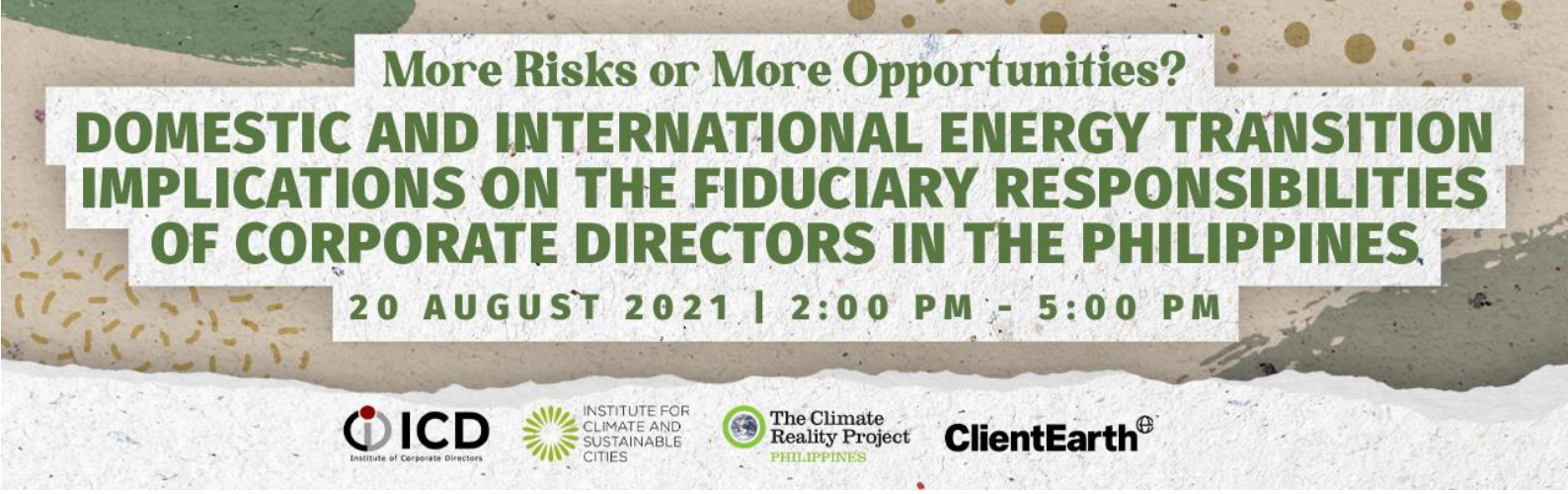

Transcript

Highlights of the Report Analysing Energy Transition Risks In The Philippine Power Sector

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I'll be presenting more on safeguarding the financial system from evolving risks, so I'll go through some insights from the report. According to Bloomberg New Energy Finance, the last coal capacity will be in 2023, with coal generation peaking by 2034. And by 2050, coal would make up 16% of total electricity.

In 2014, Marc Carney, governor of the Bank of England and Chairman of the G20 Financial Stability Board, warned investors of stranded-asset risk inherent in fossil fuel projects, meaning when these assets turn into liabilities. As we know, companies have a fiduciary duty or a legal obligation to act in the best interest of their shareholders. I believe we are joined today by two colleagues from the Climate Law Initiative and ClimateEarth who could further discuss this.

In 2017, Black Rock, the world's largest investment group with US$5 trillion assets under management, recalled that anyone who's taking a longer than the 10-year view on coal is gambling significantly. The State Street Global Advisors chief also mentioned that they have a fiduciary responsibility to their clients to maximise the probability of attractive long-term returns and will not hesitate to use their voice and vote to deliver performance outcomes.

All managers have a fiduciary duty to factor in a known financial risk. The question here is, "Can directors be held personally liable if they breach fiduciary duties, that is if they haven't acted in the best interests of their shareholders?"

The Institute for Energy Economics and Financial Analysis (IEEFA) has been tracking globally significant financial institutions' fossil fuel restrictions. Now, over 155 leading global financial institutions have pulled the plug on funding by imposing restrictions on investments for the coal sector. This progressive strangulation results in coal companies' inability to access capital for expansion, mergers, or acquisitions, as well as cutting avenues for insurance.

