Opening Remarks

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Bangkok Sustainable Banking Forum 2019

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Distinguished guests,

Ladies and gentlemen,

Good morning and welcome to the Bangkok Sustainable Banking Forum 2019. This forum was first started last year to promote sustainability practices in the Thai financial sector and to highlight the potential role of the financial sector in addressing common challenges facing the Thai society, such as income inequality, environmental degradation, excessive household debt, and the persistent problem of corruption. Certainly, addressing the challenges around environmental, social, and governance (ESG) aspects are critical for the sustainability of the Thai economy and to some may seem far beyond financial institutions' core mandates. Nevertheless, as main intermediaries of financial resources, the financial sector can influence how these resources are allocated and, hence, can influence how the economy and society progress over the long-run.

Many people may view that the concept of sustainability for the financial sector generally encompasses financial institutions partaking in charity or corporate social responsibility projects. I am afraid that the concept is often misunderstood. The core concept of sustainability needs to be considered first in the context of the long-run sustainability of the financial business itself. When financial institutions focus mainly on short-term gains, neglecting the potential long-term effects or negative spillover of their activities, this can in fact increase financial institutions' risks; risks that can impair their credibility, public trust, and financial positions in the long-run.

Allow me to highlight three well-known incidents in particular.

First, in 2016 the US Consumer Financial Protection Bureau fined Wells Fargo USD $185 million after uncovering that employees of the bank had created millions of fraudulent customers' bank and credit card accounts over a period of many years in order to achieve annual sales targets. Driven by poor internal controls and short-term incentive compensation programs, employees signed up new accounts without customers' consent, moved funds from their existing accounts, and charged fees on accounts and services customers had not signed up for. According to a report by the Bureau, "more than 1.5 million bank accounts were created, of which around 85,000 accounts incurred USD $2 million in fees.[1]" Not surprisingly, public confidence in the bank plummeted. A survey of retail banking customers conducted in late 2016 suggested that 30 percent of customers were actively exploring alternative service providers[2].

Second, between 2013 and 2015 many countries in our ASEAN region were affected by haze pollution caused by illegal forest fires started to clear land for pulpwood and oil palm plantations. One of the countries most severely affected was Singapore, where for consecutive days air quality deteriorated to dangerous levels, forcing closure of schools and impacting outdoor business and tourist activities. It was reported that Singapore incurred as much as SGD $700 million in economic loss[3]. Subsequent investigation indicated that responsible parties

1 https://files.consumerfinance.gov/f/documents/092016_cfpb_WFBconsentorder.pdf
2 http://cg42.com/wp-content/uploads/2016/12/cg42-Wells-Fargo-Mini-Study-102016vF.pdf
3 http://www.siiaonline.org/wp-content/uploads/2016/10/2016-04-Policy-Brief-SEA-Burning-Issue.pdf

included firms operating in Indonesia. Singapore banks also came under pressure from allegations that some banks may have been involved in financing corporations responsible for the forest fires. These allegations caused the public to question business practices of banks and damaged banks' reputation to such a level that banks in Singapore promptly worked together on an industry guideline, committing to the public that they would develop policies and processes to limit negative externalities of their financing activities, especially in industries with elevated social and public risks such as agriculture and forestry.

The third incident I want to highlight comes from the Thai financial sector. Over the past few years, heightened competition in the real estate sector along with rising property prices, had led to aggressive sales and promotional campaigns by property developers, attracting real as well as speculative buyers. Seeing opportunities in the sector, some banks significantly relaxed their lending standards for mortgage loans. Data revealed that as high as 25 percent of new mortgage and related loans originated in 2018 had loan-to-value ratio above 100 percent. Moreover, numbers of homebuyers were getting mortgage credit lines in amounts much higher than the underlying property purchasing values, essentially gaining the extra "cash-back" from their borrowing activities. This created perverse incentives for individuals to buy homes merely to earn the cash-back, for use on general spending. These increasingly laxed mortgage lending standards by banks have in part worsened the household debt situation in Thailand, wrongly incentivized speculative activities, fueled real estate bubbles, and exposed banks to higher credit risks when there is correction in the real estate market. As a result, this prompted the Bank of Thailand to step up our macro-prudential regulations on mortgage lending.

