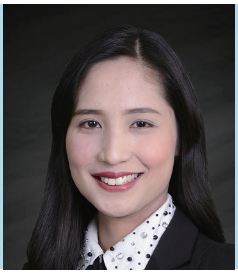


KRIZIA PAULINE FELICE S. FERRER

Securities and Exchange Commission, Philippines

KAREN G. ARIAS-ROCHA

Securities and Exchange Commission, Philippines

Sustainability Initiatives of the SEC Philippines

Introduction

Safeguarding the future through sustainable finance

In November 2013, one of the strongest and most disastrous tropical cyclones, Typhoon Haiyan, wreaked havoc on the islands of the Philippines. With maximum sustained winds reaching 235 kilometres per hour at its core, it was ranked the worst typhoon to ever hit the country in terms of damage to property. It was responsible for more than 6,300 lost lives, 3.4 million affected families, and property damage amounting to USD 2.2 billion. Typhoon Haiyan was only the 23rd of 25 tropical cyclones that entered the Philippine area and 9th to make landfall in 2013. But this was not a once-in-a-decade occurrence. A research project in 2016 found that since the late 1970s, typhoons in Asia have intensified by 12-15%, and that the share of category 4 and 5 storms doubled or even tripled. In addition, the Global Climate Risk Index 2019 identified the Philippines as the fifth most-affected country by weather-related losses in the period 1998 to 2017, with total losses amounting to USD 2.93 billion.

In the words of Secretary Dominguez during a green finance forum held at the Bangko Sentral ng Pilipinas in the beginning of 2019, "Winter is here and it will wipe out not only the people of Westeros but of the entire planet. So goes the theme of the Game of Thrones and like the series, while everyone is busy fighting their own battles – Brexit, the budget here, the wall in the United States – no one is paying attention to Climate Change."

Climate change is real and we need to face it. Although sustainable investing is not the first thing that comes to mind when thinking of climate change solutions, it may be key to ensuring the continued growth of the Philippine economy. However, as this concept is fairly new to the Philippine market, many have initially dismissed sustainable financing as simply "environmental advocacy" or "grandstanding," and not really useful to real finance. As such, the Securities and Exchange Commission (SEC) of the Philippines has taken important steps in increasing focus on innovative financial products that address sustainability issues, as well as on the importance of environmental, social, and governance (ESG) risks disclosures.

Philippine capital market development

The Philippine capital market is both old and young. Its stock market is one of the oldest in Asia. The Manila Stock Exchange (MSE) and the Makati Stock Exchange (MkSE) were established on 8 August 1927 and 27 May 1963, respectively. Both exchanges eventually merged to form the present-day Philippine Stock Exchange on 23 December 1992. Despite the early beginnings however, the market is still in the early stages of development. The SEC is currently regulating only three types of financial products: equities, corporate bonds and mutual funds.

By the end of 2018, The Philippine Stock Exchange (PSE) had only 267 listed companies and a total of 322 issuances – which is not much different from the 223 listed companies and 303 issues twenty years prior. Unlike the stock market however, the country's bond market, while still quite underdeveloped, has been growing at a rapid pace. According to the Asia Bond Monitor report of the Asian Development Bank, the Philippines has the fastest growing bond market in emerging East Asia with a recorded 11.4% year-on-year expansion in the fourth quarter of 2018.

Although the Philippine capital market is currently doing well, there is still a need for further development. Other than the issue of limited availability of financial products in the market, another major reason for some difficulty in promoting the growth of the capital market is the fact that the country's financial sector is largely dominated by banks. Financial literacy, especially knowledge of the capital market, is still lacking. Companies, more often than not, would turn to banks for funding rather than raise funds in the capital market. Likewise, individuals would dismiss potential investment opportunities in the capital market due to lack of awareness and knowledge. In 2018, total assets of the Philippines banking system amounted to USD 320.84 billion;

while assets of non-bank financial institutions (i.e., investment houses and financing companies) totalled only USD 5.35 billion.

