital bank licence categories, with particular attention to the BSP's mechanisms for governing the transition between these categories and the capital implications of digital scale within the Philippine banking system.

3.5 Evaluative Criteria

The paper's analytical assessment of the BSP framework is organized around four evaluative criteria drawn from the banking regulation and regulatory design literature. These are: internal coherence, assessed as the logical consistency between the framework's stated objectives, its definitional categories, and its enforcement mechanisms; proportionality, assessed as the alignment between regulatory obligations and the risk profile of the regulated activity at different scales of digital operation; competitive neutrality, assessed as the framework's treatment of functionally similar institutions operating under different licence categories; and inclusion-sensitivity, assessed as the framework's awareness of and accommodation for the potential access consequences of its capital and geographic requirements on underserved populations.

3.6 Limitations

The primary limitation of this paper is its non-empirical character, which precludes evaluation of the BSP framework's actual effects on market structure, institutional behavior, capital adequacy, or financial inclusion outcomes. All assessments of likely effects are grounded in regulatory design logic and comparative experience but remain prospective rather than evidential. A second limitation concerns the recency of the regulatory change and the correspondingly limited availability of formal primary regulatory text for detailed legal analysis. A third limitation is the relative sparsity of peer-reviewed literature specifically addressing Philippine banking regulation and the Philippine fintech market, which constrains the depth of locally grounded scholarly synthesis.

4. Analytical Synthesis

4.1 The Architecture of the Arbitrage: How the Gap Was Built and Why It Held

An analytically rigorous examination of the Philippine fintech–rural bank arbitrage must begin not with the behavior of the firms that exploited it but with the structural conditions that made exploitation rational.

The first was the BSP's decision to establish a distinct digital bank licence category (Pradipta et al., 2023). This was a prudentially sound design choice in isolation. The second was the maintenance of the existing rural bank licensing framework, with its capital requirements, on the premise that rural banks serve local communities (Banos et al., 2011). The third was the rapid expansion of mobile internet penetration and cloud-based financial infrastructure across the Philippines, which collapsed the economic logic of geographic operating restrictions by making national-scale digital customer acquisition possible from a single physical location (Quimba et al., 2023; Sunio et al., 2023).

None of these three conditions individually created the arbitrage. Their interaction did. When digital infrastructure made it possible to operate at national digital bank scale from within a rural bank licence structure, the capital differential between the two institutional categories became directly exploitable without any violation of the formal regulatory text. The licence was rural; the operation was national. The rules had not kept pace with what technology had made economically viable.

This structural analysis has an important implication for how the BSP's corrective response should be evaluated. The policy problem was not primarily one of firm misconduct — it was one of regulatory framework obsolescence in the face of technological change. The appropriate evaluative question is therefore not whether the BSP should have acted, but whether the instrument it chose addresses the root structural conditions rather than merely their most visible symptoms.

4.2 The Geographic Threshold: Design Logic and Internal Tensions

The geographic customer concentration limit is the most immediately consequential element of the new framework. Its design logic is clear: by restoring the operational alignment between a rural bank's geographic mandate

and its actual customer base, the threshold re-establishes the conditions under which rural bank prudential standards were originally calibrated.

The threshold-and-reclassification mechanism represents a design choice that prioritizes clarity and enforceability over gradualism. Its principal analytical strength is its binary clarity: institutions know precisely where the reclassification trigger lies and can plan their growth strategies accordingly. This clarity reduces regulatory uncertainty, which the literature on capital regulation identifies as a source of regulatory arbitrage and gaming the system, and can contribute to compliance costs (Greenwood et al., 2017; Pfeifer, 2023).

However, the threshold also embeds several internal tensions. The first is the question of metric precision. Defining what constitutes a customer located outside a rural bank's operating area in a mobile-first banking environment is not trivial. Customers may open accounts while residing within the operating area and subsequently relocate; they may maintain accounts in multiple locations; or in archipelagic contexts, their principal residence may be in one region while their economic activity is concentrated in another. If the metric is defined by account registration address, it may understate geographic dispersion; if defined by transaction location or IP geolocation, it introduces data complexity and potential for manipulation.

