Amando M Tetangco, Jr: ASEAN integration, change and collaboration

Speech by Mr Amando M Tetangco, Jr, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the International Conference and the ASEAN University Network for Business and Economics' (AUN-BE) 16th Annual General Meeting, Quezon City, 14 July 2016.

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Introduction

It is with great pleasure that I take part in celebrating the centennial year of business education in the Philippines. There is no doubt that business education has had a significant contribution to our country and it is therefore most fitting that the business school of the University of the Philippines is named after no less than a man whose imprint on the Philippine economy is unquestionable.

Certainly, there are many highlights one can identify in a century of business education, particularly with a dynamic and colorful history such as ours. But I think these are best considered in the context of your conference discussions as a fuller perspective is warranted beyond what I can share in the few minutes of my remarks. Instead of looking back then, allow me to focus on something that is already looming in the horizon.

I refer to the integration of ASEAN which is an initiative whose extent is comprehensive and whose ramifications are far reaching. Certainly, this will reshape the landscape of business within ASEAN and as such, call for a re-focusing of business education so that generations today and of the immediate future are well-positioned to operate in this market.

Stepping back: the road to integration – lessons learned

However, as we gear up for the possible changes that regional integration could create in our markets moving forward, it would be instructive to step back and consider the learnings from our experience on this road to integration. A road that takes us back to December 1997.

From the standpoint of the financial market, the lessons that we take heart are those arising from the 1997 Asian Financial Crisis and the 2008 Global Financial Crisis.

There are many details, but let me just highlight two: 1) The 1997 AFC reminded us that cross-currency and gapping risks can give rise to systemic dislocations; and 2) The 2008 GFC taught us – painfully in hindsight – that no one was monitoring the unseen risks of inter-connectedness in the economy. The GFC surfaced the "not-so-apparent" changes in the nature of macrofinancial linkages, including, among others: 1) the strength and causation of the feedback loop between the domestic real economy and its financial markets; and 2) the importance of the risk-taking channel of policy transmission. These linkages were not much considered or thought of as systemic, but they (in reality) are.

Learning from these lessons, policy makers are now focused on the "systemic-ness" of risks and how the global reform agenda could be structured to mitigate the re-emergence of such risks.

During both crises, banks played a central role in defining and disseminating the risks that nearly collapsed the financial markets. Interestingly, however, economic textbooks continue to depict banks in their "traditional" role of mobilizing savings and intermediating credit. In practice, banks are much more dynamic. They adapt to new opportunities that arise, innovating and creating new products that are seen to increase the value of their individual franchises. We only need to be reminded of our experience from both the AFC and the GFC.

As regulators, we also have had to make adjustments and broaden our perspective in bank monitoring and supervision. While our objective remains to ensure that banks operate in a safe and sound manner, we now know that it is no longer sufficient to simply hold individual banks to that standard of “safe and sound”. We have learned that we need to be cognizant of how things affect one another.

This is the specific purview of the financial stability agenda. Such a holistic view addresses the weakness brought about by the fact that banks can only see their own balance sheet and remain oblivious to how they affect the rest of the system.

The global reforms that we have seen post-2008 are premised entirely on mitigating systemic risks. The Basel 3 agenda formally covers many more risks than the previous standards and requires banks to have “higher-quality” capital. Information asymmetries will be addressed by uncompromising standards on transparency and one can see this in the reforms for OTC derivatives and repos, among others. New standards on Board responsibilities, in financial market infrastructures and in financial literacy ensure that stakeholders are aware of the issues and act accordingly.

Looking forward: global reforms and what these mean for ASEAN integration

All of these standards are discussed and finalized at the global level but they will invariably affect our approach to regional integration. This is precisely because a single market could be a source of contagion, the very same risk that became apparent in the crises of 1997 and 2008.

This is not to say, however, that integration should no longer be pursued in light of the global reforms. This is not the point. The advantages of integration are clear. Transforming 10 ASEAN jurisdictions into a single market consolidates the strength of a growing region that saves more than the rest of the world and has the vast potential of a young population. The AEC will facilitate the mobility of labor and capital among the members, Banks that are designated as QABs under the ASEAN Banking Integration Framework (ABIF) will effectively extend the reach of one jurisdiction by having “outposts” outside its national borders but still within ASEAN. The ABIF should also provide a financial highway that can harness the potential of ASEAN by developing the capacity to clear and settle intra-ASEAN trade and investments without depending on traditional correspondent banks. All these should hasten regional commerce and provide the means to parlay the growth of ASEAN, its young and dynamic retail market with high disposable income and unparalleled saving potential.

But we should also be cognizant of possible downside risks. In this regard, the logical mitigating factor is effective cross-border surveillance and the ability to take collective but pre-emptive actions.

