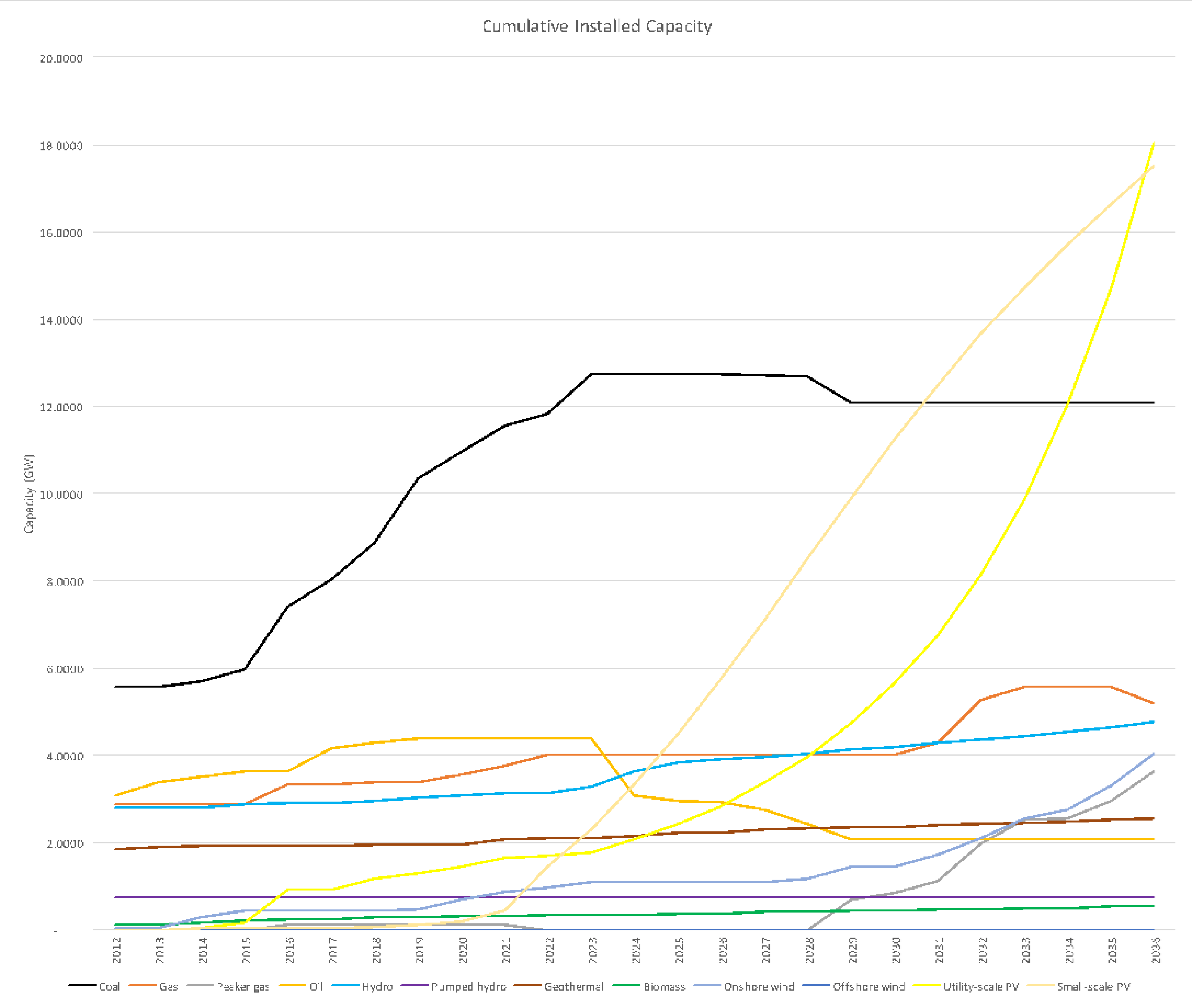
# Financial Oversight
# – Safeguarding the financial system from evolving risks

Highlights of the report *Analysing Energy Transition Risks in the Philippines Power Sector*

