Sarah Jane Ahmed, Energy Finance Analyst
May 2020

Institute for Energy Economics and Financial Analysis
IEEFA.org

Philippines Central Bank's Sustainable Finance Framework Offers New Support for Energy Transition and Renewables

The Plan Is a Catalyst for Investors Seeking ESG Compliance

Executive Summary

The Covid-19 pandemic has revealed weaknesses in many aspects of the Philippines' energy and financial market design and is now accelerating trends with the potential to reshape society, businesses, and social and physical infrastructure. But it has also demanded a demonstration of leadership in the Philippines as it champions global standards for finance and business. The pandemic has exposed the country's ill-prepared supply chains, lack of digitization and inability to retain critical functionality during low-probability and high consequence events.

Rebuilding emerging market economies like the Philippines, and locking in a healthy recovery, hinges on increasing resilience and improving the country's ability to deal with shocks of non-financial origin. This calls for leadership from the financial and energy sectors to encourage critical investments in climate mitigation, pandemic preparedness, and sustainability.

Safeguarding the System

In April 2020, the Monetary Board of the Central Bank of the Philippines (Bangko Sentral ng Pilipinas) approved the Sustainable Finance Framework to safeguard the financial system from the evolving material hazards of physical climate risk and transition risk including stranded assets. In other words, it gives banks the impetus to start pricing not only climate and transition risk, but also to value climate-resilience and low-carbon opportunities. The Governor of the Central Bank has said that "banks shall adopt a transition plan with specific timelines to implement the board-approved strategies and policies integrating sustainability principles into their corporate governance

Locking in a healthy recovery hinges on increasing resilience.

and risk management frameworks as well as in their strategic objectives and operations".

This transition plan will be an important catalyst for investors who are also putting more weight on environmental, social and governance (ESG) standards, and complements the work of the Securities and Exchange Commission (SEC) which previously released mandatory ESG reporting guidelines for publicly-listed companies, starting 2020, and issued the ASEAN green bonds standards in 2018. In 2019, the Philippines listed US$2.02 billion of green bonds, the third largest issuer in Southeast Asia after Singapore (US$6.20 billion) and Indonesia (US$2.88 billion).

The Sustainable Finance Framework was approved in the same month the Ayala Corporation committed its AC Energy sector subsidiary to drive the energy transition by rebalancing its generation portfolio to grow renewable energy assets and divest from coal by 2025, with a complete exit by 2030. These market signals build on the Energy Secretary's priority program, the Green Energy Auction, to auction off 2,000MW of domestic renewable energy to be the catalyst for investment, competition, transparency, and low prices for end-users. Its success will determine the credibility of the Department of Energy's policymaking process.

Such an energy transition is supported by Manuel V. Pangilinan, chairman of Meralco, the largest utility company in the Philippines. "The pandemic has become the 'catalyst' for Meralco's digital pivot…COVID-19 is life-changing, and it calls all of us to a paradigm shift in everything we do […] Meralco will play its part, regardless of the condition – this is the assurance we have given to our customers and the government."

Now is an ideal time to drive the energy transition as Meralco has experienced a fall in peak demand of almost 40% during the lockdown to 4,516 megawatts (MW) in March 2020 and further to 4,289 MW in April. The Department of Energy (DOE) peak demand forecast for the Luzon grid, where Meralco operates, was 12,285MW for May 2020. However, given the Covid-19 pandemic, peak demand is likely more than 60% lower than initial expectations. As a result, Meralco has declared "*force majeure*" to avoid having to buy power from several independent power producers (IPPs). This measure may well impact coal plants in the pipeline, including Meralco's generation businesses, if there is no longer a business case for coal in the medium-term.

Green Energy auction to be the catalyst for investment, competition, transparency, and low prices.

The market will need to adjust to this significant decline in demand and build its knowledge of these risks into corporate governance and risk management, while benefiting from the opportunities that arise from reduced exposure, which is what the Sustainable Finance Framework advocates. Modular domestic and localized renewable energy and grid investments can ensure energy access and reduce overall system cost while improving domestic energy security and resilience by reducing exposure to international volatility and supply chain risk. Efficient use of power and renewable energy brings cost-competitiveness and has been an important job creator.

Under the Sustainable Finance Framework, banks will have three years to comply and integrate transition plans, with timelines, into their corporate governance and risk management framework. Banks are expected, in the next six months, to provide board-approved transition plans to the Central Bank. A near-term boost to the economy could include modernizing energy infrastructure to drive job growth supported by domestic renewable energy and storage, with financing from banks looking to comply with the Sustainable Finance Framework.

Robust messaging from financial regulators, the Central Bank and SEC, and corporations such as Ayala Corp, to ensure that finance increases social and infrastructure resilience to new risks and opportunities can provide the decisive leadership needed to keep pace with innovation and support sustainable growth. Power sector policymakers, regulators and stakeholders can support these gains by rapidly improving the design of the power market to ensure system flexibility and encourage energy security through domestic renewable energy.

Moreover, to echo a previous IEEFA commentary, the country's high electricity prices will naturally be a focus over the next 18 – 24 months if the Philippines hopes to attract foreign manufacturers looking for a new cost-competitive home in the region. By implementing policies that curb costly excess coal power capacity and prioritize flexibility and sustainability, the Department of Energy can guide a shift in the allocation of capital to underpin the energy transition.

About IEEFA

The Institute for Energy Economics and Financial Analysis (IEEFA) examines issues related to energy markets, trends and policies. The Institute's mission is to accelerate the transition to a diverse, sustainable and profitable energy economy. www.ieefa.org

About the Author

Sara Jane Ahmed

Sara Jane Ahmed is an energy finance analyst with IEEFA and co-convener of the Greening the Banks initiative in the Philippines. A former investment advisor specializing in originating and structuring energy opportunities in emerging markets, she has worked for the World Resources Institute and Grameen Bank.