Amando Tetangco: Corporate, environmental and social governance - continuing capacity building

Speech by Mr Amando M Tetangco, Jr, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the BSP-IFC Mini Forum (and Ceremonial MOU Signing), Manila, 26 May 2017.

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Good morning ladies and gentlemen, and welcome to the Bangko Sentral ng Pilipinas (BSP).

Let me begin this keynote with the ending of a paper written by a Professor Emeritus from Harvard[1] "Good governance is an important condition that we hope all the world can enjoy. There is much to be understood about the concept and how it can be achieved. But like all good ideas, it is not a magic bullet." This quote poetically captures the three points I wish to share with you today:

1) First… Over the years, the BSP and the banking industry have done much to ensure that good corporate governance (CG) sits at the core of decision making and institutional operations;

2) Second… There is more to learn, for example, concepts like environmental and social governance (ESG) and risk management (ESRM). These principles need deeper exploration and understanding in the context of banking and finance; and

3) Third… Indeed, good governance is not a magic bullet by itself. Practitioners must faithfully practice the principles. Whether it is about CG or ESG, institutions and its employees need to remain well-equipped to demonstrate, embed and practice good governance in daily operations.

Good Corporate Governance in the BSP and the Banking Sector

To expound on my first point, let me share that the BSP champions good governance within the organization, and as supervisor of the banking system. Internally, we have adopted a corporate governance framework and defined strategic priorities focused on a strong governance mechanism, operational excellence, organizational readiness and engaged stakeholders. We continue to improve our bank-wide risk management system and institute business process improvements. We strive to promote a culture of fair and responsive treatment of all our stakeholders. We have clearly defined and communicated expectations from each employee in carrying-out the BSP mission. We have a performance scorecard that checks our progress and achievements.

These efforts have borne fruit. The BSP was recently recognized as an Island of Good Governance by the Institute of Corporate Directors and Institute for Solidarity in Asia.

As regulator, we adopted a three-phase governance reform program for BSP-supervised financial institutions. We started with the fit and proper requirements for the board of directors and senior officers, followed by the issuance of standards for checks and balances systems. We are now in the third phase, with the issuance of guidelines on the management of specific risk areas such as credit, information technology and operational risks[2], paving way for enhanced guidelines on risk governance.

The BSP views good CG as the foundation of a safe, sound and efficient financial system. As keepers of 80 percent of the financial system's assets, Philippine banks must hold up to high CG standards. Adherence to these standards always start at, and is the full responsibility of, the board and management. This is fundamental in good CG. The "fitness and propriety" of the board and senior officers should pertain to their qualifications and competence, but more so to their integrity, ethics and independence.

Like parenting, good CG behavior that emanates from the board and management gets cascaded down, and modeled by, employees of the organization. Often, organizational values are “caught” by, not “taught” to, the rank and file. On the other hand, checks and balances like internal controls and compliance functions provide the handlebars that steer people and organizations toward greater transparency and accountability.

Another fundamental CG element is risk consciousness. The banking environment is always in flux, constantly affected by disruptive technology, competition from non-traditional players, unique consumer profiles and new market niches, or upgraded regulations and international standards. Old risks evolve, new ones emerge and sources of risks multiply. For banking to remain a public trust, it is imperative for banks to effectively protect their depositors, investors and institutions from undue risks.

Good risk governance begins with genuine understanding of these risks, and setting the institution’s risk appetite based on objective assessment of its capability to manage them effectively. To do this, the board and management should fully understand the data and evidence that affect the institution’s risk exposures. They should ensure adequacy of capital to absorb both the foreseeable and unexpected losses. Down the line, bank personnel also need to know the risks attendant to their operations, be equipped to mitigate, and be wary of the consequences of weak risk management.

The CG fundamentals that I have cited are universal and applicable to all financial institutions. Many of our banks are diligently exercising these principles, yet many are also struggling to do so. Nevertheless, the BSP remains confident that our CG-related regulations will continue to guide the banks toward full compliance, further strengthening and enabling them to serve a wider market.

Environmental, Social Governance and Risk Management

Let me now move on to my second point. Risk governance may be influenced by other dimensions, for example shared value[3], which refers to ways of doing business that gain competitive advantage, while also improving social, environmental and economic conditions, to achieve the double bottomline of profitability and social responsibility. This is when ESG, the set of standards that promote sustainability; and ESRM, a risk management tool that promotes sustainable finance, usually get factored in. And these are areas that we need to explore deeper.