Unfortunately, that is not as easy as it sounds. ASEAN member states are at different stages of financial market development. Furthermore, the 10 jurisdictions may very well respond differently to the same risk due to idiosyncratic factors in their local markets. Effectively then, “information” becomes the commodity and how we handle it becomes the value proposition of the product.

Managing information has its own set of challenges. In this day and age of financial technology, we take advantage of the expediencies that fintech offers but we still have to be wary of the cyber-security issues that arise, such as the increasing trend of phishing and identity theft cases. Cross-border commerce is literally consummated in a few keyboard strokes, which highlights how the human intervention part of fintech can possibly compromise prudential standards and create trouble.

Ladies and gentlemen, this is a rich area where business education can take an active role. Here I refer to your potential in developing and preparing market participants who would have the requisite financial integrity, which is so crucial to keeping individual financial institutions and the overall financial system, safe and sound. In addition, it would be beneficial if you turn your economic research towards deepening our understanding of the human behavior side of markets. This should help us be more adept at finding the convergence points among policy intent, market expectations and the eventual outcomes of market behavior.

The business environment today is certainly dynamic not only because of the usual evolution of the markets. Instead, the dynamism of the markets is driven by a fundamental shift in the market architecture. While we all recognize the importance of an enabled environment for the business community, we cannot afford to concede the overall stability of financial markets.

BSP Initiatives on FS and regional integration

This shift towards financial stability – both as the prudential norm and as it affects regional integration – requires a broader mindset from all of us.

At the Bangko Sentral ng Pilipinas, we have invested a lot towards the pursuit of financial stability. We created a high-level Financial Stability Committee at the BSP and thereafter collaborated with the DoF, BTr, SEC, IC and PDIC to establish the Financial Stability Coordination Council. Within this ambit, a formal definition of financial stability has been adopted and there is a continuing assessment of regional integration as a financial stability issue.

Parallel initiatives are meant to strengthen market governance and risk controls. We raised the standards on bank capital, clarified supervisory expectations on the management of risks and enhanced board and management governance protocols. We have actively advocated financial inclusion and consumer protection, crafting a national strategy in the former and establishing a formal bank framework for the latter. New guidelines on credit and operational risks have been issued, with the IT Risk Framework issued several years ago, long before concerns regarding cyber security came about.

Our active participation in regional forums is with a clear view of pursuing financial stability. We welcome the challenge of being the incoming Chair of the Working Committee on ASEAN Banking Integration Framework (WC-ABIF) as well as executing the ABIF Learning Roadmap which the BSP led in crafting. In addition, we make time to be engaged at the FSB Regional Consultative Group for Asia (FSB-RCGA) and the EMEAP Working Group for Banking Supervision (EMEAP-WGBS). Both of these are principally platforms for calibrating global reforms into the regional context.

I would be remiss if I do not share with you our involvement in the best-practice process of the OECD International Network for Financial Education (OECD-INFE). It is clear to us that financial education can better anchor financial stability by providing financial consumers the means to be well-informed of their financial opportunities. Our work with INFE has in fact led to the creation of the BSP's Consumer Protection Framework which is a milestone in many respects.

Final thoughts

On the whole, market conditions remain fluid and this requires constant diligence in monitoring, evaluating and responding to developments.

While there is much that a century of business education has taught us, we also have to accept that the change in the market is more than just its landscape. More fundamentally, the market's dynamics and its architecture– how products, transactions, institutions and industries affect one another directly or indirectly – have evolved. The very nature of risks and how regulators approach these risks have likewise seen significant change thru the years.

All these were the focus of our attention even before the Chinese economy showed weakness, the US Fed's decision to raise its benchmark rates in December, the subsequent tightening of market liquidity and well before Brexit. The integration of ASEAN as a single production base and a harmonized market for banking, securities and insurance products adds a further layer of market evolution that all of us need to fully appreciate and prepare for.

Indeed, there are many challenges ahead. A century of experience and learnings in business gives us a solid foundation. But now is the time too to shift gears. We accept that we do not know everything ahead but we can count on a century of collaboration to move us forward.

Let us not forget that strength is not granted. Rather it is achieved. Reforms such as the integration of ASEAN allow us to position ourselves within an evolving market, not just for today but more so for the foreseeable future. The changes that reforms instigate may not always be convenient, but with the right mix and a healthy dose of collaboration, they will make us better.

I am confident that we have the capacity and the commitment to build a better foundation for the future. We accept that change is the norm. Thru cooperation and collaboration, I am optimistic that the uncertain future can be managed, putting us in an excellent position to face risks and allowing us to reap benefits.

Thank you and good day.