The SEC recognises the importance of a developed and well-functioning capital market and has renewed its efforts into deepening the Philippine capital market to increase local private investments, attract global investors, and enhance financial stability. Considering the astonishing amount of global capital looking for sustainable investments – which is currently estimated at USD 89 trillion (representing the assets under management of more than 2,000 firms who have signed on to the United Nations (UN) Principles for Responsible Investment) – the SEC could leverage on this opportunity to deepen the capital market and increase market participation.

Corporate Governance and Philippine Publicly Listed Companies

In the advent of the East Asian Financial Crisis in 1997, corporate governance (CG) was a major focus in the reform packages associated with the rescue programs for the countries. On closer inspection, key players in the market saw its relevance to the Philippines considering that the country had similar bad CG practices as Indonesia and Thailand, and strived to reform CG in the Philippines. Although introducing a corporate governance reform process in the Philippines did not come without challenges, with the cooperation of CG advocates, the private sector and the Philippine Government, good corporate governance was able to take root in the industry. Good corporate governance became one of the SEC's principal advocacies when it issued its first Corporate Governance Code in April 2002. The 2002 Code was applicable to corporations whose securities are registered or listed, grantees of permits / licenses and secondary franchise by the SEC, public companies and branches and subsidiaries of foreign corporations operating in the Philippines whose securities are registered or listed. The Code was issued to aggressively promote corporate governance reforms that aimed to increase investor confidence, develop the capital market and help the corporate sector achieve long term viability that will have a positive direct impact to the economy.

To further strengthen corporate governance in the country, the SEC then released the Revised Code of Corporate Governance (RCCG) that took effect in 15 July 2009. The noticeable difference between the 2002 Code and the RCCG is the deletion of branches and subsidiaries of foreign corporations operating in the Philippines whose securities are registered or listed. It is also in the RCCG that the SEC reintroduced the concept of stakeholders. In its amendment in 2014, the RCCG recognized the vital role that the stakeholders play in the corporate or business ecosystem.

Aware of the constant changes and developments in the global practice of corporate governance, the SEC released the SEC Corporate Governance Blueprint in 2015. This Blueprint is the SEC's roadmap for the five years to 2020 with the aim of raising Philippine corporate governance standards to a level at par with the global standards. The first action item for implementation in the Blueprint was the drafting of the 2016 Code of Corporate Governance for Publicly Listed Companies (PLCs). Following the recent developments, especially with the release of the 2015 G20 / Organisation for Economic Co-operation and Development (OECD) Principles of Corporate Governance, the 2016 Code's main features are: the increase in board responsibilities, competence and commitment of directors, protection of shareholders and other stakeholders, and promotion of full disclosure and transparency in both financial and non-financial reporting. Although the SEC Corporate Governance Blueprint only mentioned in passing the importance of sustainability reporting and that the regulator had not yet issued reporting guidelines that are specific to sustainability other than the Corporate Social Responsibility (CSR) Act, the 2016 Code fully addressed sustainability concerns through Principle 10, Recommendation 10.1. The Recommendation states that the Board should have a clear and focused policy on the disclosure of non-financial information with emphasis on the management of economic, environment, social and governance (EESG) impacts of the company's business, which underpin sustainability. Companies should adopt a globally recognized framework in reporting sustainability and non-financial issues.

Few but significant factors drove the SEC to come up with Principle 10. First, an increase in external pressures, including resource scarcity, globalisation and access to information, pushed the regulator to look at how businesses integrate sustainable practices in their operations. Secondly, it was brought to the attention of the SEC that sustainability reporting is already being practiced by 93% of the world's largest 250 companies and 75% of the top 100 companies in 49 countries. Regrettably, only less than 22% of publicly listed companies in the Philippines have published a report on their sustainability impact and performance. On a positive note, this handful of PLCs did not publish their sustainability reporting because of regulation. They were driven by either accidental awareness of sustainable business practices or by pressure from their institutional investors and stakeholders. Even so, it is important to note that this 22% of the total 275 PLCs in the country will not even make a dent in the sustainability reporting arena.

