

## **Philippines: Financial Sector Assessment Program—IOSCO Objectives and Principles of Securities Regulation Assessment**

This Financial Sector Assessment Program—IOSCO Objectives and Principles of Securities Regulation Assessment was prepared by a staff team of the International Monetary Fund and the World Bank as part of the Financial Sector Assessment Program for the **Philippines**. It is based on consultations with the authorities and other information available at the time it was completed on **July 2002**. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of the **Philippines** or the Executive Boards of the IMF and the World Bank.

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FINANCIAL SECTOR ASSESSMENT PROGRAM

# PHILIPPINES

## IOSCO OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION

**JULY 2002 \***

THE WORLD BANK  
FINANCIAL SECTOR VICE PRESIDENCY

INTERNATIONAL MONETARY FUND  
MONETARY AND FINANCIAL SYSTEMS DEPARTMENT

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\* The assessments were based on information gathered during missions that took place on October 8–23 and November 19–December 6, 2001.

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## I. SUMMARY ASSESSMENT

### A. General

1. A joint World Bank/International Monetary Fund mission visited the Republic of the Philippines during the period October 8–23 and November 19–December 6, 2001 as part of the Financial Sector Assessment Program (FSAP). The aim was to assess the effectiveness of securities regulation, soundness of market intermediaries, and development prospects for the capital markets, including observance of the IOSCO Objectives and Principles of Securities Regulation. This IOSCO assessment was conducted by Noritaka Akamatsu, Lead Financial Economist of the World Bank.

### B. Institutional and Macroprudential Setting, Market Structure—Overview

#### Supervisory framework

2. The SEC is the primary regulatory authority over the capital markets and their participants. The BSP also supervises NBFIs to the extent that they have ownership links with banks, and are permitted to have quasi-banking function and trust operations and offer foreign exchange products and services. The Securities Regulation Code (SRC) is the main legal basis for the regulation of the markets. The SRC narrowed and redefined the scope of responsibilities of the SEC to enable the regulator to focus on regulation of the securities market and its enforcement in particular. However, further rationalization of the scope seems necessary and is expected. The SRC also provided for demutualization of the Philippine Stock Exchange (PSE) which addressed, among other things, the PSE's conflicts of interest as a self-regulatory organization (SRO).

3. In addition to the SRC, the Corporation Code provides basic rules for establishment and governance of companies. There are also laws dedicated to governing each type of nonbank financial institutions (NBFIs) and universal banks participating in the market. Those include the Presidential Decree 129 on Investment Houses, the Financing Company Act of 1998 and the Investment Company Act of 1960. For each law, the SEC provides Implementing Rules and Regulations (IRR) to substantiate the laws with detailed provisions. Among the laws, the Investment Company Act is due to be amended, which is expected to bring investment advisers under the supervision by the SEC. The General Banking Law of 2000 and the BSP Manual of Regulations for NBFIs further provide rules for quasi-banking and trust functions of NBFIs and rules for universal banks and commercial banks to be engaged in the securities business and to own NBFIs subsidiaries. The BSP supervises NBFIs on the basis of this law and the regulations.

#### Market structure

4. The equity market is built around the Philippine Stock Exchange (PSE). It is supported by the Philippine Central Depository (PCD) and the Securities Clearing Corporation of the Philippines (SCCP) for clearance and settlement of trades. Key market

intermediaries include: 44 Investment Houses 44, 174 Financing Companies, 176 Broker-Dealer firms, 19 Mutual Funds and 15 Investment Management Companies. Of those, seven Investment Houses and seven Financing Companies can have a quasi-banking function which is defined by the General Banking Law as an ability to raise financing from more than 19 creditors. The Investment Houses are permitted to conduct underwriting of new issues of securities, thus required of a greater capital base (P300 million for Investment House as compared to P100 million for Broker Dealers). As of the end of September 2001, the total assets of the mutual funds amount to slightly less than P10 billion. Most of the NBFIs are owned or affiliated to commercial banks.

5. The PSE lists 231 companies and one series of Small Denomination Government bonds. The market capitalization at the end of August 2001 was P2,429 billion (US\$47 billion), representing nearly 80 percent of the GDP, a high figure for a country with per capita income of about US\$1,000. On the other hand, the annualized market turnover drastically declined to P173 billion (7.1 percent turnover) in 2001 from the peak of P781 billion (40 percent turnover) in 1999. Given the substantial level of capitalization, this represents low liquidity. An important attribute to the low liquidity is the small free float portion of corporate shares (about 15 percent) due to the holding of controlling shares by founding families of the companies.

