Benjamin E Diokno: The Philippine economy - moving the financial services industry forward through inclusive technology, green initiatives

Speech by Mr Benjamin E Diokno, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at The Asian Banker's Finance Philippines 2019, Manila, 10 October 2019.

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Officials from The Asian Banker, fellow speakers, representatives from the banking and finance industry, members of the business community, friends from the media, ladies and gentlemen, good morning.

I would like to thank The Asian Banker for inviting me today. I am delighted to be here not only because this is a venue to address key stakeholders of the Bangko Sentral ng Pilipinas (BSP) but also because the theme "Embarking on Sustainable Innovation in the Digital Economy" is very close to the heart of the BSP as we aim to bring Central Banking closer to the people.

But before I go into our efforts toward "sustainable innovation," allow me to first give a brief overview of the Philippines' macroeconomic environment, under which our financial services industry is operating in.

As recognized by relevant observers here and abroad, the Philippines is among the fastest growing and most resilient economies in the world today. The Philippines is in a very 'nice' place right now.

First, economic growth is robust, hitting 6.2 percent last year and expected by the government to remain in the 6-percent territory this year before accelerating further over the next three years.

Second, inflation is manageable, settling at 0.9 percent in September—the lowest in over three years. It is projected to remain well within the BSP's official target range of 2 to 4 percent up to 2021.

Third, external payments position is comfortable, serving as a solid buffer for the economy against external headwinds.

The gross international reserves (GIR) as of September 2019 stood at $86.2 billion, which is equivalent to 7.5 months of imports and payments for services and primary income.

Fourth, fiscal position is healthy, supporting the government's ambitious infrastructure development agenda and rising investments in human capital development.

The budget deficit is programmed to stay at a comfortable 3.2 percent of GDP up to 2022.

Government debt, which stood at 43.7 percent of GDP as of end-June 2019, is seen to continue its downward trend as growth of the economy outpaces the increase in the debt stock.

Fifth, the banking sector is sound and stable, helping fuel growth of the economy through credit and other financial services.

Capitalization is more than sufficient, with the capital adequacy ratio (CAR) of universal and commercial banks staying at 15.9 percent in June 2019. This is higher than the BSP's minimum regulatory requirement of 10 percent and the internationally prescribed floor of 8 percent.

Exposure to bad debts is minimal, with the non-performing loans (NPL) ratio staying at a mere

1.7 percent in August 2019. Total assets of the banking sector continue to grow, rising by 9.0 percent to ₱17.4 trillion year-on-year as of end-August 2019.

Topping all these is a demographic advantage, with the median age of the population at 24 years old.

In an ageing world, the Philippines' young, educated, and vibrant workforce is helping propel robust, sustainable, and more inclusive economic growth for the country.

Amid this favorable backdrop, the BSP has served as a pillar of strength for the economy over the years by fulfilling its mandate of price and financial stability.

Moving forward, the BSP is committed to playing an even more active role in maintaining economic stability and in helping achieve the economy's long-term development goals, among which is to reach high-income status by 2040.

We will do so by maximizing the provisions of our newly amended Charter, which enhances the BSP's ability to manage liquidity and supervise the financial sector together with other financial regulators, as well as of the recently signed National Payment Systems Act, which formally recognizes the BSP as supervisor of the country's payments and settlements system.

Now, allow me to focus on "sustainable innovation" in the country's financial services sector and the BSP's role in enabling it.

When I say the BSP is committed to playing a more active role in helping achieve the economy's development goals, what I mean is we are doing tasks outside the traditional central banking function of maintaining price and financial stability.

We want to contribute more to poverty reduction. This will make the BSP more relevant and closer to the Filipino people—something I consider to be my personal mission.

We are doing this through our financial inclusion agenda and ensuring greater access to financial products and services.

What better way can we accelerate financial inclusion than by promoting a more extensive use of financial technologies or fintech.

With the high penetration rate of mobile phones in the country, where even low-income earners own cell phones—the ability of fintech to accelerate financial inclusion is well recognized.