For the past decade, the SEC has done its part to promote good governance to its regulated entities as evidenced in the numerous Codes, Circulars and Rules and Regulations it has issued since 2002. Unfortunately, the exclusion of non-financial information, particularly on economic, environmental and social (EES) impacts, from the PLCs' submission of mandatory reports to the Commission can be attributed to the lack of regulation pertaining to non-financial disclosures with emphasis on EES. With the national programs and policies such as AmBisyon Natin 2040 which was pegged to the universal targets on sustainability like the UN Sustainable Development Goals (UN SDGs), agencies in the Philippine government are now aligning initiatives, rules and regulations towards the achievement of ESG universal and national targets.

Moving Towards a Sustainable Philippine Capital Market

Promoting sustainable finance in the Philippines

Sustainable finance has made substantial progress in the Philippine market. Currently the market is valued at USD 1.49 billion – with seven labelled green bond issuances and one labelled sustainability bond issuance (Table 1). Notably, five of these transactions have been in Philippine pesos or linked to Philippine pesos (about USD 775 million equivalent), which is critical to induce other Philippine firms to seek sustainable investors and grow the market.

The first Philippine labelled green bond was issued by AP Renewables, Inc.

(APRI) in 2016. It was a landmark transaction for climate finance as well as for capital market development in the Philippines. The innovative structure of the issue was able to pave the way for financing large infrastructure projects and enhancing bankability of projects. This transaction also won the recognition of the international market. The deal was awarded the 2016 Bond Deal of the Year by Project Finance International magazine of Thomson Reuters, and the Best Renewable Deal of the Year at the Alpha Southeast Asia Awards. It also received the title of "first" in a number of areas: first labelled-green bond in the Philippines; first Climate Bonds Initiative (CBI)-certified green bond in the Asia Pacific; first CBI-certified green bond for a single project in Emerging Markets; first project finance notes issued in Philippine pesos in the power sector, specifically for on-shore market; first credit-enhanced project notes in Southeast Asia (excluding Malaysia) since the Asian Financial Crisis; and first transaction of the Credit Guarantee and Investment Facility (CGIF) in the Philippine market.

With this ground-breaking issuance, the SEC, together with other regulators of the Association of Southeast Asian Nations (ASEAN) Capital Markets Forum (ACMF) recognised the potential of green finance in furthering the group's objective of supporting sustainable growth in the region and attracting greater global investments. As such, following the 25th meeting of the ACMF on 8 September 2019 in Jakarta, Indonesia, the ACMF committed to taking a leadership role in identifying green finance standards that can be applied in the ASEAN region and established the ACMF Green Finance Working Group. The working group is currently chaired by the Securities and Exchange Commission, Philippines (SEC Philippines) and the Securities Commission Malaysia (SC Malaysia).

As its first project, the group developed the ASEAN Green Bonds Standards (AGBS). And to ensure that the ASEAN Standards are in line with international principles, the ACMF engaged with the International Capital Markets Association (ICMA) and built the ASEAN Standards from the ICMA Green Bond Principles. The ASEAN Standard drafters also extensively consulted other specialists in this market, including investment banks, funds, multilateral development banks and even non-government organisations and ESG ratings providers. ASEAN then decided to take a step further by explicitly excluding fossil fuel power from the eligible use of proceeds under the AGBS. Fundamentally, the goal of the AGBS is to provide a framework that ensures transparency. In this way, investors would be able to determine for themselves, based on the disclosures required by the ASEAN Standards, if a particular offering qualifies under their mandate for green investments. Further, second-party opinions on an issuer's green framework, provided by firms with established expertise in this sector, likewise provide an additional tool for investors to make informed judgements regarding an offering's "green-ness."