6. The debt market is dominated by the government securities which are traded in the over-the-counter (OTC) market except for the one series of Small Denomination Bonds. The total capitalization of the government securities including those issued by government-owned and-controlled companies (GOCCs) and local government units (LGUs) stood at P1,128 billion, about 30 percent of GDP, as of July 2001. Of the amount, the national government debt amounted to P1,118 billion. 40 percent of the national government debt was in the form of treasury bills which generate most of the liquidity of the government securities (i.e., 40 percent turnover for all government securities and 90 percent for T-bills). Commercial papers (CPs) are the second most important instruments. While its capitalization (P35 billion as of October 15, 2001) is very small as compared to the government securities, they are significantly more liquid (annual turnover ratio of 500 percent). Trading of government securities is dominated by commercial banks while investment houses seem to trade CPs actively.

### **C. General Preconditions for Effective Securities Regulation**

7. Legislative bills currently being read in the congress is expected to address a need to rationalize taxation of financial instruments and services from various angles. In particular, elimination of Documentary Stamp Tax on the secondary market trading and securities lending and borrowing transactions is expected to have a significant positive impact on the market liquidity. The rationalization is also expected to provide more equal treatment and fairer market access for both domestic and foreign investors and market participants to stimulate competition.

8. The SEC and the PSE are in the process of implementing the reforms mandated by the SRC. The SEC has restructured its organization and renewing its staffing with a focus on strengthening the enforcement capacity of the SEC. These new organizational changes and capacity building need to be reasonably completed before the SEC starts functioning at its full capacity under the SRC. The PSE also corporatized itself, reformed its board and is now due to go public to restructure its ownership structure.

### D. Main Findings Summary

Table 1. Summary of Main Findings of Assessment of Implementation of the IOSCO Objectives and Principles of Securities Regulation

Subject	Main Findings
Principles relating to the regulator, (CPs 1–5)	Implemented. The SRC made the SEC a more enforcement-oriented, operationally independent regulator with clear objective and procedures. It has been better empowered to enforce the law and given adequate budgetary resources relative to the narrowed responsibilities. Computerization of the data administration has recently achieved significant progress. It needs to continue to work on enhancing enforcement skills of the staff. Its accountability also can be simplified and clarified.
Principles of self-regulation (CPs 6–7)	Partially [nearly] implemented. Against the SRC, the PSE has been corporatized and its Board of Governors has been reformed to become more independent of its member broker dealers. The PSE now needs to go public to diversify away from the excessive broker dealer dominance in ownership. It needs to enhance its market surveillance system and Net Capital reporting system. The PSE, together with the SEC, is considering spinning out of its Compliance and Surveillance Group to make it a dedicated self-regulator.
Principles for the enforcement of securities regulation (CPs 8–10)	Partially [nearly] implemented. The SRC provided comprehensive inspection, investigation, surveillance and enforcement powers for the SEC. The SEC needs to continue to enhance the staff skill in using the comprehensive powers. Its electronic information management capacity needs to be further enhanced to avail more human resources for enforcement activities while readily availing accurate, updated information for inspection, investigation and surveillance.
Principles for cooperation in regulation (CPs 11–13)	Implemented. The SEC has authority to share public and non-public information with both domestic and foreign counterparts. The rules of confidentiality of information is sound. It only needs to agree on MOUs with willing counterparts. The Anti-Money Laundering Act (AMLA) also facilitates to overcome obstacles created by the Bank Secrecy Law.
Principles for issuers (CPs 14–16)	Implemented. The disclosure regime is up to a high standards. The SEC still plays significant role to ensure that minority shareholders' interest is protected. However, the strong founder family ownerships generally make it a difficult environment to defend interest of minority shareholders. The SEC is committed to completing the adoption of the International Accounting Standards by 2005.
Principles for collective investment schemes (CPs 17–20)	Partially implemented. The existing Investment Company Act, while providing core elements needed for CIS regulation, is outdated and requires clarification and rationalization for its various parts. In addition, it does not accept foreigners as members of the boards of directors,

	discouraging foreign investment. It also leaves investment advisors unregulated. The passage of the Revised Investment Company Act is awaited.
Principles for market intermediaries (CPs 21–24)	Implemented. The eligibility criteria and procedures of registration are clear and sound. Capital and other prudential requirements are clearly established. Model Internal Supervision, Control and Compliance Procedures as well as SRC Rules are sound. The procedures to deal with failure of market intermediaries are clearly established. The system to monitor Net Capital may be computerized to achieve daily monitoring.
Principles for the secondary market (CPs 25–30)	Partially implemented. The PSE is a highly autonomous market operator. With the demutualization, it has become a for-profit corporation which is self-regulating. At the same time, the Fixed Income Exchange and/or the Commodity Futures Exchange will likely be introduced soon. Competition emerging among these markets may raise doubt about credibility of their self-regulatory functions. The SEC is encouraged to provide key benchmarks through the SRC Rules and/or SEC Orders to show what it envisages as a ground design of the Philippine capital markets in which various exchanges can compete as a for-profit businesses.

### E. Authorities' Response and Recommended Next Steps

9. **Principles relating to the regulators (CPs1–5).** The SEC shall intensify the in-house training of its staff to enhance their skills on market surveillance, investigation and enforcement. The full computerization of our data is also going on. The Manual of Operations and Procedures for its staff is being reviewed and revised for simplicity and clarity.

