Nestor A Espenilla, Jr: Thinking out of the Bank

Speech by Mr Nestor A Espenilla, Jr, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the Cocktail Hour: Up Close and Personal with the BSP Governor, Manila, 26 October 2017.

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WTCMM Chairman Guilly Luchangco, WTCMM President Pamela Pascua and officers of WTCMM, partners from the private sector, fellow public servants, special guests, ladies and gentlemen, good afternoon.

To get up close and personal – This underlines the Terms of Reference for this afternoon's cocktail hour. .... I think the natural tendency is for people not to disclose too much of themselves... Candor requires courage. Sharing about one's identity, vision and values, necessitates confidence.

I welcome this opportunity to share more about the Bangko Sentral ng Pilipinas, who we are, our policy thrusts and initiatives. To be able to engage our stakeholders in the shared task of national development, we must make ourselves and our mandates more widely known and understood.

Getting Past First Impressions

With Philippine banknotes issued by the BSP and marked with our logo... with banks making reference to our authority... and with our name mentioned in media fairly often, it is easy for Filipinos to know OF the Bangko Sentral... But KNOWING the BSP is an entirely different thing. Allow me to take us beyond acquaintance...

Apart from being a supervisor and regulator of banks and other financial institutions, and apart from being the sole issuer of our currency, most of what we do at the BSP seems esoteric to the general public. This is not surprising as the workings of economics, statistics, data analytics and the like, often do not enjoy public attention (maybe, even public interest).

Issuing and implementing policies to promote stability is the crucial work that the BSP does in the background.

When one thinks of the BSP, one may have the initial impression that our functions are detached and removed from everyday life... the impression is that perhaps, the policies and regulations we churn out do not have that much impact on the ordinary citizen... I hope very much that we would get past this notion.

As businessmen, investors and consumers, you may have seen and experienced that the Philippines has, been enjoying strong economic growth with financial stability. We are seen as one of the fastest growing and most resilient economies in the region and the world.

The economy has experienced sustained uninterrupted expansion for the past 74 consecutive quarters — spanning 18 years! Over the past five years, the domestic economy expanded by more than 6 percent annually, providing more opportunities across all segments of society.

Traditional Central Banking

Let me share an open secret: Central Banks worldwide (and the BSP is no exception) are traditionally conservative institutions and some would argue, boring. Understandably so since stability is our main concern. Thus, doing novel things may not be intuitively consistent with this goal.

In its invitation, the WTCMM asked me to share my plans and programs in the continuity of providing the country a strong monetary and financial system. This is really the traditional part of central banking, focusing on our core mandates of price and financial stability.

The BSP adopted the inflation targeting framework in 2002 to achieve low and stable inflation. This was accomplished, providing credibility to what we do as a monetary authority.

Inflation continues to remain low and stable with well-anchored inflation expectations. Headline inflation rose to 3.4 percent year-on-year in September, making the resulting year-to-date average inflation rate of 3.1 percent within the Government's target range of 3.0 percent ± 1.0 percentage point for 2017. We expect to sustain this through 2018 to 2019 based on our forecast.

In 2016, we formally adopted the interest rate corridor (IRC) system, which enhances the link between the BSP's monetary policy stance and financial markets. The primary benefit of the adoption of an IRC system in the Philippines is the strengthening of monetary policy transmission by ensuring that money market interest rates are meaningfully influenced by the BSP's policy rate. We continue to refine the implementation of the IRC system to make it more market-friendly.

Our financial sector also demonstrates stability and robust growth. Domestic liquidity conditions remain ample to support lending. Banks remain strong, supported by a stable capital base and satisfactory asset quality. The non-performing loan ratio (NPL) is down to just 2.0 percent as of end-August 2017. Actually, it's negative if we net out the generous allowance for loan losses. As of end-June 2017, capital adequacy ratio (CAR) of universal and commercial banks is very healthy at 16.0 percent on a consolidated basis.

Getting Personal

The road to a resilient banking sector has not been easy. The Asian financial crisis revealed weaknesses in bank management and also banking supervision. The BSP implemented bold and systematic banking reforms to rise above the crisis and get the financial system and the economy going again. This was a journey I was very personally involved in, being deputy governor for supervision for the last twelve years before I become governor.

