Amando M. Tetangco, Jr: Recognizing Success and Managing Black Swans, Elephants in the room and Grey Rhinos

Speech by Mr Amando M. Tetangco, Jr, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the FMAP 2016 Awards and Fellowship Night, Makati City, 21 July 2016.

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I am pleased to join you tonight as we recognize those whom the industry has chosen as the best in 15 award categories. To the awardees, allow me to extend my early congratulations for a job well done. I know that being "recognized by peers" is one of the strongest motivations for anyone to be the best that he can be at his chosen craft. So, keep up the good work!

Tonight's celebration is also about the fund management industry itself, which has grown consistently over the years. If we count only the trust institutions that report to the BSP, assets under management as of end March 2016 stood at P2.7T. FMAP estimates that if the other asset management companies are included, this figure will grow to almost P4T, covering 174 peso-denominated fixed income and equity funds and 52 foreign denominated funds.

The BSP expects these numbers would continue to grow moving forward. The Philippines' strong economic growth nestled by a stable inflation environment, robust external liquidity position, and a sound banking system, could only further boost the market's confidence in our domestic financial markets.

The global investors have now become more discriminating, their search for yield during this extended period of low global interest rates is balanced by the need for stability of returns. The local investor is also becoming more selective and growing in sophistication, gaining more willingness to try newer products to meet specific needs.

With this operating framework, the FMAP and its members must certainly evolve with the changing needs of your constituents.

It was "Uncle Ben" (Ben Parker, the step-uncle of Spiderman) who said that "with great power come great responsibility". I cannot think of a greater responsibility for a market practitioner than to be entrusted with managing the hard-earned funds of others. Funds that will allow your clients to raise and educate their kids, buy their dream home, care for aging parents, go on that much awaited vacation or save for a stress-free retirement.

There are many issues that we could discuss at length with respect to this "greater responsibility", but for tonight, allow me to only (and briefly) raise just two of these issues.

First, financial consumer protection is not simply a popular advocacy, it is one which is central to prudential oversight. Several studies have shown that the disruptions of the Global Financial Crisis were particularly costly because investors found themselves unprepared for the market reversal. In many cases, these investors were enticed by the returns promised by agents without necessarily understanding the risks that they were taking.

In other cases, financial products were so novel that the industry itself did not fully envision how and thru which channels the risks would materialize. To be fair, our technical models were imprecise. But we must also admit, with some dose of humility in hindsight, that, collectively, the markets underestimated the risks and their consequences.

Because of the agency nature of your business, the industry cannot thrive without considering the specific needs of each client. Your clients must also be empowered so they could better define their requirements and how their financial resources could be optimized to meet these needs. Such symbiotic relationship therefore necessitates that we adhere to the standards on financial literacy as a pro-active initiative and consumer redress as a remedial measure, where warranted.

The second issue I wish to cover is this – the asset management business has systemic implications.

Consider the two basic types of agency agreements 1) the passively managed funds, performance of which mirrors or closely tracks that of a specific benchmark, and 2) the actively managed or specialist funds, which are not linked to a specific benchmark. There are positives to this dichotomy. Actively managed funds have the advantage of potentially higher yields while passive funds provide lower costs. The downside however is that shifting towards higher-yield-but-illiquid exposures exacerbates the vulnerability of financial consumers towards market risk, while the ease of passive funds also nurtures "herding" behaviour as well as correlated market movements.

These notions are confirmed by empirical work at the BIS,[1] among others, that have shown that "asset managers in EME asset markets tend to behave in a correlated manner and that investment flows to asset managers and asset prices amplify each other's fluctuations".

This is why my second message for the industry is this: Do not be oblivious to financial stability issues.

Ladies and gentlemen, we "live" in an industry where "change" is literally a minute by minute phenomenon (i.e., not only in financial rates and prices but also in market sentiment). But there are also those tail risks, the "Black Swan" risk, as popularized by Taleb.[2] Moving from "the elephant in the room", Wucker recently talks of the "grey rhino" as the highly probable high impact but neglected threat.[3]

I am not sure how swans, elephants and rhinos come together, but I am certain that we do not want any of what they represent to come true. We can look towards regulation to manage market conduct within acceptable norms, but, in the end, it will have to be the market practitioners who need to be committed to upholding the standards.

Ladies and gentlemen, the recognition announced tonight confirms my view that FMAP and its members cherish the higher goals we set for ourselves and your chosen business.

On the part of the BSP, we recognize that investors and fund managers should have the leeway to invest in alternative instruments across jurisdictions or in different currency denominations. Within the bounds of client suitability and effective management of risks, we are prepared to revisit existing regulations and make the needed changes. This will not only deepen the capital market but more so provide investors with more choices within the perimeter of tolerable financial risks.

The BSP will always be your partner and I am sure FMAP stands ready to always join us in the journey for professional excellence, for consumer protection and for financial stability.

Congratulations to the asset management industry. Congratulations to the awardees.

Thank you and good evening.

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1 Ken Miyajima and Ilhyock Shim. "Asset Managers in Emerging Markets". BIS Quarterly Review. September 2014. Pp. 19-31.

2 N. Taleb. The Black Swan: The Impact of the Highly Improbable. New York: Random House. 2007.

3 Michele Wucker. The Gray Rhino: How to Recognize and Act on the Obvious Dangers We Ignore. St. Martin's Press. April 2016.