10. **Principles of self-regulation (CPs 6–7).** The listing of the PSE is the second phase of demutualization. The Board is only waiting for the right time to go public. In the meantime, to implement the provisions of the SRC on the 20 percent ownership cap of broker dealers, the SEC has directed the PSE to offer its shares to institutional investors and has likewise suggested the ADB and the IFC to consider taking a stake in the Exchange. Discussions on ensuring the independence of the Compliance and Surveillance Group of the PSE (CSG-PSE) is being undertaken by the Market Regulation Department of the SEC. Although the PSE-CSG has already been incorporated as separate entity from that of the PSE, the PSE President has requested for the delay of the operationalization of the CSG-PSE as an independent SRO as the PSE tries to study ways of achieving full independence of the CSG while remaining part of the PSE organizational structure.

11. **Principles for the enforcement of securities regulations (CPs 8–10).** On April 16, 2002, the SEC has operationalized its on-line filing for the registration of companies. Thereafter, reportorial requirements shall be filed electronically. Even the net-capital requirements from broker dealers shall be electronically fined and analyzed by our MRD.

12. **Principles for cooperation in regulation (CPs 11–13).** The SEC recently acquired a favorable endorsement from the Department of Foreign Affairs (DFA) to enter into MOU with its counterparts. It is currently finalizing an MOU with Indonesia’s BAPEPAM. Similar agreements with other regulators are being considered.

13. **Principles for issuers (CPs 14–16).** The SEC has recently approved the *Code of Corporate Governance* which shall be “mandatory” for all corporations whose securities are registered or listed, corporations which are grantees of permits/licenses and secondary franchise from the SEC and public companies.

14. **Principles for collective investment schemes (CPs 17–20).** The SEC hopes that the Revised Investment Company Act will soon be passed into law by this year. While the SEC is ready to appear any time before Congressional hearings, it has no control of what the priority Bills and schedule of our lawmakers are.

15. **Principles for market intermediaries (CPS 21–24).** The system to monitor Net Capital of brokers dealers is now being prepared by our MIS in cooperation with our MRD. The SEC hopes before the end of the second quarter, a system for testing shall be ready.

16. **Principles for the secondary market (CPs 25–30).** With the establishment and operationalization of the Fixed Income Exchange (FIE) and the revival of the Futures Exchange, the FSAP mission raised concerns that competition emerging among markets may raise doubts about credibility of their self-regulatory functions. The mission has thus suggested that the SEC provide key benchmarks through Rules and/or Orders to define what its concept of Philippine capital markets is in an environment where various exchanges compete as for-profit businesses. The SEC shall take note of this suggestion and will see to it that the mission’s concerns will be properly addressed.

## II. DETAILED ASSESSMENT

### A. Information and Methodology Used for Assessment

17. The analysis contained in this assessment is based on information collected through extensive hearings with the SEC, the BSP, the Bureau of Treasury (BOT), numerous market participants and institutions including the Philippine Stock Exchange (PSE), the Philippine Central Depository (PCD), the Securities Clearing Corporation of the Philippines (SCCP), industry associations including the Investment House Association of the Philippines (IHAP), Investment Company Association of the Philippines (ICAP) and the Securities Brokers and Dealers Association of the Philippines (SBDAP), the Bankers’ Association of the Philippines (BAP), LGU Guarantee Corporation, the Philippine Rating Services and a number of other individual private financial institutions. In particular, the hearings with the SEC involved Chairperson, commissioners, directors, division chiefs and line officers who all impressively accommodated the demand for information, for which the assessor is grateful.

18. The assessment was based on thorough reviews of relevant laws including amendments and corresponding rules and regulations of the SEC, the BSP and the SRO (currently only the PSE) against each of the 30 IOSCO Principles for Securities Regulation. To the extent possible, it also examined supervisory capacity and practices actually developed and adopted by the SEC, the BSP, the PSE and, in some cases, even their member firms to verify actual application of the laws and regulations and their enforcement. The assessment adopted the self-assessment methodologies developed by the IOSCO and made extensive use of the High Level Survey Questionnaire and the set of five Self-Assessment Methodologies developed by IOSCO. The SEC kindly provided thorough responses to all the detailed questions in the Methodologies as well as the Questionnaire and discussed with the assessor in length wherever clarification was needed.

19. As it is clear in the above, the SEC was the primary counterpart in conducting this assessment although the BSP and the PSE also participated. All the responses to the IOSCO Questionnaire and Methodologies were prepared by the SEC. To avoid duplication with the Basle Core Principles assessment which focuses on the framework of bank supervision and the BSP's supervisory capacity, this assessment focuses primarily on the regulatory capacity of the SEC and the PSE as far as the market authorities are concerned.

