FAIR FINANCE PHILIPPINES POSITION PAPER: Environmental, Social, Governance Policy

Fair Finance Philippines believes that sustainable finance and ESG integration creates **long-term shared value for all stakeholders, the society at large and the environment.** ESG integration promotes sustainable development while ensuring Philippine financial institutions remain globally competitive to meet the demands and standards of the global financial industry.

In line with this, we call on the Bangko Sentral ng Pilipinas (BSP) to commit to the following minimum standards for the proposed regulatory framework on sustainable finance:

THE BUSINESS CASE FOR SUSTAINABLE FINANCE IS STRONG. ESG AND SUSTAINABILITY INTEGRATION IS NOT A VALUES-BASED EXERCISE BUT RATHER IS A VALUE-BASED ONE.

There is growing evidence that the market rewards companies with strong sustainability performance on material issues.[1] The first academic evidence was found in 2016 by Khan, Serafeim and Yoon of Harvard Business School. The study also found that good performance on material sustainability issues can be value-enhancing for shareholders and is a reliable positive indicator of future financial performance.[2]

> **"Sustainable finance, as defined by experts, is any form of financial service which integrates environmental, social or governance (ESG) criteria into business or investment decisions."**
> **(Sustainalytics 2019)**

Additionally, ESG issues are becoming a significant factor that can directly affect a company's reputation.[3] Reputational risk and economic losses are particularly high in such a social media and internet savvy country like the Philippines where viral posts exposing human rights and labor rights violations have led to massive citizen action through consumer boycott. Infamously, after NutriAsia violently dispersed striking workers and threatened legal action against them, consumers campaigned for a widespread boycott which cost the company at least P200 Million in losses.[4]

Globally, prominent asset managers are recognizing the importance of ESG and sustainability data in business and investment decisions. US-based asset managers use ESG and sustainability factors as an additional lens on business risk. While BlackRock and Vanguard have launched actively managed ESG Funds and their Chief Executive Officers (CEOs) have written public letters to other CEOs highlighting the importance of ESG and sustainability factors in their firm's decisions.

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[1]Blackrock. Sustainability: the future of investing. February 2019. Page 4.

[2]Khan, Mozaffar N., George Serafeim, and Aaron Yoon. "Corporate Sustainability: First Evidence on Materiality." Harvard Business School Working Paper, No. 15-073, March 2015. http://nrs.harvard.edu/urn-3:HUL.InstRepos:14369106

[3]NIRI Policy Statement – ESG Disclosures. January 2019. Page 3. https://www.niri.org/NIRI/media/NIRI/Advocacy/ESG-Policy-Statement-final.pdf

[4]Velez, Freddie. Mass and prayer rally for Nutri-Asia Inc. striking workers. 4 July 2018. https://news.mb.com.ph/2018/07/04/mass-and-prayer-rally-for-nutri-asia-inc-striking-workers/

[5]Regnan. ESG integration for investment performance: Testing of Regnan ESG Materiality research. October 2018. Page 1-2. https://www.regnan.com/esg-integration-for-investment-performance

With the increasing integration of economies and industries, so does the importance of increasing the global competitiveness of Philippine financial institutions in a manner that optimizes long term value and reduces long term risk. One of the ways to achieve this is by ensuring the high performance of the financial sector on material ESG and sustainable issues as a sound and value-based business decision which also has the added value of satisfying ethical considerations of a value-based approach.[5]

"To prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society."
(Larry Fink of BlackRock, 2018 Letter to CEOs)

A HOLISTIC APPROACH IS CRITICAL TO THE INTEGRATION OF ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) AND SUSTAINABILITY PRINCIPLES IN BUSINESS AND/OR INVESTMENT DECISIONS.

Governance is the ESG factor that is already integrated into existing processes and mechanisms of most financial institutions and publicly listed companies in the Philippines due to regulations by the Securities and Exchange Commission (SEC) since 2002.