**Sara Jane Ahmed**

Markus Spiske on Unsplash




Source: Bloomberg New Energy Finance, 2019

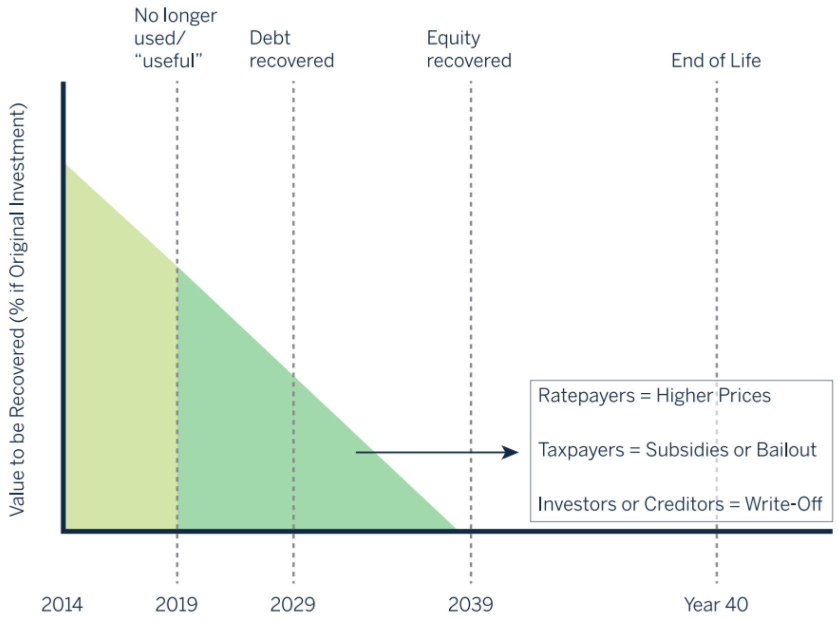
**The last coal capacity addition will be in 2023 and generation peaks in 2034. By 2050, coal supplies just 16% of total electricity, down from 55% today. Coal capacity falls from 37% in 2018 to 4% in 2050.**

# Pre-2020

In 2014, Mark Carney, governor of the Bank of England and chairman of the G20 Financial Stability Board, warned investors of the stranded-asset risk inherent in fossil fuel projects.

In 2017, BlackRock, the world's largest investment group with US$5 trillion assets under management, announced that it was wary of coal assets. Global head of BlackRock's infrastructure investment group, **“Anyone who's looking to take beyond a 10-year view on coal is gambling very significantly.”**

Figure 1. Prospective Fossil Fuel Plant



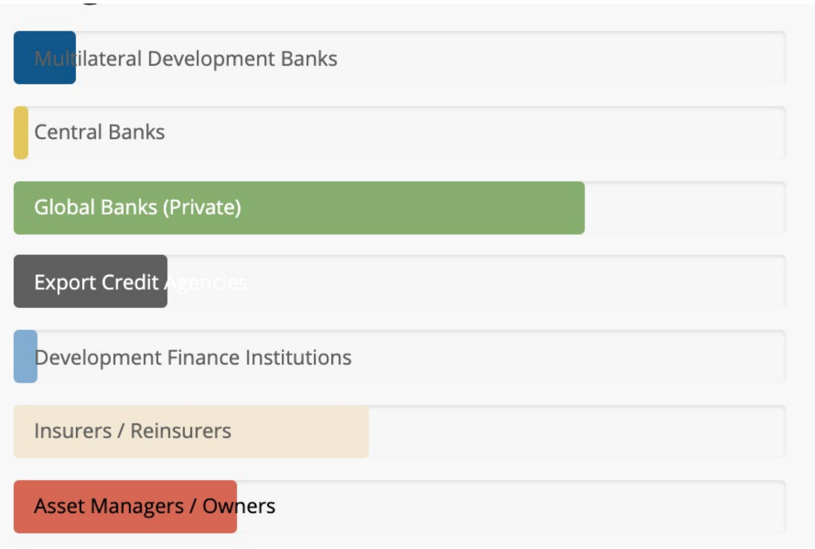

“Ultimately, we have a **fiduciary responsibility** to our clients to maximize the probability of attractive long-term returns — and will never hesitate to use our voice and vote to deliver better performance for them,” State Street Global Advisors chief Cyrus Taraporevala. “This is why we are so focused on financially material ESG issues.”

