Nestor A Espenilla, Jr: Build, build, building our FIN-frastructure

Speech by Mr Nestor A Espenilla, Jr, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at The Asset's 12th Philippine Forum, Pasay City, 24 October 2017.

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I am pleased to be your keynote speaker this morning in *The Asset's 12th Philippine Forum*.

In the forum briefer, the national Government's focus on building infrastructure is described as a step towards "defining new dimensions in development"... What a positive theme to build on!

Infrastructure development is vital to economic growth. When one looks at the key facilities for the efficient functioning of a nation: transportation, communication, water, energy... it is evident that infrastructure development is all about building networks of viable, productive and meaningful connections. Indeed, the goal of having sound and reliable infrastructure is to include more and more people into development.

At the Bangko Sentral, we too are eager to pursue development in inclusive ways. In our role as central monetary authority, as supervisor of financial institutions, and as guardian of the payments and settlements system, our thrust is to ensure that the business and operating environment is sound and stable... and that our policies and regulations encourage the build, build, build of a progressive and inclusive financial infrastructure... I will now coin a word.... "FINfrastructure." (I googled this and the search did not turn up any results. As far as I know, it's original). FINfrastructure. :)

Strong Foundation for FINfrastructure Building

To initiate building any infrastructure project, it is necessary to have a solid and reliable foundation. Key statistics show that we enjoy a strong economic base.

The Philippines experienced sustained uninterrupted expansion for the past 74 consecutive quarters, spanning 18 years. The economy is expected to grow within Government's real GDP growth targets of 6.5-7.5 percent for 2017, and 7.0-8.0 percent for 2018. Strong domestic demand and an expansive government budget for infrastructure development underpin this growth. Overseas Filipino remittances and BPO sector revenues continue to drive our economy.

Inflation remains low and stable, and expectations continue to be well-anchored. For the first nine months of 2017, inflation rate averaged 3.1 percent. We remain on track to stay within the target range of 2 to 4 percent for 2017, and inflation is projected to settle near the midpoint in 2017–2019.

Despite global shifts, the balance of payments (BOP) is under control. The country's BOP in September in fact posted a surplus of US$24 million, a reversal from the previous months' deficit. While we project an overall BOP deficit for 2017, we expect this to remain at less than 1 percent of GDP. This is something that can readily funded given the large level of international reserves, our other external liquidity buffers, and our market access.

The emergence of a current account (CA) deficit can be attributed to the strong demand for imports associated with the sustained and broad-based expansion of the domestic economy's capital formation, production and consumption.

The increased demand for dollars also reflects residents' investments abroad and prepayments of foreign debt. However, continued strong inflows from overseas Filipinos' remittances, business process outsourcing receipts, and revenues from the tourism sector, help support the balance of payments.

The financial sector also demonstrates strength and sustained growth. Our banks continue to enjoy strong balance sheets and satisfactory asset quality. The banking system's resources expanded by 15.4 percent as of end-August 2017. Asset growth is supported by a stable deposit funding base. In line with the country's domestic growth, banks' total loan portfolio grew by 17.3 percent and is diverse across industry sectors.

Notwithstanding sustained expansion in credit, banks demonstrate prudence in lending. Banks' NPL ratios improved to 2.0 percent as of end-August 2017. Banks also maintained adequate buffer for loan losses, registering a higher NPL coverage ratio of 114.1 percent.

Meanwhile, banks continue to build up their capital position. As of end-June 2017, the capital adequacy ratio (CAR) of universal and commercial banks (U/KBs) registered at 16.0 percent.

This solid performance did not happen overnight. Rather, it is the result of deep and meaningful financial sector reforms boldly implemented over the years. Today, we continue to promote sound corporate governance standards, a stronger capital base, and improved risk management practices. For instance, just this month, the Monetary Board approved the revision of the guidelines on liquidity risk management, signifying enhancements to our guidelines which were first issued in 2006. This is part of a broader set of BSP reforms on liquidity standards. This initiative was preceded by the issuance of the liquidity coverage ratio (or "LCR") framework in March 2016. It will be followed by issuances on the implementation of the net stable funding ratio (or "NSFR"), which is part of the Basel III Liquidity Standards; and intraday liquidity reporting requirements.

Vigilance as We Build

The economic landscape looks good, with conditions ripe for building. However, as we build, we must be mindful and vigilant of challenges.

For example, there could be some transitory upside risks to inflation owing to the possible impact of the proposed tax reform program along with pending petitions to raise power rates. This notwithstanding, inflation expectations continue to be within target over the policy horizon.

The BSP also continues to watch against financial market volatility emanating from uncertainty in the pace of normalization of U.S. monetary policy as well as geopolitical issues that may have impact on the stability of financial markets, on movement of capital flows, and on continued economic activity.

INFRA supports the Superstructure

At the BSP, our mandate is to provide policy direction in the areas of money, banking and credit. We do not ourselves build the FINfrastructure. Rather, our task is to promote an environment for those that do (this includes many in this prominent audience).... We do this through implementation of rules and regulations, through the launching of initiatives, and through sound, prudent and progressive banking reforms.

As I say this, the fact that what we do in the BSP is slightly invisible becomes apparent. But insight is that the very word itself, "infrastructure" is preceded by the Latin prefix, INFRA... which means "below"... which while underneath and invisible, provides support to the superstructure flourishing above it. In this sense, I am heartened. What an honor for the BSP to serve in this way!

The FINfrastructure Agenda

At the BSP, our agenda on FINfrastructure focuses on financial sector and market infrastructure reforms that aim to enhance access to credit and other financial services, deepen local currency debt and foreign exchange markets, and digitalize our financial system. These are strategic and complementary reforms that reinforce sustainable economic growth and push further our financial inclusion agenda.