## **B. Institutional and Macroprudential Setting, Market Structure—Overview**

### **Supervisory framework**

20. The Philippines' regulatory and supervisory framework is, while comprehensive in coverage, complex. It is due to the fact that the financial industry and services are increasingly conglomerated and universalized with functional regulation while the regulatory authorities remain to be fragmented. The SEC is the primary regulatory authority over the capital markets and their participants. Nonbank financial institutions (NBFIs) are regulated and supervised by the SEC. However, the BSP also supervises many NBFIs because of: i) their close ownership links with banks, ii) quasi-banking function and trust operations permitted for some of them<sup>1</sup> based on licenses by the BSP and iii) offer of financial products and services involving foreign exchange transactions. On the other hand, Universal Banks are also permitted, based on registration with the SEC, to undertake underwriting as well as brokerage and dealing of securities. Broadly, the SEC's regulation and supervision tend to emphasize investor protection and fair market conduct while those of the BSP tend to emphasize financial soundness of the intermediaries. Finally, the Philippine Stock Exchange

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<sup>1</sup> Investment houses and financing companies may have quasi-banking functions subject to BSP licensing and supervision under the General Banking Law of 2000. License for trust functions can also be granted for NBFIs under the Law.

(PSE) is working as a front line regulator of the market as an authorized self-regulatory organization (SRO)<sup>2</sup>.

21. While the SEC has a long history since 1936, its powers and responsibilities have been redefined by the Securities Regulation Code (SRC) issued in July 2000. Executive Order No. 192 of January 7, 2000 transferred the SEC out of the Office of the President and brought it under the “administrative supervision” of the Department of Finance (DOF).<sup>3</sup> Prior to the SRC, the SEC had a quasi-judiciary function to rule on intra-corporate disputes and corporate rehabilitation. The SRC (Section 5.2) transferred this function out of the SEC to court. With this narrowed scope of responsibilities, the SEC can now focus more on regulation and supervision of the securities market and its participants with a greater emphasis on enforcement. However, the scope of the SEC’s responsibility still remains to be too broad firstly because the responsibility to register all corporations (publicly or privately held), partnerships and associations still remains with the SEC and secondly because the SEC is responsible for regulating and supervising a wide range of NBFIs including not only broker-dealers, investment houses and mutual funds but also financing companies, Pre-Need Plans, lending investors and others.

22. Currently, investment advisors are not regulated and supervised by the SEC except for the requirement of registration with the SEC as corporation. However, the Revised Investment Company Act of 2001 now being read in the Congress is expected to bring them under the authority of the SEC. On the other hand, Pre-Need Plans are, by the nature of the business, similar to an insurance company, and therefore, their regulatory and supervisory responsibility is expected to be transferred out of the SEC to the Insurance Commission of the DOF. The lending investors are also not securities market participants. While they are in large number (said to be 4,000 to 7,000), most of them are small single proprietorships and not registered as corporation nor as partnership with the SEC. Instead, they are registered with the Department of Trade and Industry (DTI). If some of them upgrade themselves to become financing companies, those will formally come under the supervision by the SEC.

23. The legal framework for the securities market and its participants is also complex because there is a separate law for each type of those NBFIs, and consists of the Securities Regulation Code July 2000 (SRC), the Corporation Code of May 1980, the Presidential Decree 129 on Investment Houses (PD 129), the Financing Company Act of 1998 and the Investment Company Act of 1960. For each of the laws, the SEC issued Implementing Rules

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<sup>2</sup> While other industry bodies or market institutions such as the Investment Company Association of the Philippines (ICAP) and the Securities Clearing Corporation of the Philippines (SCCP) set code of conducts for the members, they are not (yet) formally recognized as SROs.

<sup>3</sup> i.e., the SEC is accountable to the DOF for its financial efficiency and operational effectiveness but free from the DOF’s interference with day-to-day activities, as defined in the Administrative Code of 1987 (Section 38, Chapter 7, Title III, Book IV).

and Regulations (IRR) to substantiate the law with more specific details of standards, forms and procedures.<sup>4</sup>

24. The General Banking Law of 2000 and the BSP Manual of Regulations for NBFIs further provide, among other things, rules for quasi-banking and trust functions of NBFIs. They also provide rules for Universal Banks and Commercial Banks to be engaged in the securities business and to own NBFIs subsidiaries including Investment Houses and Broker Dealers and empower the BSP to supervise them. To clarify roles of each regulator in regulating and supervising different types of financial institutions and business operations, the Memorandum of Agreement (MOA) was signed between the SEC and the BSP in June 2001. The MOA clarified each regulator's role not only between the regulators but also for the regulated. It proved to be helpful in avoiding confusions, overlaps and overlooked loopholes in the regulatory and supervisory process of the financial conglomerates and universal banks. Another important legislation passed by the Congress in October 2001 is Anti-Money Laundering Act. The SEC is preparing its IRR for the Act in consultation with the Anti-Money Laundering Council in which the BSP also participates.<sup>5</sup>