Just a few months after the SEC adopted the AGBS through Memorandum Circular No.12 series 2018 on August 2018, the Rizal Commercial Banking Corporation (RCBC) became the first Philippine ASEAN green bond, and the sixth in the region. RCBC's listing of their 15 billion peso Green Bonds (USD 287 million) on 1 February 2019 represented two significant milestones for the Philippines: (i) it is the first peso-denominated green bond issued by a universal bank in the country, and (ii) it is the first bond in the Philippines to be issued under the ASEAN Green Bond Standards.

Feedback from investors regarding this issuance has been remarkable. Although RCBC is the first bank to issue a Green

Table 1: Philippine Green, Social, and Sustainability Bond Issues

No	Name of Issuer	Type of Project	Issue Size (million)	Issue Year	Tenure (years)
1	AP Renewables Inc.	Renewable Energy	PHP 10,700 [USD 225]	2016	10
2	BDO Unibank	Climate-smart projects including renewable energy, green buildings, and energy-efficient equipment	USD 150	2018	–
3	International Finance Corp.	IFC Climate Projects; climate-smart projects including renewable energy, and energy efficiency	PHP 4,800 [USD 90]	2018	15
4	Sindicatum Renewable Energy Co. Pte. Ltd.	Philippine renewable energy projects	PHP 1,060 [USD 20]	2018	10
5	China Banking Corporation	Climate-smart projects, including renewable energy, green buildings, energy efficiency and water conservation	USD 150	2018	–
6	Rizal Commercial Banking Corporation	Renewable energy, green buildings, clean transport, energy efficiency, pollution prevention & control	PHP 15,000 [USD 287]	2019	1.5
7	AC Energy Finance International Limited	Renewable energy	USD 410	2019	5 / 10
8	Rizal Commercial Banking Corporation	Renewable energy, green buildings, clean transportation, energy efficiency, pollution prevention and control, sustainable water management, environmentally sustainable management of living natural resources and land use, affordable basic infrastructure, access to essential services, employment generation, affordable housing and socioeconomic advancement and empowerment	PHP 8,000 [USD 154]	2019	2

Note: As of June 2019
Source: Securities and Exchange Commission, Philippines

Peso Bond, and only the fourth bank to issue bonds under Bangko Sentral ng Pilipinas (BSP) Circular 1010, its ASEAN Green Bond was three times over-subscribed. Furthermore, RCBC was able to achieve the lowest cost of borrowing of any bank as of its listing, at 6.7315%, for its 1.5-year paper. It also appears that RCBC's issuance has benefited from many of the ancillary advantages that green bonds are generally known to provide. One key benefit is a broadening of the investor base and higher visibility to ESG-oriented investors. For this specific RCBC ASEAN Green Bond, retail investors, particularly new retail investors, came out in force – comprising more than 60% of the issue.

Through RCBC's green bond issuance, the SEC gained proof of concept for ASEAN Green Bond Standards in the Philippines. The SEC was able to know for certain that:

1) Supply for green investment exists: local banks have green assets in their portfolios and have customer demand to justify raising green funds;

2) Competitive demand exists: particularly on the retail side, there is demand for banks to issue bonds under BSP Circular 1010;

3) The process of identifying existing green assets and obtaining the ASEAN Green label can recognise untapped value and provide better information to manage risk;

4) Overall development of the capital market: with a wider investor base available to fund a greater range of borrowers.

Following the success of the ASEAN Green Bond Standards, both locally and within the region, the SEC together with the other ACMF members again worked to develop the ASEAN Social Bond Standards (ASBS) and the ASEAN Sustainability Bond Standards (ASUS) to complement the AGBS that was launched in November 2017. Once again, the ASEAN regulators engaged with ICMA and built the ASEAN Standards from the globally-accepted ICMA Principles and were able to launch both ASEAN standards in October 2018 during the 2nd ASEAN Capital Conference.