The second internal tension concerns the geographic threshold's interaction with financial inclusion objectives. The rural banking sector in the Philippines has historically served as a primary formal financial access point for communities in island provinces and agricultural regions that commercial and thrift banks do not find commercially viable (Meslier-Crouzille et al., 2011). If digital platforms built on rural bank licences have extended this access further by enabling account opening and transaction services for mobile-first customers in communities without physical bank branches, the geographic threshold may constrain precisely the population that the rural bank framework was originally designed to serve.

4.3 The Tiered Capital Ladder: Proportionality and Competitive Implications

The tiered capital framework — linking digital adoption rates to progressive capital requirements, from approximately PHP 200 million at 30 percent digital onboarding to PHP 1 billion at 75 percent — represents a more structurally innovative element of the BSP's response. Where the geographic threshold addresses the classification problem, the tiered capital ladder addresses the underlying incentive architecture by making the cost of digital scale visible and binding before the reclassification threshold is reached.

Evaluated against the four criteria established in the methodology — internal coherence, proportionality, competitive neutrality, and inclusion-sensitivity — the tiered capital ladder performs differentially across dimensions. On internal coherence, the framework is broadly sound. On proportionality, the framework is credible but imprecise — an institution with 50 percent digital customers may face substantially different risk profiles depending on the nature of its products, the income and financial literacy profile of its customer base, and the robustness of its technology infrastructure. On competitive neutrality, the framework introduces meaningful improvements over the pre-existing regime. On inclusion-sensitivity, the framework is the least developed.

4.4 Market Structure Implications: Consolidation, Exit, and the Competitive Landscape

The tiered capital ladder is likely to foster consolidation within the Philippine digital banking market (Settlements, 2006). Institutions with rural bank licences engaging in electronic banking require larger core capital, which influences their strategic choices regarding digital banking requirements (Sinaga et al., 2024). For smaller institutions, challenges in capital-raising capacity mean meeting capital requirements is not straightforward (Settlements, 2006; Sinaga et al., 2024).

The consolidation dynamic has both efficiency-enhancing and access-reducing dimensions (Berger et al., 1998; Mester, 2005). On the efficiency side, consolidation may produce institutions with stronger capital buffers, more robust technology infrastructure, and more sophisticated risk management (Mester, 2005; Settlements, 2006). On the access side, the exit of smaller digitally active rural banks from the mobile banking space — or their absorption into larger institutions with different market orientations — may reduce the institutional diversity of the Philippine banking sector in ways that narrow the range of products, pricing structures, and customer segments served (Berger et al., 1998; Meslier-Crouzille et al., 2011).

The BSP's decision to grant digital bank licences to six banks (Pradipta et al., 2023) compounds this dynamic. By restricting new entry at the top of the market while simultaneously raising capital requirements for existing participants operating through rural bank licences, the framework is likely to produce a digital banking market in which the incumbent digital banks face reduced competitive pressure from below, even as the overall market consolidates.

4.5 Comparative Regulatory Perspective: Where the BSP Framework Sits

Situated within the comparative landscape of digital banking regulation in Southeast Asia, the BSP's framework occupies a distinctive position. The BSP's framework is interventionist; Indonesia, however, has demonstrated a largely acquisition-permissive approach to digital banking development (Lathifah & Suyanto, 2022; Andaru & Hadinugroho, 2024). Singapore has implemented a tightly managed and stringent digital bank licence framework, granting a limited number of licences after a rigorous application process (Asia Small and Medium-Sized Enterprise Monitor 2020, 2020). Malaysia's licensing model for digital banks establishes graduated operational permissions tied to demonstrated financial and operational maturity, with a simplified regulatory framework in the initial phase and lifting of restrictions after a transitional period (Ehrentraud et al., 2020).