25. There are several legislative bills currently in reading in the Congress which are expected to provide important additional legal infrastructure for the capital markets. Those include House Bills on the revised Investment Company Act of 2001 (House Bill No. 2814), Securitization (House Bill No. 2759), Special Purpose Asset Vehicle (House Bill No. 3236 intended for off-loading non-performing assets of banks), Personal Equity and Retirement Account (PERA) (House Bill No. 1665) and Financial Sector Tax Reform Bill. In particular, the last has four components including: 1) introduction of Financial Institutions Tax (FIT) on banks and nonbanks, 2) introduction of Thin Capitalization Rule (TCR) or Maximum Debt Funding Percentage Rule, 3) rationalization of taxation of foreign currency deposit units (FCDUs) and 4) rationalization of the documentary stamp taxes (DST). Elimination of DST on secondary market trading and securities lending and borrowing transactions is expected to have a significant positive impact on liquidity of the securities market. For those lending investors which are not able to upgrade themselves to become financing companies, there is currently a Lending Company Act being considered as part of the Micro Finance Program, which, if promulgated, may transfer their supervisory responsibility out of the SEC to the DTI or local authorities.

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<sup>4</sup> I.e., i) Implementing Rules and Regulations of the Securities Regulation Code; ii) SEC Circular No. 4, 2001 on Procedures in the Enforcement of the Corporation Code, iii) the SRC and other Existing Laws Implemented by the Commission; iv) Basic Rules and Regulations to Implement the Provisions of Presidential Decree No. 129; v) Rules and Regulations to Implement the Provisions of the Republic Act 8556 (i.e., the Financing Company Act); vi) New Rules on the Registration and Sale of Pre-Need Plans under Section 16 of the SRC.

<sup>5</sup> The SEC's IRR for the Act is to be coordinated with its SRC Rule 30.2-6 on Supervision against SRC Article 30 on Transactions and Responsibility of Brokers and Dealers and the Model Internal Supervision and Control and Compliance Procedures to be adopted by broker-dealers, investment houses and universal banks.

## Market structure

26. Key market institutions include the Philippine Stock Exchange (PSE), the Philippine Central Depository (PCD) and the Securities Clearing Corporation of the Philippines (SCCP). Key market intermediaries include: Investment Houses (7:37), Financing Companies (7:167), Broker-Dealer firms (176), Mutual Funds (19) and Investment Management Companies (15). Of those, Investment Houses and Financing Companies can have a quasi-banking function which is defined by the General Banking Law as an ability to raise financing from more than 19 creditors.<sup>6</sup> The numbers in the parentheses indicate numbers of licensed firms. For the Investment Houses and Financing Companies, the first numbers show those with a quasi-banking function and the second numbers, those without. A key difference between the Investment Houses and Broker Dealers is that the former is permitted to conduct underwriting of new issues of securities, thus required of a greater capital base (P300 million for Investment House as compared to P100 million for Broker Dealers). As of the end of September 2001, the total assets of the mutual funds amount to slightly less than P10 billion. It is also noteworthy that most of the NBFIs are owned or affiliated to commercial banks. In fact, some commercial banks have been licensed as Universal Banks under the Universal Banking Act. Theoretically, they are permitted to conduct securities business directly under their roof. However, most of them have so far chosen to do the business through subsidiary broker dealers and/or investment houses.

27. The PSE, which was created by a merger between the Manila Stock Exchange and the Makati Stock Exchange in 1994, lists 231 companies including one small and medium size company as of end August 2001. It also lists one series of Small Denomination Government Bonds. The total market capitalization as of end August 2001, not including the government bonds, stood at P2,429 billion (US\$47 billion) representing a slight decline since the end of 2000 but surpassing the pre-crisis peak of P2,122 billion in 1996. As of end 2000, the ratio of market capitalization to the GDP was 78.1 percent while its pre-crisis peak was 97.8 percent in 1996, indicating a quite significant size of the market for a country with per capita income of about US\$1,000. However, the annualized market turnover for 2001 has declined to P173 billion from the peak of P781 billion in 1999, reflecting a fragile recovery from the crisis. In terms of number of shares traded, the decline is more striking; i.e., annualized volume for 2001 has declined to 192 billion shares from the hay days of 2,274 billion shares in 1996. Because of this depressed market activities, the PCD and the SCCP (and to some extent the PSE), whose revenues depend significantly on the trading volume, are currently experiencing financial difficulties. The market turnover ratio for this year is only 7.1 percent while that for the year of recovery (i.e., 1999) was 40 percent. By any scale, the market is illiquid for a market with capitalization of about 80 percent of the country's GDP. An important attribute to this generally low liquidity despite the high capitalization is the small

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<sup>6</sup> Instruments issued by a quasi bank which are sold to more than 19 creditors are considered "deposit substitutes" and are subject to the reserve requirement. Commercial papers (CPs) and even Treasury securities on repurchase agreements (repos) can be included among such instruments if sold to more than 19 investors/counterparties.