To further support the Philippines' sustainable development needs, the SEC adopted the ASBS and ASUS through Memorandum Circular No.9 series 2019 (ASBS), and Memorandum Circular No. 8 series 2019 (ASUS) in April 2019. Again, RCBC was the first mover and issued the first Philippine ASEAN Sustainability Bond in June 2019. From the initial USD 96 million offer, RCBC upsized their issuance to USD 154 million due to the strong demand they received from retail investors.

Through these transactions, the SEC saw that green funding attracts clients looking to finance sustainable solutions. A loan portfolio that includes sustainable assets is generally less exposed to risks posed by new environmental regulations (e.g., carbon tax; increased emission standards), technological obsolescence (e.g., coal fired power vs energy storage in batteries, distributed generation) and climate change (e.g., damage wrought by increasingly violent weather). These features make green funding a good risk management strategy for both sides of the balance sheet, with greater diversification on the liability side and healthier loans or other assets on the other side. As such, the SEC is continuously engaging the market to promote awareness of sustainable investment and encourage greater investment in country.

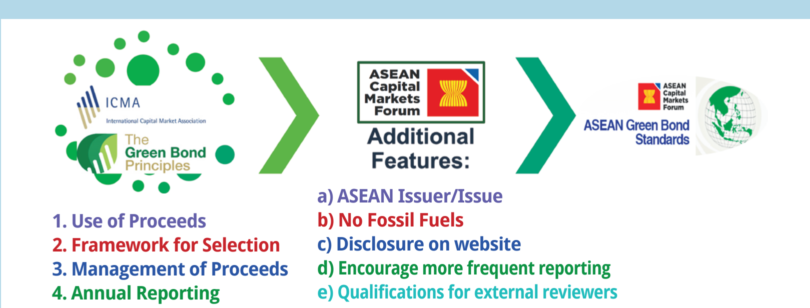
Promoting sustainability reporting in the Philippines

Hand in hand with the promotion of green, social, and sustainable finance, the SEC also recognised not only the growing global interest, but also the importance of ESG transparency in achieving a sustainable market. And so, on 15 February 2019 the SEC issued SEC Memorandum Circular No. 4, Series of 2019 or Sustainability Reporting Guidelines for Publicly Listed Companies. The intention is to promote sustainability reporting that: is both relevant and value-adding to the Philippine PLCs; will help PLCs identify, evaluate and manage their material EES risks and opportunities; will help them to assess and improve their non-financial performance across EES aspects of their organization to optimize business operations; will improve competitiveness and long term success; will provide a mechanism to allow companies to communicate with stakeholders, including current and potential investors; and will enable PLCs to measure and monitor their contributions towards achieving universal targets of sustainability, such as the UN SDG and national policies and programs, such as AmBisyon Natin 2040. The Guidelines include a Sustainability Reporting Framework that builds upon four globally accepted frameworks: Global Reporting Initiative's (GRI) Sustainability Reporting Standards, International Integrated Reporting Council's (IIRC) Integrated Reporting (IR) Framework, Sustainability Accounting Standards Board's (SASB) Sustainability Accounting Standards and the recommendations of the Task Force on Climate-related Financial Disclosure (TCFD). Sustainability Reporting Principles, Management Approach Component and Materiality Assessment Process are also included in the Guidelines to assist PLCs in identifying what indicators or topics are material to them and should be disclosed using the Sustainability Reporting Template that the SEC prescribed.

In addition, the Guidelines and the template also provide for a section related to the 17 UN SDGs. Disclosure would be required on how companies' products and services contribute positively and negatively to the UN SDGs. The Guidelines and the template omit the required disclosure on the governance of the organization as companies are already required to report this to the SEC through the Integrated Annual Corporate Governance Report (I-ACGR).

The Guidelines adopted a "comply or explain" approach for the first three years after implementation. This means that companies would be required to attach the Sustainability Reporting Template to their Annual Reports but they could provide explanations for items on which they still have no available data. The first submission shall be attached to the PLCs' 2019 An-

Figure 1: ASEAN Green Bond Standards Development



Source: Securities and Exchange Commission, Philippines nual Reports to be submitted in 2020.

