

Benjamin E Diokno: Sustainable finance towards a climate-resilient Philippine economy

Speech by Mr Benjamin E Diokno, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the 2nd Annual National Business Climate Action Summit, Pasay City, 21 November 2019.

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Secretary Emmanuel de Guzman of the Climate Change Commission, Ms. Ma. Alegria Limjoco, President, Philippine Chamber of Commerce and Industry, Mr. Titon Mitra, Resident Representative of the United Nations Development Programme (UNDP) Philippines, colleagues from the other government agencies, fellow speakers, friends from the banking industry, development partners, sustainability advocates, esteemed guests, a pleasant morning to all of you!

First, let me congratulate the Climate Change Commission, the PCCI, the Philippine Business for the Environment, and the UNDP for organizing this 2nd Annual National Business Climate Action Summit. I am honored to join you in this important gathering as we exchange views on sustainable finance and firm up our commitment in pursuing a low-carbon, climate-resilient, and sustainable development pathway for the Philippines.

According to a study made by Climate Central and published on the Nature Communications journal, the impacts of sea-level rise and coastal flooding is seen to become more extensive that could erase coastal cities by 2050. The Philippines is one of the countries identified to be in danger and the National Capital Region could likely be submerged due to climate change.

Then, last 8 November 2019, we commemorated the 6th year anniversary of Typhoon Yolanda which is considered to be the strongest typhoon that struck the country in 2013. Lastly, three major earthquakes hit North Cotabato and surrounding provinces in October 2019 alone. Thousands of families were affected and scores of houses and infrastructures were damaged.

After what happened, we cannot help but ask ourselves if we are ready to withstand any other form of calamity that may befall on us? If we are uncertain with our answers, all these headlines should serve as a strong wakeup call.

We should prepare for threats or risks that may happen any time especially those that have prolonged significant impact such as those resulting from environmental degradation or climate change risk.

Several climate vulnerability reports have consistently positioned the Philippines at the top as one of the countries exposed and vulnerable to natural disasters or climate change hazards. These facts provide a strong impetus and sense of urgency for all stakeholders to work together to address environmental issues including climate change.

In light of this urgent call for action, global leaders and financial regulators embarked on a mission to understand and manage the potential impact of climate and environment-related risks to the local and global economy.

The National Government, on its part, has deployed a number of initiatives which aim to address climate change risks. Through the years, several special laws have been enacted and implemented. These include the Clean Air Act, Clean Water Act, Solid Waste Management Act, Renewable Energy Act, Climate Change Act, among others.

The Philippine Development Plan of 2017–2022 outlines the government's climate-related and other environmental priorities.

Some of the strategies included in the PDP are as follows: (i) promotion of green technology innovations; (ii) institution of appropriate incentives to intensify the use of more energy efficient technologies; (iii) further development and use of renewable energy; (iv) promotion of climate-smart infrastructures and designs; (v) promotion of low-carbon, energy-efficient and environment-friendly urban transport systems; and (vi) promotion of sustainable consumption and production.

We understand that the Climate Change Commission has a huge task to coordinate, monitor and evaluate the programs and action plans of the Government to ensure that climate change is mainstreamed into the national and local development plans and programs.

With the growing sustainability considerations, a crucial question is what is the role of financial authorities and supervisors? Indeed, central banks can shape their response to climate and environment-related risks in line with their mandates.

At the BSP, we have remained steadfast in the pursuit of our core mandates with the end goal of achieving a more globally competitive Philippine economy, and a safe, sound and stable financial system. The BSP's mandates on price and financial stability and efficient payments system have been strengthened with the amendments to the BSP Charter in February 2019. So, how do we address the effects of climate change?

On monetary policy, data on natural disasters, including the damage to the agriculture sector and other industries essentially feed into the BSP's policy analysis.

The potential impact of climate patterns such as La Nina and El Nino episodes and natural disasters are used by the BSP in quantifying the potential impact of adverse weather conditions on the agriculture sector and in turn, inflation trends.

On financial stability, the BSP knows the potentially significant impact of climate change and other environmental-related risks to the financial system. In particular, this may affect the credit and operational risk exposures of banks that would, in turn, translate into profitability and solvency concerns.

We also recognize that the BSP has a role to play in the process. In line with this, we have rolled out a two-pronged approach in promoting environmental, social and governance (ESG) principles. First, through capacity building and awareness campaign, and second by mainstreaming ESG principles through the issuance of enabling regulations. We deem that this approach will increase the BSP and the banks' understanding of the risks posed by environment degradation and climate change on the financial sector, enhance capacity to manage these risks, and increase banks' awareness on the investment opportunities for green or sustainable projects before issuing regulatory expectations on sustainable finance.

Meanwhile, operationally, the BSP is already undertaking pockets of activities related to green practices. Just recently, the BSP participated in the open-ended green bond fund launched by the Bank for International Settlements as part of sustainable investing in reserve management.

The BSP also implemented the MB Paperlite Facility that resulted in the significant reduction of paper usage during MB meetings, and installed energy-efficient mechanisms such as solar panels and inverter technology in air-conditioning systems. Lastly, the BSP will be issuing ESG-related regulations in phases. All of these are part of our commitment to adopt a culture that embodies sustainability.