free float portion of corporate shares (about 15 percent) due to the holding of controlling shares by founding families of the companies.<sup>7</sup>

28. The domestic debt market is dominated by the government securities which are traded in the over-the-counter (OTC) market with an exception of one series of Small Denomination Bonds listed on the PSE. As of end July 2001, the market capitalization, including that of debt issued by government owned and controlled companies (GOCCs) and local government units (LGUs), stood P1,128 billion, i.e., about 30 percent of the GDP. Of the amount, P1,118 billion is of the national government debt including government-guaranteed debt of GOCCs, LGUs, etc. It is likely to increase further due to the expected budget deficit of the government. The capitalization of commercial papers (CPs), the second most important debt instruments, stood at P35 billion as of October 15 this year and declined from P44 billion at end 2000. The decline was due to the depressed demand for credit by companies and businesses. However, the liquidity of the instruments is much higher as compared to that of the equity. The annual turnover ratio for the CPs is around 500 percent while the government securities is roughly 40 percent. The most of the turnover for the government securities is attributed to short-term T-bills which account for over 40 percent of the total capitalization of the domestic government securities and have an annual turnover ratio of about 90 percent. The trading of the government securities is dominated by commercial banks (said to be 70–80 percent) while investment houses seem to trade CPs actively. Generally, the liquidity of the government securities is low compared to that of developed market which can surpass 10 times a year (i.e., over 1,000 percent annual turnover). In particular, long-term bonds including Treasury bonds are rarely traded.

### **C. General Preconditions for Effective Securities Regulation**

29. Among the legislative bills currently in reading in the Congress, House Bill on the revised Investment Company Act of 2001 (House Bill No. 2814) is expected to allow foreign investors to have representation in the board of directors of mutual funds. On the other hand, the Financial Sector Tax Reform Bill, which is currently being read in the Congress, is expected to reduce or eliminate the privilege currently enjoyed by foreign banks through the introduction of Maximum Debt Funding Percentage Rule. These are intended to provide more equal treatment and fairer market access for both domestic and foreign investors and market participants.

30. The Financial Sector Tax Reform Bill has three additional components including: 1) introduction of Financial Institutions Tax (FIT) on banks and nonbanks, 2) rationalization of taxation of foreign currency deposit units (FCDUs) and 3) rationalization of the documentary stamp taxes (DST). In particular, elimination of DST on secondary market trading and securities lending and borrowing transactions is expected to have a significant positive impact on liquidity of the securities market. In addition, Securitization (House Bill No. 2759), Special Purpose Asset Vehicle (House Bill No. 3236 intended for off-loading

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<sup>7</sup> This implicates existence of some corporate governance problems.

non-performing assets of banks) and Personal Equity and Retirement Account (PERA) (House Bill No. 1665) also involve elements to rationalize taxation on creation of the new financial schemes, instruments and transactions. Passage of these bills are awaited to provide a more leveled playing field for market participants, eliminate impediments for transactions and trading and encourage liquidity in the market.<sup>8</sup>

31. The SRC provided a basis for two important reforms to ensure effective securities regulation. One is the redefining of the SEC's regulatory responsibility and associated reorganization and capacity building efforts, and the other is the demutualization of the PSE. Firstly, the SRC transferred out from the SEC the quasi-judiciary function to rule on intra-corporate disputes and corporate rehabilitation, which made the scope of the SEC's responsibility more manageable. Prior to the SRC, the SEC had this quasi-judiciary responsibility over not only publicly held companies about all companies including privately held ones incorporated in the Philippines. The SEC was then heavily overburdened with this responsibility and could not devote adequate resources to supervision of the securities market and industry and enforcement of the securities regulation.<sup>9</sup> In response to the narrowed responsibilities, the SEC fundamentally reorganized itself as of the end of 2000 as mandated by the SRC. However, it is still in the process of building its capacity to reorient itself to enforcement. For example, it has once almost halved the number of staff from 708 and is now trying to fill about 70 positions to bring up the number to the planned 428. The staff also need to be trained to enhance their enforcement skills.

32. The SRC also provided three critical strengths to the SEC to facilitate the reorganization efforts. One is the enhanced salary standards to attract and retain highly qualified staff. Another is enhanced financial resources for the SEC to provide the salary and improve its management information systems (MIS). The other is the indemnification of the commissioners and staff from law suits in the bona fide discharge of their functions and powers.<sup>10</sup> The enhanced salary standards seem to be already attracting good attention among qualified college graduates and financial and legal professionals. While the indemnification of the commissioners and staff will provide more confidence and security in enforcing the laws and regulations, the ongoing hiring effort is taking time due to the need to take best advantage of the interest of many qualified. These new organizational changes and capacity

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<sup>8</sup> In addition to the bills and recently amended laws, the Memorandum of Agreement between the SEC and the BSP has clarified supervisory responsibilities of the SEC and the BSP in regulating and supervising universal banks and NBFIs which are members of financial conglomerates including banks and/or have quasi-banking functions and/or trust functions. The MOA not only filled loopholes and rationalized the responsibility sharing but also made those clearer to the regulated and thus effectuated the securities regulation.