The SEC hopes that the guidelines will boost both the quantity and quality of sustainability reporting in the country, provide current investors with more actionable information that will assist them in their investment decisions, and attract additional investors including those from overseas to invest in Philippine companies.

The Future of ESG in the Philippines

Challenges to drive ESG initiatives in the Philippines

When the SEC first began to promote sustainable finance in the Philippine market through the issuance of the Guidelines for ASEAN Green Bonds, the reception was lukewarm. Operating in an emerging economy, Philippine investors and issuers are just concerned with their bottom lines. And the SEC often faced the question: "What's in it for me?" However, recently the SEC is seeing that corporations are increasingly concerned with the sustainability of their companies and are paying third parties to have their ESG scores assessed. Likewise, investors are demanding more information on their investments and the risks they are exposed to over the medium and long term.

Some of the key challenges that the SEC, as well as other regulators of the financial industry, will have to address include:

1) How to effectively facilitate an enabling environment where innovative financing solutions like green bonds and transparency through ESG disclosures are encouraged.

2) How to effectively create awareness of sustainability reporting for PLC boards and management.

In this regard, it is ideal for a Sustainability Champion to come from the board level. Leadership and commitment should come from the top for the initiative to have a trickle-down effect on employees. It is easier for the organization to push forward with its ESG reporting if there is full support from the board. However, there should be awareness on the part of the board and management to get their buy-in on this initiative.

The times are changing, and the Philippines will be forced to adapt or be overcome by the effects of a global phenomenon that cannot be overturned. The ESG initiatives that the SEC has been promoting so far are critical tools in helping to ensure a resilient Philippine economy. These initiatives represent the SEC's understanding that markets will flourish when transparency requirements enable investors to make informed governance, management and investment decisions.

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KRIZIA PAULINE FELICE S. FERRER

Securities Examiner / Economist, Securities and Exchange Commission, Philippines

Krizia Pauline Felice S. Ferrer is a Securities Examiner / Economist for the Markets and Securities Regulation Department of the Securities and Exchange Commission, Philippines. She works mainly on policy formulation and rule-making for the securities market. Specifically, she reviews proposed rules of self-regulatory organizations and other market participants, and the proposed products and services in the market to ensure consistency with securities laws, regulations, policies and global best practices. She currently leads the technical team that supports the SEC's initiative to develop the sustainable financing market in the Philippines. Specifically, she is the lead contributor to the SEC Memorandum Circulars involving the implementation of the ASEAN Green, Social, and Sustainability Bond Standards in the Philippines. She also represents the SEC in various ASEAN working groups including the ASEAN Capital Markets Forum (ACMF) Working Group on Green Finance. She holds a Bachelor of Science degree in Business Economics, magna cum laude, from the University of the Philippines School of Economics.

KAREN G. ARIAS-ROCHA

Securities Specialist II, Securities and Exchange Commission, Philippines

Karen G. Arias-Rocha is a Securities Specialist II at the Securities and Exchange Commission, Philippines. She is one of the original members of the Corporate Governance Division of the SEC when the Division was created in 2012. She is one of the lead contributors in the drafting and release of the 2013 Annual Corporate Governance Report for Publicly Listed Companies, the 2015 Philippine SEC Corporate Governance Blueprint, the 2016 Code of Corporate Governance for Publicly-Listed Companies, the 2017 Integrated Annual Corporate Governance Report for Publicly Listed Companies, and the Sustainability Reporting Guidelines for Publicly Listed Companies. She has organized numerous workshops, roundtable discussions and forums to support the promotion of corporate governance practices and sustainability in the corporate sector. She has conducted seminars and training sessions on PSEC corporate governance issuances, rules and regulations. Currently, she is working closely with the ASEAN Capital Markets Forum (ACMF) Corporate Governance Working Group D and the Asian Development Bank (ADB) on the ASEAN Corporate Governance Scorecard (ACGS) Initiative.