CIRCULAR NO. _______
Series of _______

Subject: **Guidelines on the Integration of Sustainability Principles in Investment Activities of Banks**

The Monetary Board, in its Resolution No. _____ dated ___________, approved the supervisory expectations on the integration of sustainability principles in the investment activities of banks.

Section 1. Section 614 of the MORB on Investment Activities of BSP-supervised Financial Institutions, introduced under Circular No. 1042 dated 25 July 2019, is hereby amended as follows:

"**Policy statement.** The Bangko Sentral recognizes that the effective management of risks associated with a BSP-supervised financial institution's (BSFI) investment activities is essential in ensuring its continued safety and soundness. The Bangko Sentral likewise recognizes that BSFIs' investment activities may play a role in supporting national goals in promoting sustainable finance.

These guidelines are being issued to set expectations on the prudent conduct of investment activities and the minimum practices that a BSFI should establish for the management and control of risks associated with investments. ~~These guidelines neither limit nor expand the activities that BSFIs may undertake under existing regulations.~~ These guidelines likewise set expectations on the integration of sustainability principles in investment processes.

Scope of Application. xxx

Risk Management Framework. A BSFI shall have systems to manage the risks arising from its investment activities. xxx

a. **Board and senior management oversight.**

As investment activities comprise a major area of a BSFI's operations, the board of directors shall perform the following, in accordance with Section 132 *(Specific duties and responsibilities of the board of directors)*:

(1) Approve portfolio objectives, overall investment strategies, general investment policies, and limits, that are consistent with the BSFI's financial condition and risk tolerance. XXX

xxx

(4) Oversee the integration of sustainability principles in its investment activities. Should the changes be made in the strategies and management of investments to address sustainability objectives of a BSFI, such may be under the control of the appropriate committee it set as provided under Section 153 *(Sustainable Finance Framework)*.

As senior management is responsible for implementing board-approved strategic objectives, it shall therefore:

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b. **Policies, Procedures and Limits**

A BSFI shall institute policies, procedures, and limits that provide a framework for managing investment activities. The framework shall be consistent with the organization's broader business strategies, including its sustainability objectives, priorities and goals; capital adequacy;; technical expertise;; and risk tolerance. In setting policies, procedures and limits, a BSFI shall be guided by the following:

(1) Policies and procedures should clearly articulate guidelines for the acquisition and recording of investments. xxx

(2) Policies should promote the development of a comprehensive understanding of the risks associated with investments prior to acquisition and on an ongoing basis. In particular, these should require the following:

(a) xxx
(b) xxx
(c) the due diligence review to cover:
i. xxx
xxx

iv. the identification of appropriate methodologies for the allocation of appropriate capital based on the risk inherent in the BSFI's investment activities, and the identification of all material risks, including environmental and social (E&S) risks, and their potential impact on the safety and soundness of the institution;

xxx

The conduct of due diligence reviews for new plain vanilla instruments xxx.

(3) Policies and procedures shall provide the BSFI's approach for implementing the sustainability objectives of investment strategies. For this purpose, a BSFI may adopt any or all of the following approaches:

(a) Integration – This approach involves an explicit and systematic inclusion of material E&S issues in investment analysis and decisions, to better manage risks and improve returns. This approach does not require benchmarking or overweighting or underweighting securities, nor ex ante criteria for inclusion or exclusion.

(b) Screening – This approach involves the application of filters to lists of potential investments to rule companies in or out of contention for investment, based on the BSFI's preferences, values or ethics. Screening can be categorized as follows:

i. Exclusionary screening – refers to avoiding securities of companies or countries on the basis of traditional moral values (e.g., issuers belonging to the gambling or military weapons industries) or standards and norms (e.g., those pertaining to human rights, working conditions, or environmental protection). The exclusionary screening should also consider that economic activities comply with Philippine laws, including environmental laws and regulations.

ii. Best-in-class selection - refers to preferring companies or countries with better or improving E&S performance relative to sector peers. This is also referred to as positive selection or positive alignment. This approach may be implemented on either the level of E&S performance or the change in E&S performance. A BSFI adopting this approach is expected to verify E&S controversies involving the company or country in order to avoid potentially misleading claims.

(c) Thematic – refers to investing that is based on trends, such as social, industrial, and demographic trends. This approach seeks to combine attractive risk return profiles with an intention to contribute to a specific environmental or social outcome. It likewise includes impact investing. For this purpose, impact investing refers to investing with the disclosed intention to generate and measure social and environmental benefits alongside a financial return.

A BSFI may adopt other approaches it deems appropriate depending on the nature of its investments, volume of transactions, and existing risk management system; *Provided*, That the related sustainability factors are sufficiently captured.

(4) Policies and procedures shall provide for control mechanisms in order to prevent investing in companies that engage in *greenwashing*. For this purpose, *greenwashing* refers to the deceptive marketing used to persuade the public that an organization's products, aims, and policies are environmentally friendly.[1] The term *greenwashing* is often used in the broader sustainability context.[2]

[1] https://www.imf.org/-/media/Files/Publications/GFSR/2021/October/English/ch3.ashx
[2] https://www.bis.org/publ/bppdf/bispap118.pdf

(5) ~~(3)~~ The limits for investment activities shall be consistent with the BSFI's institution-wide risk limits. The limit structure may apply at the institutional, portfolio, sub-portfolio, or individual instrument levels, or a combination thereof. The BSFI's determination of the appropriate limits structure shall be guided by the diversity, complexity, and purpose of its portfolios (e.g., a BSFI with substantial holdings of non-resident issued instruments should establish country risk limits. In the same vein, a BSFI with material exposure to E&S risks in its investment portfolio/s may establish relevant E&S risk limits.)