<sup>9</sup> Introduction of an electronic filing system for registration of companies and public issues of securities is also currently studied to reduce the still heavy workload in the SEC related to companies so that it can further focus on other regulatory, supervisory and enforcement activities than processing of the documents.

<sup>10</sup> These measures to strengthen the SEC which are often politically difficult to adopt were made possible due largely to the strong public concerns about the investigation of the controversial price manipulation case of the Best World Resources (BW) Corporation.

building need to be reasonably completed before the SEC starts functioning at its full capacity under the SRC.

33. The other important reform is the demutualization of the PSE. The PSE has been criticized for being a cozy club of member brokers at the expense of their client investors. Hence, in the wake of the BW scandal, the PSE's SRO license was once suspended by the SEC in March 2000. By the passage of SRC, the demutualization was made a requirement and a majority of directors of its board had to be non-brokers. The PSE implemented the demutualization and associated reform of its board in August last year and, by doing so successfully persuaded the SEC to restore its SRO status. However, the ownership of the PSE still remains 100 percent with the participating brokers, which leaves some doubt about the credibility of the PSE to act in the interest of investors rather than the brokers.

34. The concentration of the PSE's ownership in the participating brokers appears to be also affecting the business interest of the Securities Clearing Corporation of the Philippines (SCCP), which is a majority controlled subsidiary of the PSE. To ensure safe settlement, the SCCP needs to provide proper disciplines for the participating brokers to comply with the rules to control exposures and settlement. This includes imposition of appropriate penalties and/or sanctions when any participating broker defaults. The current concentration of the ownership appears to be making it difficult for the SCCP to act against the business interest of the participating brokers. Hence, diversification of the PSE's ownership by going public needs to be carried out as soon as possible as required by the SRC.

35. Finally, effective securities regulation requires investors well educated of their rights and ways to protect those. The investor base in the Philippines is still thin and understanding of the general public about the securities investment is very limited. Broadening the investor base is a challenging task because of the damage to the public image of the securities investment caused by the BW scandal. In addition, the thin free float portion of the listed equity makes it difficult to attract individual investors. The SEC and the PSE need to conduct an educational campaign to enhance investors understanding of securities investment, their rights in doing so, ways to protect those and means available for them to do so. At the same time, they also need to work on enhancing the corporate governance of listed companies which are currently predominantly owned and controlled by the founding families.

#### **D. Principal-by-Principle Assessment**

36. Section 2 of the SRC provides the State Policy as the objectives which the SRC is enacted to achieve. In comparison with the three objectives provided by the IOSCO, the State Policy objectives expressly include investor protection. One of the IOSCO objective of ensuring the market being fair, efficient and transparent is implicitly provided in the expression to eliminate or minimize fraudulent or manipulative devices and practices which create distortions in the free market. However, the third objective of IOSCO, the reduction of systemic risk, is not expressly recognized in the State Policy. Instead, the State Policy emphasizes promotion of development of the market and its role to achieve social equity. The explicit recognition of self-regulation in the State Policy is also noteworthy. Generally,

these emphases and characteristics of the law are consistent with the actual regulatory standards and practices of the SEC.

Table 2. Detailed Assessment of Implementation of the IOSCO Objectives and Principles of Securities Regulation