Over the years, our regulatory issuances allowed a wider range, as well as expanded physical and virtual reach, of financial services. For example, we now allow third party retail outlets to function as cash agents as well as the implementation of reduced Know-Your-Customer (KYC) rules for certain low-risk accounts and the use of technology to comply with KYC requirements.

Likewise, the BSP supports efforts to build financial infrastructure and viable ecosystems to facilitate a more equitable allocation of credit.

Earlier, we talked about the Government's thrust for infrastructure. Part of BSP FINfrastructure agenda is collaborating with other government agencies and industry stakeholders to deepen the local currency debt market, given its vital role in complementing bank lending to support long-term financing requirements of corporates and the Government, particularly for its "Build, Build, Build" program.

As early as June last year, the BSP has started the groundwork for project financing under Circular No. 914. Last month, the Monetary Board approved amendments to streamline requirements of issuance of bonds and commercial papers by banks and quasi-banks (QBs), thereby providing them more flexibility in tapping capital markets as alternative funding source. These amendments, as embodied in Circular No. 975, include the removal of required eligible collaterals. At the same time, just this month, we issued Circular No. 976, which provide enhancements to the prudential reporting requirements over project finance exposures. It is important to sharpen BSP's assessment of banks' exposure to project finance, given that demand is expected to pick up and gain traction as the country moves towards its infrastructure goals.

Complementing capital market development initiatives, we are also pursuing foreign exchange (FX) market reforms to deepen and increase efficiency of the FX market, and reduce cost of doing business.

Building FINfrastucture with FINtech

Technological development has significantly changed the business of banking and finance. Financial transactions can conveniently be made on the move, in the comfort of one's home, using a smart phone. There is a shorter turnaround time for financial transactions.

Nowadays, retail financial services are further being digitized via mobile wallets, payment applications, robo-advisors, equity crowd-funding platforms for access to private and alternative investment opportunities, and online lending platforms.

These breakthroughs are revolutionalizing the financial landscape. Sound FINfrastructure is needed to support it.

The BSP is actively leading industry-wide initiatives to operationalize the National Retail Payment System (NRPS) to enable customers to make payments and transfer funds between and among accounts using any digital device. The goal is for us to transition into a cash-lite economy. We are seeing progress in this area. First, with the establishment of the payment system management body, incorporated as Philippine Payments Management, Inc., there is now an organized governance structure of retail payment systems in the country. We are also currently working with the industry on the formation of two priority Automated Clearing Houses (ACHs), the Batch Credit Push EFT (called PesoNet), and the Real-time EFT Credit (called InstaPay). The PesoNet is set to launch on November 8, 2017.

The BSP is also mindful that fintech also poses technology-related risks. With this in mind, the BSP follows a test-and-learn approach that allows an enabling environment for new collaborations to prosper. We encourage bank and non-bank partnerships with fintech startups to maximize the benefits of innovative digital platforms, efficiency of gains, and cost savings.

We are also aware that new entrants may cause disruptions in the financial ecosystem since traditional players may be unable to immediately respond to increasing competition. Hence, we monitor fintech activities to better understand their business models, processes and systems.

Moreover, the BSP has enhanced existing regulations to ensure that non-banks such as pawnshops and money service businesses are properly supervised as they compete in delivering bank-like services. Relatedly, we regulate entities that use virtual currency as underlying instruments for remittance.

The BSP has also provided guidelines on BSP-supervised financial institutions to ensure that risks resulting from usage of social media are adequately assessed and managed. Lastly, the BSP is enhancing its information security framework to consider cybersecurity controls.

While the term, “Financial Infrastructure” refers broadly to a system that allows for the effective operation of financial intermediaries, encompassing even the legal and regulatory framework... I would like to think of FINfrastructure as one that addresses the very heart of why infrastructure exists: to connect people, to enable inclusion and to provide a network for more Filipinos to enjoy the benefits of economic progress and development.

Leveraging on Fintech fosters Inclusion

The BSP is committed to promoting financial inclusion. (Incidentally, financial inclusion is one of the foundations of the Philippine Development Plan 2017 to 2022, Ambisyon Natin 2040.). The ultimate goal is to reach the unbanked and underserved populace. Fintech can be leveraged to achieve this. Jack Ma, founder and executive chairman of Alibaba expressed this by saying, “Fintech or Techfin is to rebuild the system with technology…to solve the problem of a lack of inclusiveness.”

We believe in leveraging on digitization so that it is responsive to a broader economy. This is why we are also closely working with the National Government for the adoption of a biometric-based foundational ID system.

Build, Build, Building Together

Ladies and gentlemen, this Forum is an opportune time to encourage each one here — pillars of society, movers and shakers in the banking and financial industries, to all work together.

The Philippines is increasingly populated by young, tech-savvy ‘millenials.’ This growing customer-base prefers streamlined processes and products and services that can be accessed via electronic services. This market is on the lookout for new offerings. We can therefore capitalize on this opportunity by allowing fintech to come into play. The BSP is supportive of fintech innovations and see much potential in this area. Indeed we are, as the forum’s briefer says, in an “energized backdrop.”

I have said in several speeches before that Fintech is borderless with varied and plenty players. This, constant engagement with Fintech innovators, other regulators and industry players is important. This is to foster a deeper understanding of risks, gauge market conduct expectations and inculcate appreciation for financial inclusion goals. I reiterate this today.

On behalf of the BSP and the Monetary Board, I thank the organizers for the opportunity to share our initiatives with you today as we work toward a better Philippines.

Mabuhay ang Pilipinas. Mabuhay tayong lahat.