Amando M Tetangco, Jr: Developing the Philippine capital market – leveraging policy intentions into concrete actions

Speech by Mr Amando M Tetangco, Jr, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the IHAP Membership Meeting and Induction Ceremonies, Manila, 10 June 2015.

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I join you this afternoon to once again share my thoughts on the prospects of our financial market. I have been asked specifically to talk about the issues confronting the capital market and identify policy directions.

From where we came

Everyone in this room is well aware that this issue is neither new nor novel. The path that we have traversed on this issue has been long, to say the least, if not scenic. At the risk that they might deny their years of market service, I see colleagues in this room who will remember the major reforms in the late 1970s that eventually led to the introduction of universal banking by 1981.

We did not only aspire to have bigger banks, we also wanted them to be one-stop FIs that could offer a slew of products. Thus, we brought investment banking into the fold of merchant banking nearly two decades before the US Congress repealed the venerable Glass-Steagall Act in favor of the Gramm-Leach-Bliley law of 1999.

Responding to market requirements, we saw the development of Commercial Papers, although not of the 6–9 month tenor. LTCPs provided a means of funding while addressing peculiar local features.

As the Asian Financial Crisis curtailed longer-term funding, the market's creativity once again became evident with the introduction of Non-Deliverable Forwards. NDFs provided a hedge for eligible transactions, anchoring expectations on the dollar-peso rate.

We introduced structural changes such as having a Real-Time Gross Settlement (RTGS) system through PhilPass. We insisted on the standard of Delivery-versus-Payment (DvP) and even signed a cooperative agreement with the market to initiate the Philippine Settlement Highway (PSH).

From practically non-existent a decade ago, there are now more corporate debt securities. Investors have a fairly broad range of choices over the 175 that are listed, with maturities extending to over 18 years remaining. Government securities of course has been a staple and from a trading volume of PHP437.7 billion in 2005 on the exchange, we now have PHP1.93 trillion for the first five months of 2015, following the full-2014 trading volume of PHP4.40 trillion.

To where we need to go

Our numbers will be rather modest by global standards but it cannot be denied that we have indeed come far in the last 15 years. For that, allow me to congratulate all the stakeholders of the Philippine capital market.

With the applause, one can almost hear people murmur, so let me say it aloud.

Yes, ladies and gentlemen, there is a "but". We have come this far but there is much that still lies ahead.

Our rapidly growing economy needs a deep and active domestic debt market more than ever, both to provide the more stable funding for infrastructure and other long-term needs as well as the investment outlets of a quality and variety that meet the diverse requirements of our savers.

But it will not come about of its own without our active collaboration to build a market that inspires trust and confidence. It requires the cooperation and commitment of government as major issuer, of the financial regulators, of the tax authority, and you, the market players. Together we must build a public good that advances the welfare of all.

At the very core, we need to maintain transparency and adhere to strong standards of governance. We desire prices to be efficiently discovered. As a market, we have experienced the dangers of purely bilateral trades, uncontrolled leverage and inefficient settlement.

We need a yield curve that reflects active trade across a broad range of activities to serve as the sensitive and critical reference point to properly price risk and guide the market through changing conditions.

We need competent and responsible market intermediaries and reliable and robust infrastructure that can provide the desired efficient access to the markets from wherever they are in our archipelago.

Changing market incentives

Ladies and gentlemen, the issues I just raised comprise a long enough list, but as you know, they are not exactly new either. With all the challenges, we remain a bank-based financial market. I believe however that three developments are pushing the pace of real reforms in our capital market.

First, banks today face a “new normal” - one that demands a “fresh perspective on risk”. Necessarily, this means banks must define a new strategic path moving forward. Although capital adequacy ratios have been kept above the regulatory minimum, capital is as much a scarce resource as any. In this sense, banks may be very liquid but they cannot and should not chase every credit option that comes their way. In other words, in building their portfolios, banks must not sacrifice their credit underwriting standards. For users of funds, therefore, the capital market should present a real alternative.

Second, bank balance sheets have been under intense global scrutiny. As a result, the global reform agenda is calibrated to “making more resilient financial institutions”. That simply means that the prudential bar has been raised, both for capital adequacy and the quality of risk management .

The Single Borrowers Limit on banks will be an increasingly binding constraint as bigger projects are put into play. But the remedy is not in relaxing established prudential standards that help us manage excessive credit risk concentration and protect financial stability. The constructive response is for the capital market to step up and seize the opportunity.

This brings me to the third point. There is now a perceptible shift from banking to capital markets. Regulatory authorities are actively discussing this evolving phenomenon. Not that it is a negative development, but more to dimension its potential implications. To be sure, low global rates have encouraged this shift but I would think that the fundamental drivers precisely relate to the strategic allocation of risk capital and the new mindfulness to the inter-relatedness of risks in banking.

These three drivers I just mentioned augur well for the capital market. The real question however is: are we ready to take full advantage of them?

Getting to a Better and Desired State

Everyone in this venue appreciates that we could better tap these opportunities if critical reforms can be addressed. And these issues are precisely the object of the regulatory reforms we have been pursuing, essentially to enhance price discovery, promote responsible market conduct and enable product innovation.

Our market infrastructure – from pre to post-trade activities, for both payments and transfers – is yet another area which regulators have been focusing on. While there are ongoing cross-border initiatives, the main policy driver is still efficiency within an integrated market. Thus, we look to harmonize applicable processes across products and define standards, as may be warranted. Developing the proper market infrastructure is now high on the priority of the Financial Sector Forum and the Financial Stability Coordination Council.

The BSP is also set to consider a major reform of how we conduct monetary policy. We are developing new approaches to enhance open market operations and start to move away from a high reserve requirement regime in the context of establishing an Interest Rate Corridor System. The objective is to achieve greater efficiency in the conduct of monetary policy but it should also pave the way for the full development of the domestic money market that is the anchor of real price discovery and better liquidity management for the broader market.

Final thoughts

As you can see, ladies and gentlemen, the issues that confront our capital market are not new. Neither are we at the nascent stages of reforms. In fact, we have made significant strides towards a more organized market. But to take us forward and further, we need to take key reforms to their logical conclusion. I would not say that this is the last mile because there will always be more reforms as markets evolve. But we are at the cusp of critical change.

As important as these reforms are, we can never underestimate the value of governance. What makes this industry so unique is not just the blocks of funds that move from stakeholder to stakeholder. Instead, it is the fact that we are able to serve the interests of those stakeholders even if their interests may be competing.

The anchor is governance so that risks are fully priced to generate reasonable returns to the risk-taker. We need established governance principles too so that we can manage conflicts of interest which are inherent in financial markets. We need those same governance standards as a guide for executing the reforms that we have lined up for our market.

Ladies and gentlemen, we have always pursued the development of our capital market as a policy agenda. We are yet at another cusp where we can make significant change. Anchored on good governance and a clear vision of what we desire of the capital market, it would be quite an achievement for all stakeholders if we see the changes come to fruition.

Wouldn’t it be such a feat for us to stop talking of pursuing capital market development and instead talk of sustaining a developed capital market?

Thank you and good afternoon.