What distinguishes the BSP's approach is its use of ex post reclassification mechanisms — triggered by operational behavior — rather than ex ante entry screening as the primary regulatory control instrument. A framework relying exclusively on ex ante entry controls could not address the existing stock of licence-category mismatches.

This ex post character also creates a precedent of potential significance for the broader Southeast Asian regulatory community. As digital banking continues to expand across markets where legacy institutional categories remain in place, the challenge of addressing accumulated licence-reality mismatches without creating disruptive market discontinuities will be a recurring regulatory design problem. The BSP's framework — with its defined threshold, reclassification trigger, transition window, and tiered capital ladder — offers one coherent model for how this challenge can be approached, and its implementation experience will be of genuine comparative interest to regulators in Malaysia, Indonesia, Vietnam, and other markets where analogous dynamics are developing or may emerge.

5. Discussion of Findings

5.1 The Broader Regulatory Significance of the Philippine Case

The analytical findings presented in Section 4 carry implications that extend well beyond the immediate question of how the BSP has chosen to govern the boundary between rural and digital bank licence categories in the Philippines. At a more fundamental level, the Philippine case crystallizes a regulatory design challenge that is increasingly common across emerging-market financial systems: the challenge of governing institutional scale in an environment where technology has decoupled operational reach from physical presence (Adjasi et al., 2023; Zetzsche et al., 2017).

For banking regulators in Asia and comparable emerging markets, the Philippine episode carries a clear and generalizable lesson: licensing frameworks that define institutional categories primarily through physical or geographic criteria are structurally vulnerable to technology-enabled arbitrage in ways that their designers could not have anticipated (Eichengreen, 2021; Flögel & Beckamp, 2020). The rural bank operating area concept made regulatory sense when the cost of serving customers at a distance was high enough to make geographic operating restrictions economically binding. Once digital infrastructure collapsed that cost, the geographic restriction ceased to function as a meaningful scale constraint.

5.2 Prudential Tightening and the Inclusion Trade-Off: A Structured Assessment

The most contested implication of the BSP's framework concerns its potential effects on financial inclusion. In the short run, the most immediate inclusion risk is contraction in digital service availability for customers who have been onboarded by rural banks operating beyond the new geographic threshold. If institutions facing reclassification pressure choose to cap new digital customer acquisition from out-of-area locations, customers in underserved communities who have come to rely on these platforms for basic financial services may find their access constrained without equivalent alternatives being available.

In the long run, however, the inclusion calculus is less clearly adverse. Institutions that are inadequately capitalized relative to their operational risk profile are inherently fragile, and their failure imposes costs on depositors,

borrowers, and the broader financial system (Schich, 2009) that can disproportionately affect low-income and financially unsophisticated customers (Contreras et al., 2022). A regulatory framework that ensures digital banking institutions maintain capital commensurate with their scale and risk profile is, in this reading, ultimately inclusion-protective, even if its short-run transition costs include some service contraction.

This challenge points toward a specific policy design gap in the current framework: the absence of inclusion-sensitive transition provisions.

5.3 The Competition Architecture of the New Regime

This configuration is not without regulatory rationale, but its competitive consequences merit explicit acknowledgment.

In a market with high entry barriers, limited licence availability, and elevated capital requirements for sub-digital-bank institutional forms, competitive discipline on pricing, product design, and service quality for low-income and rural customers depends critically on the commercial orientation and inclusion commitment of the incumbent licence holders. The BSP's long-standing financial inclusion initiatives and mandate (Tobin & Volz, 2018) aim to ensure effective access to a wide range of financial services by all.

5.4 Implications for Regulatory Design in Comparable Emerging-Market Contexts

For banking regulators across Southeast Asia and comparable emerging markets, the Philippine case offers several actionable analytical insights. The first is that the most durable regulatory responses to technology-enabled arbitrage are those that address the incentive architecture rather than only the most visible behavioral symptom. The combination of the geographic threshold and tiered capital ladder within a single framework is stronger than either instrument alone.