Sustainable finance is any form of financial service that integrates ESG criteria into business decisions to benefit the environment and society at large[4]. Regulators and banks in emerging markets like Indonesia, Bangladesh and Mongolia[5] are openly promoting sustainable finance through ESG standards. Around the world, there is increasing evidence that integrating ESG and ESRM in business practices result to positive returns, those that get reflected on financial statements, client retention and organizational reputation. Equally significant, banks also feel good as they contribute to socio-economic and environmental well-being of the communities in which they operate.

The BSP believes that ecological sustainability is a key pillar of inclusive growth, and sustainable finance promises to support this objective. It is consistent with the BSP’s drive to establish a responsive, responsible and inclusive financial system that delivers a high quality of life for all Filipinos. While BSP policies and regulations already promote shared value through financial inclusion, we feel the need to deepen our understanding of sustainable finance. We have to bridge the gap between what we know about financing and corporate governance, and how or when ESG should be integrated.

Hence in 2013, we began taking baby steps to understand ESG and ESRM. We became a member of the Sustainable Banking Network (SBN) with support from the International Finance

Corporation (IFC). SBN is a knowledge sharing network of banking regulators, industry associations and ESG specialists. We continue to learn and share experiences with like-minded peers and industry players already practicing sustainable finance in other jurisdictions.

In 2015, again with IFC support, we completed a scoping study on the extent of industry experience and interest in adopting ESRM. Study results showed moderate awareness, very limited experience, and mixed perceptions about the business case of ESRM adoption among local banks. Still, many believed that practicing sustainable finance can enhance their institutional reputation as good corporate citizens, and may eventually affect their business bottomline.

Understandably, profit maximization thru viable opportunities remains the driver for banks to scale-up green investments, and influence their client firms to be more environment-friendly. Banks need to see financial viability and attractive risk-return profiles of green projects and un-bundle the mainstream perception of high transaction and compliance costs. In other words, banks, and even regulators like the BSP, need to fast-track learning curves in the area of ESG and ESRM.[6]

This now brings me to my third point, and the reason why we are all here today.

CG and ESG: The Need for Continued Capacity Building

The principles of CG and ESG may be constant and universal, but situations and contexts in which they are applied are varied and mutable, and new lessons arise from each application. As markets, regulations and institutions evolve, it is necessary for CG and ESG practitioners to deepen knowledge and continue building capacities. The board and management, employees and the entire organization should not only adopt good governance policies – they need to continuously adapt, upgrade and improve to remain relevant and effective.

This is the primary intent of the BSP-IFC agreement which we will sign today, with everyone here as witnesses, and maybe even future partners. IFC will support the BSP in improving its assessment tools to ensure good governance and proper risk management in the banking system. IFC will train and advise the BSP and BSP-supervised financial institutions on a proportionate legal and regulatory framework that enhances corporate governance.

In addition, IFC and BSP shall continue to conduct awareness campaigns, capacity-building and peer learning events to deepen the industry's understanding of ESG and ESRM. In this area, we are mindful that in the Philippines, there is a spectrum of big and small banks with varied capacities, business models and risk appetites. Some will see value in ESG and ESRM; while some will simply not have the right capacity and resources to deal with these standards…for now. For those who can, and are willing, we look forward to further working with you.

Today, we have lined-up international and local speakers to jumpstart the knowledge sharing on global developments and domestic experiences on CG and ESG. I hope you all take advantage of this opportunity.

Conclusion

We thank the IFC and the World Bank for your sustained support to the BSP and the banking industry. Thank you to this community of regulators, government agencies, the banking associations, the sustainability advocates, colleagues and guests, for joining us in this endeavor. We will surely keep you involved in the next steps of the BSP-IFC partnership.

Thank you and good morning.
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[1] Grindle, Merilee S., June 2010, “Good Governance: The Inflation of an Idea”, Harvard Faculty Research Working Paper RWP10–023, Kennedy School of Government.

[2] E.g. Circular 855 on Credit Risk Management Framework; Circular 808 on Technology Risk Management; and Circular 900 on Operational Risk Management.

[3] Corporate policies and practices that enhance the competitive advantage and profitability of the company while simultaneously advancing social and economic conditions in the communities in which it operates. Shared value is not corporate social responsibility, philanthropy, or even sustainability, but a new way to achieve economic success. (Harvard Business School, Institute for Strategy and Business).

[4] Adapted from the Swiss Sustainable Finance Center.

[5] Members of the Sustainable Banking Network that have issued regulations/roadmaps/standards that specifically promote ESG standards.

[6] Frankfurt School-UNEP Centre for Climate & Sustainable Finance. “Delivering the green economy through financial policy”. Technical paper, March 2014.