**All managers have a fiduciary duty to factor in a known financial risk.**

*Can directors be held personally liable if they breach fiduciary duties, that is if they haven’t acted in the best interests of shareholders?*

# Divestment, Restrictions and Cost of Capital

**Over 155 globally significant financial institutions beginning to exit coal finance.**

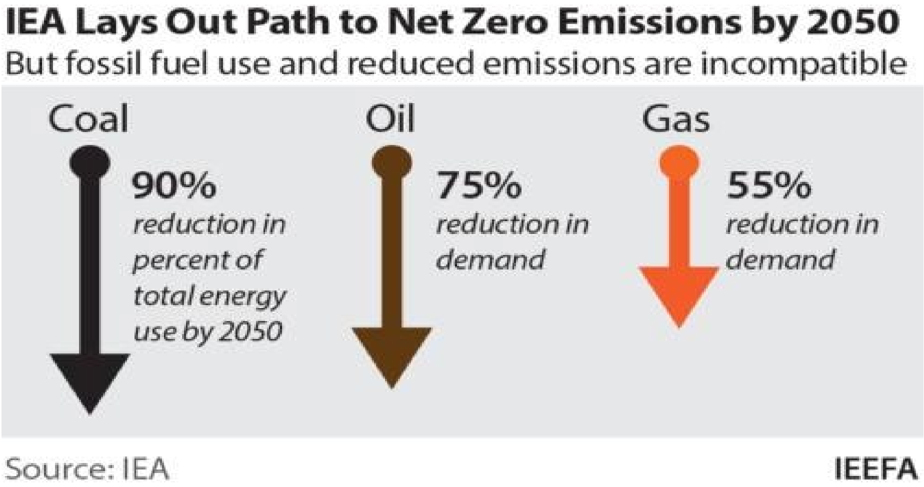



**Philippines:**

- SEC mandatory ESG reporting for publicly listed companies
- Central Bank Sustainable Finance Framework (transition risks)
- RCBC no new coal lending from 2020
- Ayala's energy arm finalize exit by 2025
- BPI to halve coal financing by 2026, phase out lending by 2033 and go down to zero by 2037

**Two major financial management firms, BlackRock and Meketa, have separately concluded that investment funds have experienced no negative financial impacts from divesting from fossil fuels.**

As BlackRock says, there is now a global tsunami of capital flowing to support the science of climate change, and the required infrastructure solutions.



# Today

**Financial risks highlighted by Philippine conglomerates:**

- The growing multi-sectoral negative action against coal has led many financial institutions to restrict investments in coal projects;
- Financing and refinancing risks in terms of the Company's inability to borrow money to fund future coal projects. While banks are still willing to lend, the cost of project financing tends to be more expensive;
- Difficulty in insurance procurement or renewal, where insurers' policy on coal underwriting and investing are also aligned with the same global trends on sustainability and ESG issues. While insurers are still willing to cover coal plants, the resulting impact is significantly higher premium rates for coal insurance year on year. Inability to fill up 100% capacity due to the reluctance or withdrawal of some insurance markets to insure coal plants has prompted the Company to resort to self-insurance. Other noteworthy risk drivers are the hardening of the insurance market aggravated by the global economic impact of the COVID-19 pandemic, and any significant losses on damage to critical assets and related business interruptions;
- Regulatory pressure, which is increasing with the recent DOE Memorandum dated December 22, 2020 re: "Advisory on the Moratorium on Endorsements for Greenfield Coal-Fired Power Projects in line with Improving the Sustainability of the Philippines' Electric Power Industry", effective October 27, 2020;
- Refinancing and liquidity risks arising from balloon / bullet payments for existing loans
- A significant portion of the captive market may shift away from coal and other hydrocarbon fuels, which may expose the coal-fired power plants of the Company to stranded-asset risk (i.e., hazard of an asset suffering from an unanticipated write-down, devaluation, or conversion to liability)."