It was a challenging journey, one which required patience and grit, given the significant implications on the existing set-up. The reforms needed called for substantial improvements in our processes and more challenging, a paradigm shift in the mind-set of bank supervisors, to a risk-based approach that allowed for innovations but also kept a firm handle over risks.

We initially adopted a gradualist approach while we worked on the buy-in of major stakeholders. Progress was also very incremental. However, in 2005, the pace of reforms accelerated and the full shift started to happen. This involved improving data collection and storage, reviewing and revising competency requirements for bank supervisors, changing the examination and off-site supervisory processes, and pursuing capacity-building to continuously upgrade the skills of bank supervisory staff. At the same time, we have aligned prudential regulations with international standards.

Today, we use a range of tools and techniques in deploying our supervisory resources on a proportionate basis. The BSP's supervisory process is also underpinned by an enforcement framework that clearly defines principles in deploying enforcement actions, including escalation processes, and the menu of actions available to supervisors.

The reforms and transformation of the banking system and how we supervise it is a continuing story. Rather than be complacent because of the success, we see this window as providing the opportunity to further deepen financial sector reforms.

Beyond Traditional Central Banking

In being a conservative central monetary authority, we face a significant tension: there are several factors that compel us to become more innovative and creative in our approaches and go beyond traditional central banking. The pervasive problem of inequality, the fast pace of technology and digitisation, the interconnectedness of markets, globalisation, regionalisation, a growing millennial population and other dynamics highlight the need for us to evolve, address issues in possibly non-traditional ways, and be steps ahead.

Towards this end, the BSP has woven in financial inclusion to its traditional objectives. As early as 2000, the BSP played a key role in expanding access to financial services to the entrepreneurial poor by mainstreaming microfinance in the banking sector. I was personally involved in these efforts, being part of the Microfinance Committee in my capacity then as Managing Director of the Supervision and Examination Sector.

In 2007, we embraced the more ambitious and broader goal of financial inclusion. As far as I know, we were the first central bank in the world to have a unit dedicated to financial inclusion. We also established at the same time dedicated units focused on consumer protection and information technology supervision. These were all deliberate investments that anticipated the digital future of finance.

While financial inclusion has been framed as an advocacy, we cannot deny its linkage to financial stability. It has been shown that broader access to bank deposits can have positive impact on financial stability by building resilience of deposit funding base. Thus, in a way, financial inclusion is not necessarily beyond the BSP's core mandate.

We have used several platforms to reach the grassroots and allow more of our countrymen greater access to financial services. These promote increased usage of the full-range of financial products for saving, remittance, payment, credit, insurance and investments, as well as acquire greater financial literacy and awareness.

In addition to increasing access through liberalized branching regulations that build on brick and mortar venues, we are leveraging on digitisation and fintech solutions to provide more financial services and reach the unbanked and the underbanked at a faster rate and at much lower cost.

We are also closely working with the National Government for the adoption of a biometric-based foundational ID system. We have identified the lack of a reliable and convenient ID system to be a major barrier to access to financial services. This initiative will bring millions of the underserved and unserved to participate in the digital finance ecosystem.

Beyond Banking: Fintech Revolution

FinTech is altering traditional concepts and the very scope of the financial system itself. Alternative sources of funding have been and continue to be developed.

We believe that payments can be a crucial step to financial inclusion. When we provide people the means to pay and receive payments using digital platforms connected to the formal financial system, users become familiar with new procedures. This eventually builds their confidence to transact within the formal financial system, and have access to more value-adding financial products and services like savings, loans, insurance and investments. This is very crucial for our country where access to an account is only around 31% of the population.

As part of our commitment to the national strategy for financial inclusion, the BSP is actively working with the industry towards enabling more Filipinos to have access to a basic transaction account in a bank or non-bank financial institution to send and receive payments via any electronic device. Last December 2015, we launched the National Retail Payment System

(NRPS) project. The NRPS, and the inter-operable digital payment ecosystem that it will enable, will make it convenient and affordable to transfer funds between and among accounts using any digital device. NRPS will facilitate our transition to a cash-lite economy.

As a key component of the NRPS initiative, the Philippine Payments Management, Inc. (PPMI) was recently registered with the Securities and Exchange (SEC). This will act as the industry-driven self-governing body to drive the responsible development and operations of the retail payment system. We are now also working with the industry on the formation of two priority Automated Clearing Houses (ACHs) that will actually deliver the payment solutions — the batch electronic fund transfer credit payment scheme (called PESO Net); and the real-time low-value push payment scheme (called InstaPay). PESO Net is set to launch on November 8, 2017, less than two weeks from now.