While it's easy to say that climate change may be shifting a lot of this for countries like the Philippines, which is not a major emitter, it is the changing climate for corporate and social

responsibility. Banks are profit-motivated without a doubt. They are being pushed today by investors and regulators to commit and wake up to the reality that techno-economic shifts are materialising into risks that could turn today's assets into non-performing loans. Thus, end up on the liability side of the balance sheet.

The Bangko Sentral ng Pilipinas' (BSP) Sustainable Finance Framework includes transition risks and physical climate risks. Banks will have to submit a three-year work plan to address these risks. The BSP's Sustainable Finance Framework complements the SEC mandatory Environmental, Social, and Governance (ESG) reporting for publicly-listed companies starting 2019.

RCBC, at the end of last year, announced that they would no longer be lending to new coal projects. Ayala's energy arm, AC Energy, plans to exit coal by 2025. BPI aims to halve coal financing by 2026, phase out by 2033, and ultimately phase down to zero by 2037. San Miguel has dropped coal expansion plans and aims to spend about a billion dollars on 30 battery projects.

This slide here shows some of the critical financial risks highlighted by Philippine conglomerates in their annual reports. I'll go through five of them. One is that financing and refinancing risks in the inability to borrow money to fund coal projects are materialising. Number two, insurance procurement is complex where insurers' policies on coal underwriting and investing are becoming increasingly aligned with global trends on sustainability and ESG issues. It means that there are significantly higher premium rates for coal insurance year on year.

It also means that some companies have resorted to self-insurance. That said, Philippine conglomerates certainly have the balance sheets to self-insure; the question is whether this is the right decision. Number three, there's regulatory pressure, which increases with the moratorium on new coal by the DOE. Number four, refinancing and liquidity risks are arising from balloon and bullet payments of existing loans.

Number five is quite significant. A substantial portion of the captive market may shift away from coal and other fossil fuels. It is likely due to the interaction of retail competition and the deflationary trajectory of renewable energy. A risk that may thus materialise is a stranded-asset risk, which is mentioned here as an unanticipated write-down, devaluation, or conversion to liability.

I've listed here just some questions to consider as we're thinking through the transition. The main message is that the traditional planning and market oversight structure presumes that the planners and the market all have perfect information. And thus, the market players can adjust to and allocate risk appropriately. It is demonstrably not the case in a period of rapid technology change. Our understanding of financial risks, also related to climate and resilience, is still evolving.

In the report, we looked at a bond prospectus of a coal project for retail investors. In this case, the excerpt, the question here, “Is the language on the regulatory environment adequate?" We find here that one shouldn't collaborate with regulators; either you're compliant or not. That's binary, and there are no bonus points for keeping abreast of

environmental laws. But the language here really suggests that it's difficult to verify compliance or that it's a work-in-progress. Realistically, it indicates that there may be a lack of internal controls, and it appears that this is more a “build and buy and hope it's okay" strategy.

We also look into whether it's feasible to model this project. We see that many new bond perspectives discuss the quarantine, the impacts of COVID-19. Still, more importantly, it's about prolonged economic disruption. Many of these perspectives have challenges to cash flows, and that they have specific directives to try to ease the impact. However, it's very unclear, and they don't clarify the situation on payables. There's also very little evidence on how the company aims to support this project. This raises more questions than answers, and no experienced institutional investor could model this. It's challenging to assume that a retail investor possibly could.

The last question here is, "Is project risk adequate?" In terms of a systems design regulatory risk because of the energy transition and where these assets suit the market. Regarding the paragraph here or the second one on insurance, the question raised was whether there is insurance for these types of risks related to the project and system viability.

To conclude all this, it's clear that there are evolving risks in the system. On the bright side, the Philippines is not the first country to experience this across different stakeholders. There would be winners and losers, but the point here is the need to be working together towards a managed transition instead of an expensive and mismanaged transition.

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