While we are leveraging on fintech, a lot of work still needs to be done before the Philippines becomes a truly financially inclusive economy. Many Filipinos still do not own bank accounts, and so are unable to access loans and other financial services from formal channels.

Nevertheless, we are working our way there.

First, internet and mobile phone banking. Banks that offer internet and mobile phone banking have increased over the years.

This has allowed more people to do online transactions, not only to pay bills and purchase merchandise goods, but also to avail themselves of savings, investments, and insurance products.

As of end-2018, there were 48 banks that have already made their financial services accessible through the internet, and 26 banks that have made their services accessible through mobile phones.

Second, interoperable payment systems. In the past, transferring funds from an account in one bank to another account in a different bank required physical movement of cash.

Now, following the launch of interoperable payments systems, funds can be transferred electronically through InstaPay, for low-value and real-time fund transfers, and PESONet, for bigger-value fund transfers confirmed within the same banking day.

As of end-July 2019, there were 43 financial institutions participating in InstaPay and 51 participating in PESONet, with more to come.

Third, the Philippine ID system. Following the signing into law of the Philippine Identification System Act (PhilSys) in August last year, the country will soon have a national identification system.

The objective is for all Filipinos to be properly identified using a unified system that gathers basic identification and biometrics information.

The BSP has assumed the task of printing the IDs. We are doing this because we don't want We expect the Philippine ID system to significantly hasten financial inclusion, as this addresses the problem of lack of formal IDs—which are required to open a bank account.

Fourth, non-bank electronic money issuers. A recent phenomenon that is significantly boosting financial inclusion in the country is the emergence of non-bank e-money issuers.

These are entities other than banks that also allow people to create electronic accounts in their platforms where people can store value in these electronic accounts, and make payments or do a remittance.

As of 27 August 2019, there were 14 non-bank e-money issuers supervised by the BSP.

Fifth, quick response codes or QR codes. The use of QR codes for payments has started to gain traction. In fact, last month, I was able to buy McDonalds through QR Payment option by PayMaya.

We hope to see more of this in the future; we hope that even market vendors, cab drivers, and sari-sari store owners will be able to use QR codes as a means to accept payments. To help move this along, the BSP is working with industry players to put in place a National QR Code Standard that will enable interoperability of QR Code-based payment facilities.

Other ongoing initiatives to advance e-payments are digitalization of government collections and disbursement, and the assessment and monitoring of the country's transition to a more cash-light economy with National Payments Diagnostics.

With these updates, we expect to have at least 20 percent of all financial transactions in the country done electronically by 2020.

Nevertheless, the BSP is mindful that with innovations come risks. As such, we are keen to make sure the regulatory environment is dynamic and attuned to industry developments. As our regulated entities adopt innovations to enhance delivery of their services to customers, the BSP is likewise embracing technology to improve consumer protection.

For instance, the BSP is working to provide an alternative channel for the public to elevate banking-related complaints through an automated Chatbot system, which is targeted to go live by mid-2020.

The Chatbot, using artificial intelligence (AI) and natural language processing (NLP), will be able to adequately and efficiently handle consumer concerns coursed through channels including

SMS and social media.

In addition, the BSP has developed a prototype that allows machine-to-machine link between the BSP's system and those of its supervised entities for streamlined transmission, processing, warehousing, and analysis of banks' prudential reports. Targeted to go live by the latter part of 2020, this innovation will significantly improve timeliness, ease, and integrity of data submission.

Because of these initiatives, I am proud to report that BSP won the "Artificial Intelligence Initiative" award and the "Data Management Initiative" award by Central Banking Publications during its Fintech and Regtech Global Awards held in Singapore last month.

In any case, the BSP observes the following principles in its regulatory approach to innovations in the financial services sector: (i) risk-based supervision, (ii) active stakeholder engagement; and (iii) consumer protection.

"Risk-based" means BSP-regulated entities are enjoined to put up the necessary risk management systems and sufficient capital to cover their respective levels of exposure to technological risks.

"Active stakeholder engagement" means the BSP is actively engaging supervised entities to constantly get updates from them on innovation trends that the regulatory environment should capture.

"Consumer protection" means financial institutions offering fintech-enabled services are required to have the necessary safeguards to ensure the protection of financial consumers against IT-related fraud and data compromise.

