Amando M Tetangco, Jr: Geared up for global reform and regional integration

Speech by Mr Amando M Tetangco, Jr, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the FT-First Metro Philippines Investment Summit, Makati, 20 May 2015.

*   *   *

I am pleased to have this opportunity to share my thoughts with you this afternoon. At last year's Summit, we tackled the "new wave of volatilities" that we were then experiencing. You may recall that the markets (both global and our own) were at that time still internalizing the "reality" of Fed taper. In the interim, however, a more upbeat outlook on the US economy has surfaced as well as significantly lower oil prices. Recently, improvements have also been noted in Europe and Japan.

Domestically, there have also been quite a number of positive developments. Private consumption has remained buoyant, inflation has been kept within target, current account surpluses have been sustained and the banking system has stayed sound. Against this backdrop, the IMF, the World Bank and the ADB have all projected strong GDP growth for 2015 and 2016 for the Philippines.

Moody's backed these up by describing our banks as being "well positioned to manage unexpected downward pressures". While we await an update from S&P after its recent due diligence, Fitch has highlighted the "sound liquidity, high capital buffers and stable asset quality" of our banks.

All things considered, the Philippine financial system is in a good place today. But we can't afford to be complacent. Not at all.

For this afternoon, let's consider two things that are top-of-mind of the market that could change the situation: 1) the global reform agenda, and 2) regional financial integration.

First, the global reform agenda. We have seen the reform agenda take shape – from banking to securities, insurance, infrastructure, governance and market conduct. All these reforms are meant to institutionalize a "new normal" under a revised set of global best practices and minimum standards. We all appreciate how different this new normal is against the "older" ways of doing thing. I fully understand that making this transition is a challenge for stakeholders, regulators and the regulated alike.

The principles underlying the various reform components, however, make a clear case for why there is a need for change. As responsive and responsible agents, it is incumbent upon us to adopt and adapt.

We adopt the higher norms prescribed for good governance, risk management, market conduct and consumer protection since these define our new market architecture. However, we are equally practical and pragmatic in recognizing idiosyncratic conditions that require us to adapt the global standards in ways that better serve our prudential purposes.

Moving on to the second issue. We are seeing regional financial integration materialize into a defined reality. What was perhaps a faint prospect at an earlier time and was hardly discussed publicly, we now hear of promises of improved well-being for financial consumers and prospects of larger markets for service providers under the certainty of enhanced competition.

The integration timelines have been set and how we handle ourselves against those milestone dates will greatly determine the macro-financial landscape for generations to come. In banking, we have a few short years before Qualified ASEAN Banks (QABs) may enter our market. The integration of ASEAN insurance markets has a more assertive timeline while capital market development has a definitive vision for a harmonized framework for cross-border securities transactions. None of these integrated markets could exist, however, without the necessary pipelines and so interoperable and/or interlinked trading, clearing and settlement systems are likewise a necessity.

As you can see, ladies and gentlemen, there is much that lies ahead of us. The new normal has set the bar higher in the manner regulators supervise the financial market and how market participants conduct themselves.

Against the certainty of change, are we ready?

Thankfully, the Philippine financial system has the advantage of being in a position of strength. But, we have repeatedly argued that this strength is neither permanent nor absolute. Change is a certainty because the needs of financial consumers evolve with time. Markets, in turn, offer a richer menu of products and services that address the evolving broader needs of financial consumers. And on top of these, we have seen in recent times that markets sometimes need a fresh-but-major reboot and that too will certainly call for change.

These changes are most apparent in the recent legislative and policy initiatives to further open our banking market to foreign interests. I am often asked whether the Philippines is ready for banking integration. Although it is not as often raised, the accompanying question is why we should be part of such integration efforts.

Let me address the latter question first as a prelude to the former. The answer really may just boil down to two numbers: 600 and 31.

The latest figures suggest that the world generally saves at a rate of roughly 20% of GDP. ASEAN, however, has a Gross Domestic Saving rate of 31%. Applying these figures to the USD2.395 trillion GDP of ASEAN in 2013 , we have ASEAN saving at USD742.5 billion of which USD263.5 billion (i.e., 11% of GDP) can be seen as a saving that is higher than the norm for the rest of the world.

These are not small numbers, a good portion of which is invested outside of ASEAN. When combined with the estimated ASEAN population of over 600 million individuals, a more organized ASEAN financial market does seem to make its own case.

Preparing for new foreign interests and added competition

This brings me back to the first question: how do we prepare for the new foreign interests coming into our banking industry? Perhaps, with one eye equally focused on trying to mobilize a portion of the USD742.5 billion in ASEAN saving in 2013 alone?

Unfortunately, there is no switch that we can conveniently toggle between “on” and “off” for this. The best preparation is simply to have each bank operate with due recognition of the impact of financial risks on its own balance sheet and that of the system as a whole.

This combines 1) the effective management of risk exposures and the enforcement of a binding governance culture at the bank level and 2) the regulatory oversight and mitigation of systemic pressures that may be developing. This is the specific context of what we euphemistically refer to as an “enabled environment”. It is simply a regulatory framework that deliberately nurtures the creativity of providers to deliver innovative product and services while giving regulators enough leeway to intervene to address conflicts of interests, including the possibility that what may be good for individual banks may not necessarily be beneficial to the system at large.

In the capital market, we need to strengthen and finalize our pricing conventions so that there are no material gaps between reference rates and market valuation. We strongly subscribe to price discovery and we aspire to implement the principles on financial benchmarks soonest.

Market infrastructure, of course, plays a central role for the efficient transfer of funds and settlement of obligations, whether onshore or offshore. The BSP is playing a very prominent role in regional and global discussions to calibrate the global OTC Derivatives infrastructure requirements to better reflect the less active markets in Asia. Currently, financial regulators are actively reviewing our payments and settlement system so that a harmonized domestic structure puts us in a viable position to be a strong node within the ASEAN network. Indeed, to the extent possible, we lend our voice in global and regional forums where market reforms are either being designed or discussed for cross-border application.

To be sure, we will not forget our financial consumer. The Financial Consumer Protection Framework recently approved by the Monetary Board is a milestone in what can prudentially be expected by consumers and of financial service providers. The fact that a recent World Bank-funded review describes our consumer protection framework as one of the best in the world is a major strength as we move forward.

Collaboration and cooperation

Ladies and gentlemen, much has already been put on our collective plate but the reality is that much more can be expected ahead of us. It is not our intention to push all of these to our supervised entities for them to deal with on their own. Critical collaboration and cooperation is necessary because these are major developments that will dictate the market landscape for decades ahead.

This extent of collaboration is an essential facet of how we got to this position of strength. Now, we have to build upon that collaboration and that position of strength for us to move forward. The winds of change have brought both the global reforms and regional integration into their respective mature stages and it is now the challenge of execution that is before us.

We may not always agree with the specific form of the global and regional changes but, perhaps, we can agree on the principles for which change is being espoused. Borrowing from the website of the Financial Stability Board, we continuously need to build resilient financial institutions, make markets safer, instill more effective supervision and institutionalize more effective resolution regimes. In other words, we need to uphold transparency, be mindful of contagion and concentration, and monitor simple risks that can subtly transform into systemic vulnerabilities.

Ladies and gentlemen, vigilance has been the seed for which we are now reaping the fruit of macro-financial strength. Being continually cognizant of the need for such vigilance and adhering to the discipline of governance are the keys to continued resilience. These are the responsible investments we need to make and with contributions from all stakeholders, we can expect a better and stronger financial market ahead.

Thank you and good afternoon.