Over the years, we have taken a very active role in ensuring that our policy and regulatory environment provide opportunities for innovation while ensuring risks are well-managed. We have learned to be open-minded to change.

Among central banks, we are a pioneer in the use of the “test and learn” approach, now called the regulatory sandbox. One of the earliest applications of this was for e-money in 2004, when few people have heard of it. We allowed non-banks to pilot the provision of e-money within defined parameters. We have since then used this test and learn approach to allow piloting of many other fintech innovations in our system.

We are doing our own fintech experimentation to improve our own capability. We are exploring an API system to connect financial service providers to the BSP. This would strengthen BSP’s risk-based regulatory and supervisory activities, and may very well be an initial step to building capacity for big data analytics. This is Regtech.

Earlier this year, we issued various regulations aimed at mitigating effects of technology-related risks, including AML/CFT and other concerns with respect to fintech. This includes enhanced regulations to ensure that non-banks such as pawnshops and money service businesses are properly supervised as they compete in delivering bank-like services. This also extends to entities that use virtual currency as underlying instruments for remittance. We expect financial access to further expand with our recent issuance allowing technology-enabled third party retail outlets to function as bank cash agents. Complementing these are regulations that allow reduced Know-Your-Customer (KYC) processes for certain low-risk accounts and the use of technology for KYC. These amendments aim to facilitate frictionless customer on-boarding and convenient customer access.

In keeping with our mandate to maintain financial stability, soon we shall be issuing enhanced information security framework to strengthen cybersecurity controls in line with a rapidly evolving cyberthreat landscape surrounding financial institutions. It is vital that we preserve the balance between innovation and risk management.

Game-Changing Financial Sector Reforms

Given the country’s potential as a promising investment destination, our domestic capital market is being positioned to serve as an important source of long-term funding and as a complement to bank lending to support economic growth.

In this regard, we are closely collaborating with other government agencies, namely the Department of Finance (DOF), Securities and Exchange Commission (SEC) and Bureau of the Treasury (BTr), and industry stakeholders to deepen the local currency debt market.

Complementing this local currency debt market development initiatives, we are also further liberalizing foreign exchange (FX) rules in order to enhance the ease of doing business. This forms part of a broader agenda for an organized FX market to enhance depth and transparency, improve price discovery, and increase availability of FX products, especially hedging instruments.

Mutuality in Relationships

Indeed, the economic circumstances today demand fresh and bold approaches. But to succeed, collaboration and cooperation is key — with other government agencies and with you, our stakeholders in the private sector and the Filipino public.

Any great innovation effort begins with understanding "the who, what, and whys" of those we serve... In other words, who are our customers? What needs do they have? And why do they have these needs?... This is the true essence of customer-centricity, empathising with the experiences of our stakeholders. We in the BSP cannot answer these questions – who, what and why – ourselves. Our varied expertise and perspectives will need to converge for this purpose to come up with viable solutions.

The programs I mentioned – the National Retail Payment System, the biometric-based ID system, even the deepening of the capital market are endeavours that cut across sectors. Their success hinge largely on the buy-in and cooperation of all those involved and all who will ultimately be benefitted.

Challenge

As I close, let me reiterate what I earlier said about customer-centricity, and also return to the theme – getting up-close and personal... While this was intended to refer to our own interaction and discussions here... to be more effective in what we do, we MUST – by all means – get up close and personal... with our citizens, and you, with your clients and customers.

We have an increasing population of millennials who are tech-savvy, somewhat impatient and in need of faster and more streamlined products and services. This group prefers to be on the move and is thus partial to electronic services. Observing this group and exploring their needs will uncover a number of ways in which they may be served.

Moreover, in the area of fostering greater financial inclusion, empathy with underprivileged sectors and with sectors challenged with access to formal credit will spur us to become more innovative together. It is time to get personal. Our businesses, our services and our mandates ARE personal.

In meeting this challenge so that we can have more inclusive growth, the BSP is here with you. On behalf of the Monetary Board and the Bangko Sentral ng Pilipinas, I thank you for your kind attention.