I've talked a lot about "innovations" but let me also go into the sustainable aspect in all these.

Needless to say that there is an urgent need for the entire world to more vigorously address climate change. I'm sure that by now, we are all familiar with a young environmentalist—a 16-year-old girl from Sweden named Greta Thunberg who addressed the United Nations and challenged policymakers worldwide to squarely address the issue.

What does this have to do with us in the Philippines' financial services industry? Well, the BSP recognizes the crucial role it plays in driving investments that promote climate-resilient, green, and sustainable growth.

In fact, the BSP has a two-pronged approach to promoting sustainable finance: 1) capacity building and awareness campaigns, and 2) enabling regulations.

In capacity building, the BSP takes part in several domestic and international fora on sustainability. One of which is the ASEAN Task Force on the Roles of Central Banks in Addressing Climate and Environment-Related Risks. The task force will conduct a study on the roles of central banks in addressing climate and environment-related risk to monetary, financial, and broader macroeconomic stability.

The BSP is also a member of the International Finance Corporation (IFC)-supported Sustainable Banking Network. The BSP, together with IFC, conducted a scoping research to better understand how to best embed environmental and social risk management as well as sustainable finance principles in the business decisions of financial institutions.

The BSP is also coordinating with the British Embassy in Manila on the possible capacity building initiatives under the Low Carbon Energy Programme (LCEP) of the UK Prosperity Fund. LCEP can provide support in terms of policy, capacity building, technical assistance and market development.

In enabling regulations, the BSP has come up with a proposed policy framework for sustainable finance, and we are currently in the process of consolidating and evaluating comments from industry players.

Some of the highlights of the proposed regulatory framework are as follows:

(1) Banks are expected to integrate environmental and social governance (ESG), and sustainability principles in their strategic direction, as well as in their corporate governance and risk management frameworks.

(2) Banks shall conduct scenario analysis and stress testing of its business exposures to assess their vulnerabilities over several ESG scenarios. Results shall be taken into account in their capital planning and business strategies.

(3) Banks will be required to disclose their sustainability agenda in their annual reports, including risk appetites in the ESG field.

The policy framework will be embodied in a circular that we will issue soon—the first of a series of circulars on sustainable finance.

In a related development, the BSP, together with the Department of Finance (DOF), co-chairs a newly formed inter-agency task force that is mandated to facilitate green finance initiatives. Members include the National Economic and Development Authority (NEDA), Bureau of the Treasury (BTR), Bases Conversion and Development Authority (BCDA), Department of Energy (DOE), and Climate Change Commission (CCC).

The interagency committee is working on a draft executive order – for the signature of the President– that will spell out deliverables and targets in relation to green finance initiatives of the country.

Meantime, some banks are already embarking on green finance while regulations on these are under way. In particular, a number of banks have put up Sustainable Energy Finance Desks, which serve as a point of contact in evaluating and monitoring sustainable energy projects. These encourage enterprises to engage in renewable energy projects.

In addition, some banks recently issued green bonds and sustainability bonds. Also, government-owned Land Bank has implemented the Climate SMART (Synergistic, Mitigation, Adaptation, Resiliency, and Transformation) Financing Program, which offers various lending facilities related to environment and sustainable financing.

While all these developments in sustainable financing are encouraging, the world is at the beginning of mass extinction due to climate change, and so much more needs to be done.

And so I challenge everyone in the financial services industry, including us regulators, to do more.

We have to be even more proactive in green financing, especially so that the Philippines is cited as among the highly vulnerable countries to the effects of climate change.

In closing, the financial services sector is at an interesting time. Technological innovations in the delivery of financial services are contributing significantly to the Philippine economy's transformation. But at the same time, with climate related risks threatening not only economic growth but life itself, industry members are also facing a great challenge.

Rest assured that we at the BSP will be working together with our supervised entities in stepping up efforts toward sustainable innovations in the financial services industry. We hope that you can also help us in stepping up and speeding up our sustainable innovations—not just for the Filipino people but with the future of our world in mind.

Thank you very much and mabuhay!