Overall, these are just a few examples of how financial institutions' own actions can contribute to the worsening of social and environmental problems, impair their credibility, and result in unintended financial losses. If there had been proper internal controls and incentives aligned, Wells Fargo's customers would not have been subject to fraud. Had financial institutions assessed the potential environmental impacts of companies they were financing, credit decisions may have had a different outcome, limiting the extent of damage on surrounding environment and on public's air quality in Singapore. With better credit culture and internal controls, Thai financial institutions could help limit the worsening of household debt and lower exposure to credit risks of their mortgage portfolios.

While in some adverse incidents financial institutions managed to avoid large financial losses or were able to take swift actions to address them, it is clear that these incidents, if left unattended by financial institutions themselves or regulators, would have resulted in continued deterioration of public trust and in the long-term potentially large financial losses. Ultimately, these incidents highlight that not properly taking sustainability risks into consideration could result in serious risks, both financial and non-financial risks, that are large enough to impact the viability of the financial institutions themselves. In other words, sustainability risks have been underpriced or underestimated in business practices of financial institutions.

Ladies and gentlemen,

Let me highlight on risks, especially credit risks, that financial institutions could face from different ESG dimensions.

On-going global warming can seriously impact future outputs, productivity, or the business continuity of borrowers, reducing their capabilities to generate income and repay debt. Persistent social issues like widening social gaps can fuel social distrust and trigger public unrest and demonstrations, resulting in economic losses. Malpractices by borrowers that have negative implications on environment and society may result in potential business failures, especially in today's society where information can be quickly disseminated through online and social media channels. Meanwhile, poor governance by financial institutions themselves can result in misallocation of funds and concentration of risks. All of these are examples of how different ESG dimensions can heighten credit risks for financial institutions.

Moreover, financial institutions may be subject to credit and reputational risks coming from their corporate clients if their clients fail to adapt business models to meet heightened standards and changing environment. Fast changes in consumer preference for sustainable products and increasing public demand for corporates to demonstrate social responsibility can negatively impact businesses should their business practices fail to meet public expectations. It is therefore important that financial institutions understand changing clients' business practices and public expectations to be able to fully assess their exposure to risks.

It is also to be noted that as intermediary of public money, financial institutions have the important role of meeting public expectations to maintain the credibility and trust of the financial system.

Ladies and gentlemen,

I would like to reiterate that financial institutions cannot underestimate the risks that come from various aspects of ESG, as these risks can impair the long-run sustainability of the financial institutions themselves. To manage and reduce these risks, it is important that financial institutions internalize sustainability considerations and properly price in potential risks into different aspects of their operations.

This starts with commitment by directors, top management, and senior executives to create a culture that embraces sustainability. This could be achieved through the setting of long-term and strategic priorities to address sustainability issues; establishing new layer of internal control to limit negative externalities of related activities; and expanding the scope of risk assessment and internal audit to account for potential risks from ESG-related issues.

For Thailand, it is encouraging to see many financial institutions beginning to incorporate sustainability practices and internalize ESG risks. Some financial institutions have explored different ways to assess and limit ESG impacts; some have improved disclosure practices; and some have adopted global sustainability standards. A few of our financial institutions have also been included in the Dow Jones Sustainability Indices. Meanwhile, the Bank of Thailand and other financial regulators have worked hand-in-hand to promote awareness, build industry's capacity and foster commitment to incorporating sustainability practices into the culture of our financial industry.

Ladies and gentlemen,

The Bangkok Sustainable Banking Forum 2019 presents another exciting opportunity for the Thai financial sector to learn from the experiences of our peers and partners who have dealt with the challenges and adverse implications of underpricing ESG risks; and see how financial institutions have used different approaches to internalize these risks. We will also learn of different countries' experiences on advancing ESG agendas and the challenges that the Thai financial sector must overcome to make a leap in our journey towards sustainability.

To end my remarks, I would like to take this opportunity to thank speakers, panelists, and the audience for your participation. I would also like to thank our organizing partners and the Bank of Thailand staff for your tremendous efforts. What we will learn together today will be an important stepping stone in Thailand's journey towards sustainability, the journey that will improve Thailand's financial resilience; limit financial sector's negative externalities on our environment and society; and address our common challenges for the quality of life of future generations. Last but not least, the sustainability of our financial sector depends on the sustainability of public trust. We need to repeatedly remind ourselves that the sustainability of public trust can be upheld only when the financial sector looks far and wide beyond their immediate responsibilities. Thank you very much.