

Nestor A Espenilla, Jr: Changes less intuitive and the digital challenge

Speech by Mr Nestor A Espenilla, Jr, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the BAIPHIL's Induction of Directors and Officers and First General Membership Meeting, Makati, 13 July 2018.

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BAIPHIL President Domingo Gavino, Jr., BAIPHIL members, Bank Presidents, Country Heads, industry partners, esteemed guests, ladies and gentlemen: Good afternoon!

364 days ago, on the 14th of July 2017 precisely, I had the honor, as newly appointed BSP Governor, to induct BAIPHIL's set of board members and officers - Ms. Irene Arroyo and her team.

Today, I again have the privilege of inducting BAIPHIL's new officers, directors, committee chairpersons and advisers! Congratulations Irene on excellently leading BAIPHIL for the past year. On behalf of my colleagues in the BSP, Assistant Governor Resty Cruz who is here with me today, and other senior officers of the BSP, I warmly congratulate BAIPHIL's new leadership. We look forward to working with you in the continued pursuit of professional growth and excellence in the banking system.

Last year, BAIPHIL's theme was "Scaling New Heights in Banking Excellence." I recall making reference to Mt. Everest with the qualification that in the banking industry, the heights we scale are not static - they are ever changing.

Indeed, this is the reality we face. Among other shifts, continuing advancements in digital technology are redefining the way we do things. Technological developments account for a growing demand for new and more sophisticated financial products and for faster and almost near real-time, same-day service delivery.

I find it encouraging that again, the BSP and BAIPHIL are on the same page. Your theme, "Fostering Stewardship amidst Financial Innovations", runs parallel to our own 25th Anniversary theme, "Navigating the Future," with focus on traversing the digital frontier and the ever-transforming economic and financial landscape.

Stewardship with Changes Less Obvious

But before I dive into the topic of digital change – a change that is evident to many - allow me to share my views on an area that is also fast-changing, but with changes perhaps less obvious, because we are very focused on the head winds.

This is the area of monetary policy design and how market-based approaches must be developed and adopted to skillfully conduct it. For me, it is a matter of urgency given the necessity to stay relevant and ahead of the times.

Now, more than ever, I find it compelling to talk about how the BSP has always been, and remains to be, committed to its price and financial stability mandate in the face of transformations in the financial system. Monetary policy is evolving in the context of a financial system that is becoming more and more sophisticated. Thus, all our present reform actions - reducing our reliance on the reserve requirement to control money supply - our liberalization of the FX market - our efforts to deepen the capital market. All our macro- and micro-prudential measures are not diversions from the goals of price and financial stability. They are deliberately pursued with the recognition that they are all linked, and form a coherent strategic purpose.

For instance, let's take the move to reduce the reserve requirement ratio - the goal is to bring it down to a single-digit level before the end of my term, five years from now. Do not look at this in isolation. Instead, may I urge you to allow deeper analysis.

It is easy to say that the RR cuts result in injecting liquidity into the system at a time when inflation seems to be on the rise. This is a simplistic view. But I dare say, we will not allow ourselves to be so limited in our evaluation. One, it cannot be denied that the economy is growing fast. Thus, more banking intermediation is needed to sustain it. I hope it would become clear that the RR cuts are intended to promote efficient financial intermediation. These reductions will help curb shadow banking, given the rising challenge of alternatives posed by developments such as fintech. Foresight is essential.

Second, the RRR cuts are not without compensating action as the IRC framework is in place to absorb excess liquidity. As such it is intended to be policy neutral operational adjustment. In fact, the liquidity releasing impact of the two previous RR cuts that we've done so far this year, is actually less than the liquidity draining impact of open market operations and our significant FX operations to manage excessive peso volatility in the face of external uncertainties. This has resulted in tighter financial conditions as evidenced by rising market interest rates.

We will continue to rely on changes in the policy rate as our key signalling mechanism of our intended monetary stance. Rest assured, the BSP is focused on managing overall domestic liquidity as influenced by multiple factors through effective open market operations. We are, in this area of less obvious but real changes, exercising stewardship, never losing our focus.

Stewardship in the Digital Age

Coming to your theme - on the need for accountability and proactive leadership to respond to a rapidly evolving financial environment - the BSP is, and has always been committed to providing an enabling regulatory environment to allow innovations to flourish while guarding against risks attendant to technological changes.

The BSP espouses a flexible "test-and-learn" approach to financial innovation. Others call this the "regulatory sandbox". Essentially, we provide a testing ground for new business models to guide us in assessing potential risks. The ultimate objective is to be aware of the risks, to employ mitigating actions as needed, but also to allow room for market players to leverage on these new technologies. Guided by this approach, the BSP ensures that the intensity and content of supervision is calibrated according to the magnitude of risks identified in a new activity. We believe that this is the only way that we can allow innovation to happen.

We also encourage dialogue and multi-stakeholder collaboration among new and incumbent players and relevant financial regulators to achieve a "whole-of-government approach." This ensures policy consistency and prevents regulatory arbitrage. We are currently working with other financial regulators in creating a new multilateral FinTech Committee under the Financial Sector Forum (FSF) which I chair. We are also closely coordinating with the National Privacy Commission and the Anti-Money Laundering Council.