# Questions to consider:

1. Do you think the risk-profile of fossil fuel generation assets have changed over the last three years?
2. How is the Philippines power sector players going about trying to configure itself for long-term system design?
3. If the market re-orients, will the asset just strand? If it strands, who has exposure? Or, can the system work off the non-performing loan and at the same time finance new capacity?
4. Ongoing renewable energy deflation which is also happening in the battery sector is the driving reason as to why this energy transition is inevitable. The interaction of ongoing deflation with retail competition and open access, tariff management (removal of pass-through and curtailment) and the likelihood of a carbon price over the next decade can accelerate the transition.
5. Considering the drivers of the transition, has your government agency, company or bank taken into consideration a series of decision points to take to allow for decisive response to rapidly evolving market conditions such as transition risk to minimize potential losses and maximum returns on policies and investments?

### In the report...

# Bond prospectus of a coal project for retail investors: Is the language on the regulatory environment adequate?

*The electric power industry is characterized by a constantly evolving regulatory environment. Any shortcoming in regulatory compliance poses negative consequences in both the net income and reputation of each Business Unit and the Group.*

*To anticipate and proactively respond to changes in regulations, the Regulatory Affairs Team of Company X constantly* ***collaborates*** *with DOE and ERC to work towards a sound and sustainable regulatory and policy environment. Similarly, the Safety, Health, Environment and Security (SHES) Team keeps abreast with environmental laws and coordinates with DENR on matters pertaining to environmental compliance.*

*These teams, among others, actively participate in consultative processes and public consultations to provide feedback and positions on proposed laws and regulations. The Company's participation likewise ensures that its interpretation of such laws and regulations is aligned with the regulators. This is done in cooperation with organized industry groups such as the Philippine Independent Power Producers Association (PIPPA) and Philippine Electric Plant Owners Association (PEPOA). Regular dialogues are conducted with host communities, media, non-government organizations, and the academe, to educate and update various groups about the power industry.*

*Company X has likewise transitioned its Legal Team to strategically focus on compliance and to continually improve the Group's overall compliance process. The Company* ***is institutionalizing*** *a compliance framework across the different business and corporate support units, and is formalizing compliance reporting requirements among the Group's compliance officers. Company X has also implemented the Company X Unified Compliance Management System, a Company X-wide initiative that is based on the Governance, Risk and Compliance framework.*

## In the report...

# *Bond prospectus of a coal project for retail investors: Can you model this?*

*“The curtailed economic activity brought about by the quarantine measures has resulted in significant drops in electricity demand and consumption which, in turn, have affected the revenue targets of the Distribution Companies, Generation Companies, and RES Business Units. Nevertheless, the Company has been in constant discussions, and has been working together with its customers and other key stakeholders to minimize the impact of the pandemic to the respective parties’ power supply agreements.*

*The Company has also been compliant with the DOE circulars on distribution utilities granting extensions on the payments of electricity consumers for bills falling due during the community quarantine period with the cumulative amount of such electricity bills being amortized in four (4) equal installments payable in the four (4) succeeding billing months following the end of the quarantine. This increased credit and collection risk has posed a challenge to the Company’s cash flows.*

*Such circulars also provide that all private and public corporations in the power sector shall be given a similar grace period for their respective obligations without interest, penalties, fees and charges, as well as the same four (4)- month amortized payment arrangement for all unpaid balances on obligations within the same period. This directive has eased the impact and helped manage the cash flows of Company X Subsidiaries, with respect to all payments due to NGCP, PSALM, IEMOP, independent power producers, and suppliers of oil and steam.*

*The Company has also been making sure that the fuel supply chain for its plants continues to remain stable, and that the supply of coal, critical spare parts, and services from outside the country continues through a number of options, including alternative local suppliers and service providers.*

*The Company continues to enable the organization to anticipate and respond accordingly as the COVID-19 situation will require.”*

In the report...

## *Bond prospectus of a coal project for retail investors:*
## *Is project risk adequate?*

*As Company X continues to grow its generation portfolio, the Company has identified project risks as a top risk. This risk is largely driven by delays in commercial operations, as well as late completion and delivery of the transmission lines that will enable full dispatch of the plants in the pipeline.*

*Project risk management plans are thoroughly defined and regularly reviewed for each project to track issues related to quality, safety, compliance, schedule, and resources. This ensures that identified risk control measures and recovery actions are implemented. Appropriate project insurance coverage, as well as periodic performance reviews of selected partners, reputable contractors and third-party suppliers, are also in place in the Company's projects.*

# Thank you!

Markus Spiske on Unsplash