

Nestor A Espenilla, Jr: Truths in lending

Speech by Mr Nestor A Espenilla, Jr, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the General Membership Meeting and Induction of Officers of the Philippine Finance Association, Inc. (PFAI) Makati City, 22 August 2017.

* * *

Philippine Finance Association, Inc. (PFAI) President, Mr. Agerico Verzola; Executive Director, Mr. Romeo Dela Rosa; outgoing and incoming PFAI officers; members; esteemed guests; ladies and gentlemen, good afternoon.

Since 1962, PFAI has been instrumental in shaping the landscape for financing and leasing industries. We in the Bangko Sentral recognise your crucial role in economic development. I congratulate PFAI in my own capacity as Governor of the BSP and also on behalf of the Monetary Board, BSP officers and staff.

I thank you also for the opportunity and privilege to keynote today's General Membership Meeting and Induction of Officers.

Borrowers and lenders

Shakespeare famously warns, "Neither a borrower nor a lender be". Through the Hamlet character Polonius, the celebrated Bard of Avon gives the didactic rationale, "For loan oft loses both itself and friend (adding that) borrowing dulls the edge of husbandry."

What a pronouncement! Without subtracting from the literary genius of England's greatest playwright and without discounting (but also without delving into) the moral risks involved in lending and borrowing from friends, we can now acknowledge how the conditions for arms-length financing have changed dramatically and have improved since the 17th century.

In fact, it is interesting that ninety-one (91) years after Hamlet was published, the Bank of England was founded in 1694, rationalising and influencing the nature and narrative of financing both in Europe and the world.

Confident of the benefits of prudent borrowing and lending we those in this room – the PFAI the Bangko Sentral ng Pilipinas and other players in the industry, laud the practices' crucial and indispensable role in national development. We know the push that responsible financing can give to businesses to industries even sharpening and making more efficient — (to the surprise of Elizabethan playwrights) — the edge of husbandry!

Five truths in lending

Important to the Philippine financing and leasing industry

As you induct your new leaders today, I wish to share and expound on five (5) truths that I believe can strategically move the industry forward. Allow me to divert from old English naysaying and focus on some "truths in lending."

First, economic conditions are favourable and allow for robust lending and leasing operations. Second, a sound legal and regulatory framework greatly ensures prudent and responsible financing practices. Third, to be more successful, industries must recognise markets; seize opportunities; leverage on digital technology; and engage in continuous training and development. Fourth, in doing so, there must be collaboration and cooperation with industry players; Fifth industries must allow open dialogue, and foster a healthy partnership with its regulators.

Let me expound.

FIRST TRUTH: Favorable economic conditions are present to allow robust industry operations

The Philippines' positive economic outlook coupled with the Government's thrust to promote infrastructure spending, favours the country's financing and leasing industries.

While global economic and political conditions remain challenging, the Philippine economy is strongly supported by buoyant consumer and corporate demand. It is projected to grow at 6.8 percent in the medium term. The inflation outlook for the next two (2) years is manageable and within the Government's three (3) percent \pm one (1) percentage point target. Moreover, our international reserves remain at a healthy level USD80.8 billion as of end-July 2017 — enough to cover almost nine months of imports and payments of goods and services.

These favourable conditions however do not do away with the need for vigilance on both our parts. Since we are a small, open market economy, the Philippines is vulnerable to abrupt shifts in global investor sentiment. These shifts can result in some volatility in the financial market.

Moreover, as the BSP adopts a market-determined exchange rate policy, fluctuations in the peso-dollar exchange rate are expected, as it adjusts to market conditions.

Mindful of potential sources of systemic risk, the BSP has strengthened the framework for financial risk surveillance even creating a dedicated unit responsible for tracking and monitoring systemic risks and their channels of contagion.

But these concerns will have implications on your operations as well, and it is wise to be watchful.

Another key development to be mindful of, is the pace by which the U.S. is normalizing its monetary policy. Even though the Fed has been gradual and relatively predictable in its approach, this nonetheless points to the onset of a rise in global interest rates. From a credit perspective, this can adversely affect borrowers' (especially highly-leveraged entities) capacity to pay.

Our assessment, however shows that domestic corporations remain to be profitable. Corporations maintain interest coverage ratios generally above standard thresholds.

SECOND TRUTH: A sound legal and regulatory framework ensures prudent and responsible financing practices

In 1998, PFAI spearheaded the passage of The Financing Company Act, today's legal foundation for the industry's operations and the bedrock for the regulation and promotion of prudent activities of financial and leasing companies while curtailing acts prejudicial to the public interest.

To protect the public interest, the BSP also updated regulations on implementing The Truth in Lending Act four (4) years ago. To promote consumer protection, we have redefined and identified coverage with more certainty. This ensures a more level playing field for credit providers, and allows transparency in lending.

Given changing market conditions and increasing sophistication of the financial services industry, the BSP designed a corporate governance framework and issued Basel III-style capital rules. BSP's comprehensive guidelines on credit and operational risk management, including technology risk and business continuity management are critical to financial institutions' sound operations. The end-goal is to foster good corporate and risk governance in banks.

Recently, the Monetary Board approved enhanced corporate governance standards, aligning BSP regulations with the SEC's Code of Corporate Governance for Publicly-Listed Companies

and international best practice. The enhancements cover the duties and responsibilities of Boards in establishing corporate culture and values and appointing key officers, among others.

Future reforms will further strengthen management of liquidity, cybersecurity and market risk in financial institutions. These intend to increase industry ability to expand, undertake prudential innovation, and participate more actively in market competition while being prepared for emerging risks.