(6) ~~(4)~~ The limits structure should reflect the amount of exposure that the BSFI is willing to accept, taking into consideration the impact of such exposure to earnings and capital in both normal and stressed conditions. xxx

c. **Risk Measurement, Monitoring and Management Information systems (MIS)**

Given the impact of investments on the risk profile of an institution, BSFIs shall ensure that they possess the capability to measure and monitor the risks associated with their investments prior to acquisition and periodically thereafter. In doing so, a BSF| shall be guided by the following:

(1) A BSFI shall have the capability to value its positions and measure exposures to each type of risk arising from such positions under both normal and stressed market conditions. On the other hand, BSFIs whose investments are limited to plain vanilla instruments in the banking book should, at a minimum, have the capability to periodically mark the positions to market/obtain the market values of their positions.

A BSFI whose investments are exposed to material E&S risks shall adopt appropriate tools and metrics to assess, measure and monitor these risks in accordance with the requirements under Section 153 *(Sustainable Finance Framework)*.

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d. **Internal Controls and Audit**

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Risks of Investment Activities. The management of risks arising from a BSFI's investment activities shall be integrated into the BSFI's overall risk management system, as required under Secs. 141 *(Supervision by Risk)*; 143 *(Credit Risk Management)*; 144 *(Market Risk Management)*; ~~and~~ 146 *(Operational Risk Management)*; and 153 *(Sustainable Finance Framework).*

The guidelines below set out the supervisory expectations on the management of major risks that are inherent to investment activities. Xxx

a. Market Risk

Xxx

b. Interest rate risk in the banking book

Xxx

c. Credit risk

(1) A BSFI's investment policies and objectives shall be consistent with its overall credit risk strategy, as set out under Sec. 143 *(Role of the Board and Senior Management and credit risk strategy)*;, and Section 153 *(Credit Risk Strategy)*.

(2) In accordance with Sec. 143 *(Credit granting and loan evaluation/analysis process and underwriting standards)*, which requires the conduct of a comprehensive assessment of the creditworthiness of obligors, a BSFI shall not acquire an investment xxx.

Consistent with Section 153 (*Risk Identification and Assessment)*, the BSFI shall consider material E&S risks in conducting due diligence on the issuer. The BSFI may adopt risk criteria to identify entities or sectors with higher E&S risks. In case of environmental risk, the criteria may include the level of green house gas (GHG) emissions, vulnerability to extreme weather events, or linkages to unsustainable energy practices, deforestation or pollution. The BSFI may likewise incorporate in its investment analysis key metrics and targets that the issuers have set for the management of their key risks.

(3) Xxx The following are examples of factors that a BSFI may consider as part of its credit risk due diligence review:

(a) Xxx

Xxx

(d) Xxx; ~~and~~

(e) Xxx and the impact of collateral deterioration and potential credit losses under adverse economic conditions~~.~~; and

(f) Key environmental or social risk indicators from the issuers, as well as external environmental or social data providers. Where the credit investment is used to finance a specific project, the BSFI shall consider the environmental or social risk profile of the project as well.

Should the BSFI place reliance on the output of third-party providers such as financial analysts, consultants, brokers, research firms, or rating companies, it shall ensure that the related due diligence processes, including the related outputs such as research and analysis, integrate E&S factors.

(4) xxx.

xxx

d. Market liquidity risk

Xxx

e. Operational risk

Xxx

Application of the guidelines.

a. General rule. These guidelines shall apply to all banks and non-bank financial institutions performing quasi-banking functions (QBs) and their financial subsidiaries. The guidelines pertaining to sustainability and E&S risks shall apply only to banks.

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d. xxx

Supervisory enforcement actions. The Bangko Sentral reserves the right to deploy its range of supervisory tools xxx.

Section 2. Section 246 of the Manual of Regulations for Banks is hereby amended as follows:

Section 246. Issuance of Bonds and Commercial Papers

All banks with quasi-banking authority issuing bonds or commercial papers shall comply with Republic Act No. 8799 or the Securities Regulation Code (SRC) and its Implementing Rules and Regulation, and other applicable rules and regulations issued by the Securities and Exchange Commission (SEC). A bank may issue bonds and/or commercial papers without prior Bangko Sentral approval: *Provided*, That it meets the prudential criteria as described in Sec. 111 *(Prudential Criteria)*.

Provided, further, That bonds issued are enrolled and/or traded in a market which is organized in accordance with the SEC rules and regulations.

In the case of issuance of green, social and sustainability bonds, including similar bonds falling within their acceptable definition, the issuing bank shall comply with the pertinent guidelines of the SEC. Consistent with Section 153 *(Disclosure Requirements)*, the issuing bank shall disclose in its Annual Report its sustainability strategic objectives and the details of the sustainable bonds issued, including the intended impact of such products. The issuing bank shall make available to the Bangko

Sentral, upon request, the relevant documents supporting such issuance.

Notice to the Bangko Sentral. xxx

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Section 3. This Circular shall take effect fifteen (15) calendar days following its publication either in the Official Gazette or in a newspaper of general circulation.

FOR THE MONETARY BOARD:

BENJAMIN E. DIOKNO
Governor

__ 2022