Environmental factors are quickly gaining local acceptance due to the vulnerability of the Philippines to climate change risk, natural disasters, and extreme weather events: the impact of which are tangible, immediate and may be catastrophic in scale. Green finance is quickly gaining momentum in the Philippines as evidenced by the resounding success of Rizal Commercial Banking Corporation (RCBC)'s peso ASEAN green bond.

On the other hand, social factors are the most difficult for the financial sector to assess and address. It is often seen as less tangible because market data showing the impact of social issues on a company's performance has no established track record. However, "the business case for integrating social issues is clear. A company's supply chain is less likely to be stable if it has poor labour practices and human rights violations."[6]

In order to integrate ESG and sustainability principles into the strategic direction, corporate governance and risk management frameworks of banks a holistic approach necessary. To illustrate, even if a green bond finances the construction of a renewable energy power plant but does not consider governance issues (ex. corruption in procurement), and social issues (ex. human rights and labour violations) then the project and the bank is still exposed to the same financial and reputation risks and volatility.

MATERIALITY MATTERS. ONE SIZE DOES NOT FIT ALL. CAPACITY-BUILDING IS IMPORTANT.

Good performance on material sustainability issues ensures that ESG and sustainability principles are integrated into the core business processes and decisions of financial institutions. Materially sustainable businesses that significantly outperform its competitors most were those with good performance on material issues and concurrently poor performance on immaterial issues. Apart from being indicators of stability and good future

[6]UN PRI. ESG Integration: How Are Social Issues Influencing Investment Decisions? 2017. Page 7. https://www.unpri.org/download?ac=6529
[7]See note 2. Page 16
[8]SASB Materiality Overview: Why is it important? Page 2. http://www.fusbp.com/wp-content/uploads/2010/09/SASB-Materiality-Overview.pdf
[9]Business Roundtable's Statement on the Purpose of a Corporation was signed by 181 CEOs in August 2019 which included global financial executives Stephen J. Squeri of American Express, James M. Cracchiolo of Ameriprise Financial, Brian Moynihan of Bank of America, Laurence Fink of BlackRock, Michael L. Corbat of Citigroup, David M. Solomon of The Goldman Sachs Group, Inc., Jamie Dimon of JPMorgan Chase & Co., Lynne M. Doughtie of KPMG LLP, Ajay Banga of Mastercard, James P. Gorman of Morgan Stanley, Douglas L. Peterson of S&P Global, Bob Moritz of PwC, Mortimer J. Buckley of Vanguard and Alfred F. Kelly, Jr of Visa. https://opportunity.businessroundtable.org/wp-content/uploads/2019/09/BRT-Statement-on-the-Purpose-of-a-Corporation-with-Signatures-1.pdf

"[T]o be valuable and credible, the development of ESG reporting practices depends on an holistic approach to your material ESG matters, and not merely the extraction (and in some cases extrapolation) of historic ESG data within your organisation. (KMPG, 2017)

financial performance, sustainability when it comes to material issues also indicates high operating efficiency.[7]

The determination of materiality is inherently a fact-specific finding that is ultimately subject to the discretion of industry players.[8] The role of the BSP and other regulators such as the SEC in capacity-building and awareness raising is crucial in ensuring ESG and sustainability integration and reporting satisfy the accepted global standards to ensure long-term creation of shared value that will generate long-term benefits for society and environment and long-term rewards for responsible financial institutions.

STAKEHOLDER ENGAGEMENT MUST INCLUDE NOT ONLY INDUSTRY PLAYERS, INVESTORS, AND SHAREHOLDERS BUT ALSO CIVIL SOCIETY SUCH AS COMMUNITIES, CONSUMERS, AND CIVIL SOCIETY ORGANIZATIONS (CSOS).