The second is that threshold-based reclassification mechanisms require exceptionally precise metric definition and verification infrastructure if they are to function as designed. The third is that prudential and inclusion objectives in digital banking regulation require active integration at the framework design stage rather than sequential management as trade-offs emerge after implementation. The fourth and perhaps most broadly applicable insight is temporal: regulatory frameworks governing technology-intensive financial services require shorter review cycles and more explicit technology-contingency provisions than frameworks governing traditional institutional categories.

6. Conclusions and Recommendations

6.1 Conclusions

This paper has examined the BSP's Prudential Requirements for Digital-Centric Thrift Banks, Rural Banks, and Cooperative Banks as a regulatory response to licence-category arbitrage in the Philippine digital banking market. Through a structured analytical and documentary review, organized around five thematic streams of scholarly and policy literature and evaluated against established principles of regulatory design, the paper has reached several conclusions of analytical and policy significance.

The first and most fundamental conclusion is that the arbitrage the BSP's framework seeks to correct was a structurally determined outcome rather than a product of firm misconduct or regulatory failure in any narrow sense. The capital differential between rural and digital bank licence categories was defensible as a matter of prudential design when rural bank geographic operating restrictions functioned as binding scale constraints. The entry of digital infrastructure into the Philippine banking market collapsed those constraints, rendering the capital differential an exploitable asymmetry rather than a risk-calibrated distinction.

The second conclusion is that the BSP's framework is analytically coherent and broadly consistent with established principles of proportionate and neutrality-oriented banking regulation. The geographic customer concentration threshold restores the operational alignment between rural bank licence categories and the institutional risk profiles for which their prudential standards were calibrated. The tiered capital ladder introduces a more continuous relationship between digital scale and capital obligation, compressing the residual arbitrage space below the reclassification threshold.

The third conclusion is that the framework, while prudentially coherent, is inadequately developed on the financial inclusion dimension. The geographic threshold and capital ladder are likely to generate consolidation pressure on smaller digitally active rural banks, and this pressure may produce short-run contraction in digital service availability for underserved communities. This is the most significant design gap identified by the paper's analysis.

The fourth conclusion concerns the broader comparative significance of the Philippine case. The BSP's use of ex post reclassification mechanisms offers a coherent model for addressing accumulated licence-reality mismatches in markets where technology-enabled arbitrage has already occurred, and its implementation experience will be of genuine comparative relevance to regulators across Southeast Asia.

6.2 Recommendations

For the BSP and comparable emerging-market banking regulators, the paper recommends the development of inclusion-sensitive implementation provisions as a necessary complement to the new prudential framework. Specifically, the BSP should consider establishing a supervisory assessment process that evaluates the socioeconomic and geographic profile of out-of-area customer populations when determining transition timelines and conditions for institutions approaching reclassification thresholds.

The paper further recommends that the BSP invest in the supervisory data infrastructure required to make the geographic customer concentration metric reliable, consistent, and manipulation-resistant as a regulatory trigger. The credibility and effectiveness of the entire threshold-and-reclassification mechanism depend on the precision and verifiability of this metric.

For the broader regional regulatory community, the paper recommends the incorporation of explicit technology-contingency review provisions into licensing frameworks governing community and sub-national banking institutions. Such provisions — requiring scheduled reassessment of categorical distinctions when defined technological or market penetration thresholds are reached — would reduce the structural lag between technological change and regulatory adaptation.

For financial institutions operating within or considering entry into the Philippine digital banking market, the paper recommends a strategic capital planning posture that treats the BSP's tiered framework as a long-run structural feature of the regulatory environment rather than a transitional imposition.

For researchers, the paper identifies several empirical questions that the Philippine case makes tractable as implementation data accumulate. These include the effect of the geographic threshold on digital customer acquisition patterns; the access consequences of capital-driven consolidation for low-income and geographically peripheral customer populations; the effectiveness of digital adoption rate as a risk proxy relative to alternative metrics; and the comparative implementation experience of threshold-and-reclassification mechanisms across Southeast Asian banking systems.

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