The BSP has also further refined existing regulations to effectively respond to digitalization of banking services, fintech developments, and the emergence of technology-related risks while remaining supportive of financial innovation.

We have rationalized the regulatory framework relative to the operations of money service businesses or MSBs. Specifically, we enhanced the customer due diligence expectations to re-balance the objectives of financial integrity and financial inclusion. Under the amended anti-money laundering (AML) rules, customer due diligence/ Know-Your-Client (KYC) requirements are relaxed for low-risk customers/accounts/transactions under certain conditions.

We have established a framework for regulating virtual currency (VC) exchanges and similar entities operating in the Philippines. Under the new framework, VC exchanges are classified as Remittance and Transfer Companies (RTCs) and are subject to registration, minimum capital requirements, internal controls, regulatory reporting and compliance with the anti-money laundering rules and regulations.

We are also collaborating with other regulators for a harmonized regulatory approach to new things such as Initial Coin Offerings and VC trading activities. We are working closely with our supervised institutions on their respective plans to launch private digital currencies and other pioneering VC technologies. Presently, we are looking into the issue of central bank-issued digital currencies and what it means for the supply of credit and the impact on the financial system. So many things are happening on the ground today.

Parallel to this, we implemented a cash agent model to provide an innovative service delivery channel through the combination of e-banking self-service online facility, and real-time transaction capabilities, together with cash in, cash out (CICO) system provided by third-party cash agents.

We take note of the rise of blockchain or distributed ledger technology (DLT). Presently, we are working closely with market innovators and industry players to explore viable but safe tie-ups of correspondent banks with DLT providers. These partnerships are seen to further enhance the synergy between banks and fintech players.

To date, we have already approved a project under the test-and-learn approach that will facilitate the creation of a real-time domestic and overseas remittance corridor without the need to establish a central operator. This will be beneficial to remittance businesses which rely heavily on correspondent banking for the safe and efficient settlement of remittance transactions particularly inflows from Overseas Filipinos to their family beneficiaries.

There is also an on-going project, probably many of you know about, it being spearheaded by the Bankers Association of the Philippines (BAP) to develop digital identification (IDs) powered by a block chain technology. The BAP has partnered with a technology and consulting company and with several domestic banks to employ a “self-sovereign” type of identity management, granting customers full control and management in the sharing of personal and sensitive information.

Amidst all these digital transformations and financial innovations, the BSP also recognizes the fundamental need to create a secure, reliable and efficient digital financial ecosystem where all these innovations can come together to achieve the greatest synergy.

In 2015, three years ago, we launched the National Retail Payments System (NRPS). It provides a policy and regulatory framework for establishing a safe, efficient, affordable, interoperable, and reliable retail payments system in the country. The payment ecosystem envisioned to arise from this is positioned to be a platform for financial innovations. Industry players can utilize fintech solutions and provide services within an organized, commercially-viable, and efficient retail payments system.

We have already achieved critical milestones since the launch of NRPS. These include the transitioning of the batch interbank fund transfer service of the Philippine Clearinghouse Corporation (PCHC) into PESO Net, and the launch of InstaPay which allows the 24/7 low-value electronic fund transfers among participating member financial institutions anywhere in the country.

The BSP is also currently exploring RegTech solutions to streamline its own supervisory functions, particularly in terms of addressing regulatory compliance and reporting of its supervised financial institutions. Our two pilots are about chat bots and APIs.

Lastly, we are enhancing our cross-border presence through multi-sectoral and regional collaborative engagements. Last November, the BSP entered into a Fintech Cooperation Agreement with the Monetary Authority of Singapore (MAS). We are working on other similar agreements with other central banks and we hope to sign some of them in the coming months.

Closing Remarks: Shared Stewardship

From this brief update, I hope I have been able to assure you of the BSP's commitment to the banking industry in taking a shared responsibility for successfully navigating the challenges of the digital frontier.

Digital technology will continue to play a decisive role in the future of banking. Its potential to transform core business models and the financial services industry will ultimately depend on our readiness to respond to evolving trends. Together and with increased collaboration, we will be able to anticipate change, identify technological trends across different sectors, and fully maximize the potential of digital innovations to provide more convenient, and efficient financial services.

As co-stewards, I encourage BAIPHIL too, to allow fintech innovations to ultimately work for the benefit of our public particularly the unbanked and underbanked. We see a lot of potential in digitalization as a tool to further promote a broad-based and inclusive growth. We need to ensure though that the design and deployment of digital financial solutions meet the highest standards of transparency, product suitability, security, and confidentiality. These must ultimately serve the interest of your customers.

With our sustained collaboration, we can definitely ride the waves of technology, reap the rewards of digital transformation, and pursue financial inclusion. What an exciting prospect! But we cannot deal with these changes applying the same constructs that we have been so used to for the last decade. We cannot look at the same problems with the same framework using our old technologies, even though we have invested heavily on those. It's time to move forward. We look forward to working with BAIPHIL more closely in these endeavors and trust that its current leadership will continue to support the BSP's initiatives to improve the overall competitiveness and relevance of our financial system in an era of digital transformation. I listened carefully to the plans of Dom and they are rightly so bold and brave. I strongly encourage you to move forward with these plans. Don't be timid. Change is upon us. We must deal with change by the horns of the bull. Thank you very much. Maraming salamat po sa inyo. Good afternoon!