And while the BSP adopts a market approach to the exchange rate, it has ongoing efforts to further liberalize foreign exchange regulations. The purpose is to make regulations more transparent, risk-based and data-driven. The amendments will ease the cost of doing business and provide residents (including finance and leasing companies) better access to foreign exchange held by the banking system.

Another important regulatory reform initiative is the adoption of the agricultural value chain financing framework. This framework expands the scope of lending from individual farmers. Other actors of the value chain, including MSMEs, the industry's primary target market are now covered.

THIRD TRUTH: The financing and leasing industry's success depends on (1) recognition of markets and the seizing of opportunities; (2) leveraging on digital technology and constant evolution; and (3) continuous training and development

- ♦ recognise markets and seize opportunities

Historically, MSMEs have been the industry's primary client base. There is economic basis for this commercial partnership. In a report, the OECD cites that asset- and trade-based financing (such as leasing and factoring) appear to be best suited for the operational requirements of MSMEs.

Industries would do well to apply their unique expertise in alternative financing models to support MSMEs. While MSMEs constitute a lucrative market base, a higher motivating factor is that MSME success is crucial to attaining broad-based and inclusive growth.

MSMEs are diverse across industries, regions and income strata. They account for 99.5 percent of the country's total establishments. They employ around 61.6 percent of the workforce. They contribute 35.7 percent of value-added output. If provided with technical and financial support, MSMEs have the potential to contribute value-added output at a rate at par with our regional peers! The PFAI is in a strategic vantage point to make this happen!

We are glad to report that the institutionalization of a database on key industry statistics, including exposures to MSMEs, will support evidence-based strategic planning for the industry. Information will provide an objective measure of the extent of the industry's evolution and contribution to the country's economic growth.

- ♦ leverage on digital technology

The dynamism of our operating environment requires us to be strategic, agile and adaptable in our thinking and actions. We must remain open to innovation and emerging trends without compromising on prudential standards and the industry's underlying vision of being at the forefront of providing greater consumer and corporate credit to accelerate inclusive growth.

Digitisation and technological developments in the delivery of services will be felt on many fronts. You will find that as companies shift towards the use of technological and digital solutions to enhance customer platforms and improve their operational efficiency, financing requirements for equipment and software investments will increase.

As your clients migrate to digi-tech, so must the PFAI and its members develop its own fintech in providing services. On this note, I encourage the PFAI to explore ways in how it can encourage its members to leverage off technology.

In this connection, I would like to share that through the strong sponsorship of the BSP, various industry players have committed to launch the National Retail Payment System, a digital ecosystem for retail payments. This will result in a safe, fast, convenient and cheaper way of effecting electronic fund transfers for you and your clients.

- ♦ engage in continuous training and development

Keeping up with developments, honing skills and increasing knowledge must be a continuing effort. In this regard, we at the Bangko Sentral recognise the importance of PFAI's seminars, workshops and educational programs. These programs enhance professional development and information databases. We note that PFAI's "SafeTNet" reinforces the industry's ability to exercise prudent and responsible lending.

FOURTH TRUTH: Collaboration and cooperation among industry players is essential to push the industry forward

Collaboration, cooperation and partnerships are central to long-term success. PFAI knows this only too well.

We commend PFAI's efforts to connect with regional counterparts through the Asian Leasing Association. This is a significant step in enabling industry practitioners to dialogue with international experts/regulators, be on top of the latest trends, and benchmark on best practices.

FIFTH TRUTH: Continuous dialogue and a partnership between regulators and the regulated result in greater industry support, rationalised regulations and national development

I am sure that other co-regulators like the SEC and BIR would welcome active, continuous and open dialogue with its regulated entities. On our part, the BSP's commitment to the execution of a market-oriented monetary policy supporting continued robust economic growth requires this cooperation.

To support a conducive business environment, the BSP works closely with its supervised and regulated entities.

It also collaborates with other regulatory authorities.

Currently, we are working on the deepening of the local currency bond market. Regulators are about to unveil a proposed capital market roadmap. I encourage the industry to actively provide inputs to the sequencing of priority areas in the plan. A vibrant capital market can serve as an alternative source of financing for the industry and powerfully complements bank lending.

In closing

As I close, let me reiterate the truths I have shared so far. First, economic conditions are favourable and allow for robust lending and leasing operations. Second, we have in place, a sound and evolving legal and regulatory framework to ensure prudent and responsible financing practices. Third, we urge players in the industry to recognise and serve markets – especially the MSME sector seize opportunities not just for profit but to actively participate in financial inclusion efforts leverage on digital technology and engage in continuous training and development. Fourth, industry players would benefit from collaboration and cooperation. Fifth and finally, continuous dialogue and a healthy partnership between regulators and the regulated would result in greater

industry support, rationalised regulations and national development. We encourage you to help us in this regard.

Rounding these points up, I will end with sage advice (again from Shakespeare). The world's pre-eminent dramatist and poet said, "Our doubts are traitors, and make us lose the good we oft might win, by fearing to attempt."

Given the crucial role we play in economic development and even in financial inclusion. Let us not fear to attempt. It is our pleasure in the BSP to stand with you, friends and colleagues of PFAI, to endeavour to believe in the great strides we can make together for the betterment of the business environment for the credit, financing and leasing industries for MSMEs for our nation.

Thank you for your kind attention. Congratulations to your new officers. Mabuhay ang ating mahal na bansang Pilipinas.