Active stakeholder engagement is key to genuine integration of ESG and sustainability principles. Sustainability is not a mere tagline or marketing campaign, it creates shared value for all stakeholders. Stakeholders should not be limited to industry and shareholders alone. It should include also include communities, consumers, employees and suppliers. Actors other than industry players, investors and ESG and financial research providers have a critical role to play in a functioning financial system. Dr. Rory Sullivan, on behalf of the Principles for Responsible Investments (PRI), illustrated the dynamic and interactive relationship between all stakeholders in a 2013 report as follows "governments provide the incentives (through regulation and other policy interventions) that determine how companies respond to particular ESG issues; business schools provide graduates with skills to analyse the implications of ESG for business and for investment performance, and NGOs provide specialist knowledge on environmental and social issues, and scrutinise and challenge the performance of companies and investors on those issues "[10]

We support the planned forward-looking scenario analysis and stress testing under Phase 2 of BSP's launch of its sustainable finance framework. We call on the BSP to actively engage with all stakeholders which includes actors other than supervised entities in order to bring together and maximize the use of available specialist knowledge and experience of non-financial stakeholders to build in-depth scenarios and stress tests.

CONCLUSION

Fair Finance Philippines and its regional network Fair Finance Asia support the creation of sustainable finance policy framework in the Philippines. We commend the highlights of the proposed framework which includes ESG integration in strategic decision-making, corporate governance, and risk management frameworks, scenario analysis and stress testing, and disclosure by the banks of their sustainability agenda in their annual reports.

We call on the BSP and other financial regulators to recognize that ESG and sustainability integration is a value-based decision rather than a values-based one which creates long-term benefits for all stakeholders while minimizing risks and volatility. We urge BSP to actively engage with civil society organizations such as NGOs, academics, communities, and consumers not just financial institutions and industry players and recognize each as a key stakeholder in the sustainability discourse.

[10]UN PRI. Building The Capacity Of Investment Actors To Use Environmental, Social And Governance (ESG) Information. Page 7. https://ec.europa.eu/docsroom/documents/21441/attachments/1/translations/en/renditions/pdf

ANNEX FACTOR

FACTOR		Examples of themes, issues, and/or legal instruments where rights and duties are expressed
ENVIRONMENTAL		• climate mitigation • climate adaptation • protection and promotion of biodiversity • renewable energy • reducing energy consumption • Protection and quality improvement of water, land, forests, plants and animals • waste management (reduction, clean up, recycling, pollution, etc.) • circular economy
SOCIAL	The Bill of Human Rights: Implementation should at least be based on:	• the United Nations (UN) International Covenant on Economic, Social and Cultural Rights • the European Pillar of Social Rights • the UN Guiding Principles on Business and Human Rights (UNGP): respect policy, due diligence, remediation process • the Organization for Economic Cooperation and Development (OECD) Due Diligence Guidance for Responsible Business Conduct and its sectoral guidance for institutional investors, lending and securities underwriting.
	The eight core labor standards of the International Labor Organization (ILO):	• Freedom of Association and Protection of the Right to Organize Convention, 1948 (No. 87) • Right to Organize and Collective Bargaining Convention, 1949 (No. 98)Forced Labor Convention, 1930 (No. 29) (and its 2014 Protocol) • Abolition of Forced Labor Convention, 1957 (No. 105) • Minimum Age Convention, 1973 (No. 138) • Worst Forms of Child Labor Convention, 1999 (No. 182) • Equal Remuneration Convention, 1951 (No. 100) • Discrimination (Employment and Occupation) Convention, 1958 (No. 111)
	Protection of consumers	• advertisement, advice and labeling ethics • data protection, cyber security and data privacy • the use and impact of artificial intelligence • financial inclusion and avoidance of excessive indebtedness
GOVERNANCE		• good governance by management & supervisory board • remuneration policies • corruption • bribery • tax evasion and avoidance • accountability • gender diversity • engagement with stakeholders • corporate strategies of excessive competitive behavior and abusive buying power