Earlier I mentioned the two-pronged approach for sustainable finance. As we build institutional capacity, we argue that sustainable finance is ultimately a public good. When done right, sustainable finance can translate into profitable investments, while at the same time attain environmental and social objectives.

We also subscribe to the idea that financial regulation can be a useful tool to contribute to the achievement of national and international environmental and social objectives. In this regard, the BSP has been actively involved in global and local conversations on sustainability through our membership in the Sustainable Banking Network, Alliance for Financial Inclusion and ASEAN.

We also participated on a study on banks' perceptions on sustainable finance as well as engaged in capacity building initiatives for both internal and external stakeholders in partnership with both local and international development partners.

On the regulatory pathway, the BSP believes that the optimal approach remains to be one that is "enabling" – one that provides ample flexibility, sensitive to risk-appetite and business models, and proportionate to the banks' size, structure and complexity of their operations. This approach aims to shift perspectives from a myopic compliance exercise to a forward looking stance that puts greater weight on the long term financial interest and sustainability of the organization.

Following this approach, the BSP will be issuing ESG related regulations in phases. The first phase will provide high level principles and broad expectations on the integration of ESG and sustainability principles in the corporate and risk governance frameworks as well as in the business strategies and operations of banks.

The second phase will provide more granular expectations in managing climate change and other environment-related risks in relation to credit, market, liquidity, and operational risks. The third phase may cover potential regulatory incentives.

Complementary to the policy issuances is our own research on the impact of natural disasters on the Philippine banking performance. Using existing regional data, we found that episodes of extreme weather conditions have negative impact on financial intermediation (deposits, loans, NPL, provision for NPL, profitability). However, the impact is short-lived given the sound financial position of banks. The damage tapers off after a year or so.

It is important, however, to underscore that we are not starting from scratch. The BSP's existing corporate and risk governance standards serve as the underpinning regulations for our ESG issuance. In particular, since 2012, we have established the accountabilities of the board and senior management in promoting good governance and in adopting effective risk management systems in banks. The BSP regulations also emphasize the adoption of appropriate credit and operational risk management systems, including stress testing framework.

This is to ensure that various risks including environmental issues and climate change risks are considered in the banks' decision-making process and stress testing exercises. The results of the stress testing should feed in the capital planning and business continuity arrangements of banks.

Moreover, with the geographical location of the Philippines, banks are prone to physical risks from severe weather condition. It is in this light that the BSP adopted a policy that provides temporary regulatory relief to banks which are located in areas affected by natural calamities. The regulatory relief aims to assist affected banks in their recovery and allow them to resume normal operations.

This refers to the risks resulting from climate change which can be event-driven (acute) or longer-term shifts in climate patterns (chronic) that may cause direct damage to assets or indirectly through the disruption of supply chain. Acute physical risks include floods, typhoons, droughts, wildfires, earthquake. Chronic physical risks include changes in precipitation and extreme weather variability, rising sea levels and chronic heat waves.

Ladies and gentlemen, there is a sound business case for sustainable finance and this is gradually gaining traction.

At present, Philippine banks are getting more involved into green finance, issuing green or sustainability bonds in order to fund and refinance renewable energy and energy efficiency projects, green buildings and other green assets.

Some banks adopted sustainability as part of their corporate social responsibility (CSR) initiatives while others have gone farther to integrate ESG principles and adopt Environment and Social Risk Management (ESRM) into their business operations.

There are banks that have adopted voluntary reporting of sustainability performance and established partnerships with international experts to assess and address climate change risks. Some banks even walked an extra mile by providing technical assistance to their clients so they themselves could imbibe sustainability practices.

The BSP is just a piece of the puzzle that will advance the country's climate and sustainability development goals.

Aware of the magnitude of multi-faceted challenges surrounding sustainable financing, the BSP is supporting the "whole-of-country" approach in this important undertaking. In this respect, the BSP along with key agencies in the government have collaborated and created an inter-agency group that will institutionalize and facilitate the implementation of a roadmap for sustainable finance.

The group is looking forward to adopting enabling policies that will promote sustainable finance. It also aims to facilitate investments in public infrastructure and mobilize funds to finance green or sustainable projects.

Apart from the public sector, there is, likewise, a need to increase awareness of the private sector, business enterprises and part of the households on the impact of climate and environment-related risks hopefully with the unceasing support by the development partners and academe. Hence, a 'whole-of-country approach' should be adopted in promoting sustainability across the country.

All said, let me leave you with some key takeaways:

Climate change and environmental challenges can pose risks on the stability of the financial system. A whole-of-country approach is basic and necessary to address such risk and scale up promotion of green/sustainable finance.

Initiatives to inclusive green/sustainable finance is yet to pick up. The BSP's support to sustainable finance is crucial, especially in promoting and signaling with stakeholders. Nevertheless, private sector response is gaining some ground.

In closing, I emphasize that sustainability is more than just a buzzword – it is a way of right living and existence. Sustainable finance is a tool to foster environment and social-friendly businesses and communities towards a climate-resilient Philippine economy.

Thank you and good morning!