<b>Principle 1.</b>	The responsibilities of the regulator should be clear and objectively stated.
Description	<p>“The regulator” of the securities market and industry consists of the SEC, the BSP and the PSE as an SRO. Firstly, Section 5 of the SRC clearly states the responsibilities and powers of the SEC to regulate the Philippine securities market and industry under the SRC, PD 902-A, the Corporation Code, PD 129 (i.e., the Investment Houses Law) the Financing Company Act and other existing laws. The powers include a broad rulemaking power as stipulated in Section 72 of the SRC, and the SEC issued Implementing Rules and Regulations (IRR) to further provide detailed provisions for each section of the SRC for its implementation. With respect to Section 5, the IRR (SRC Rules 5.1(e) and 40.5.1) provides detailed procedures for implementing the SEC’s power to suspend or take-over an Exchange. Similarly, the SEC issued: i) SEC Circular No. 4, 2001 on Procedures in the Enforcement of the Corporation Code, the SRC and other Existing Laws Implemented by the Commission; ii) Model Internal Supervision, Control and Compliance Procedures, iii) Basic Rules and Regulations to Implement the Provisions of Presidential Decree No. 129; iv) Rules and Regulations to Implement the Provisions of the Republic Act 8556 (i.e., the Financing Company Act); v) New Rules on the Registration and Sale of Pre-Need Plans under Section 16 of the SRC. The SEC is also preparing an IRR for the Money Laundering Law which was passed in September 2001. The SEC’s responsibilities can be modified by making amendments to the SRC which the SEC has authority to propose to the Congress, or amending the IRR by a decision of the SEC itself if a modification in question is within the scope of the SRC. Section 4 of the SRC provides procedures for appointment, terms of office and general criteria for removal of the chairman and commissioners of the SEC. The SRC also provided in its section 40 clear powers and responsibilities of an authorized SRO which the PSE is. The BSP’s responsibilities are clearly stated in the New Central Bank Act of June 1993, including the BSP’s responsibilities to regulate and supervise NBFIs,. In addition, the Memorandum of Agreement (MOA) signed in June this year between the SEC and the BSP clarified supervisory responsibilities of the two authorities in regulating and supervising universal banks and NBFIs which are members of financial conglomerates including banks and/or have quasi-banking functions and/or trust functions.</p>
Assessment	Implemented
Comments	<p>The Philippines’ financial sector is complex and clarity of its regulations and responsible authorities to the regulated is crucial in ensuring effectiveness of the regulation. The MOA together with the SRC and the New Central Bank Act not only filled loopholes and rationalized the responsibility sharing arrangements but also made those clearer to the regulated and thus effectuated the securities regulation. The SEC’s regulatory responsibility over Pre-Need Plans, while clear under section 16 of the SRC and the supplementing IRR, may be transferred to the Insurance Supervisory Commission, which is currently discussed in the Congress. The transfer is considered because the nature of the business of Pre-Need Plans is more akin to insurance companies, thus requiring a supervisory approach similar to that for insurance companies. The transfer, if and when occurs, should further rationalize the responsibilities of the SEC.</p>
<b>Principle 2.</b>	The regulator should be operationally independent and accountable in the exercise of its functions and powers.
Description	<p>Section 4 of the SRC charges the SEC as the Administrative Agency to put the SRC into practice. By the Executive Order 192 issued in January 2000, the SEC was transferred from the Office of the President to the Department of Finance (DOF) where the DOF assumes “administrative supervision” of the SEC. Section 38 of the Administrative Code generally</p>

	<p>defines “administrative supervision” as a type of administrative relationship between a department of the government and a regulatory agency(ies). Together, they stipulates that the DOF generally oversee the operations of the SEC and insure that the SEC is managed effectively, efficiently and economically but “without interference with day-to-day activities”. This principle of non-interference with day-to-day activities of the SEC has been actually practiced by the DOF, which provides for operational independence of the SEC. Section 6 of the SRC provides indemnification for the commissioners and staff of the SEC in the bona fide discharge of their functions and powers, which supports operational independence of the SEC. In particular, Section 6.2 provides for handling of confidential information, which is supplemented by SRC Rule 6.2 on Rules of Conduct for Commissioners, Officers and Employees. Section 66 also provides rules for disclosure of commercially sensitive information, which are supplemented by SRC Rule 66. Under the administrative supervision of the DOF, the SEC is accountable to the DOF and may be required to submit reports and subject to management audit, performance evaluation and inspection to determine compliance with policies, standards, and guidelines of the DOF. In reality, however, the Commission of Audit financially audits the SEC as it does for all government bodies and agencies on behalf of the Congress. The Department of Budget and Management also holds the SEC financially accountable, based on the audit by the Commission of Audit. The Congress, by its power to summon the government bodies and agencies to hearing, call on the SEC also for hearing as a need arises (e.g., a controversy, etc.) but at least once a year for a regular hearing. On the other hand, the DOF is not exercising some of the key functions of the “administrative supervision” as defined under the Administrative Code. Section 70 of the SRC provides that the judiciary (the Court of Appeals) has a power to review the SEC’s decisions based on a petition in accordance with the Rules of Court. The SEC also issues annual report to the public although it does not include a financial statement of the SEC.</p>
Assessment	Implemented
Comments	<p>Section 75 of the SRC enables the SEC to retain P100 million from its fee and other income as part of its resources, additional to the budgetary allocation by the Department of Budget and Management (DBM), to finance its operations. By the power to control the budget allocation the DBM can potentially exercise influence on the operations of the SEC. Although Sections 4.4 and 7.2 of the SRC expressly stipulate that salary compensation standards of the commissioners and staff of the SEC should be comparable to those of the BSP, the SEC is a government agency unlike the case of the BSP which is a corporate body whose independence from the government is clearer. Hence, there still seems to be room for interpretation of relevant laws such as the Administrative Code which stipulates standards of salary compensations for government officials. What is clear, however, is that if the DBM reduces the budget allocation on the ground of the Administrative Code, it would defeat the purpose of Section 75 of the SRC.</p> <p>While under Section 4 of the SRC the President appoints Chairman and the Commissioners. Furthermore, appointment of Directors, General Council and General Accountant also needs to be approved by the President as required by the Career Executive Services Officers Act. It is suggested that appointment of such staff may be left for the decision of the Chairperson who has to be appointed by the President anyway. On the other hand, the Executive Order 192 specifically notes the formulation of capital market development and savings mobilization policies as an area where the Department of Finance (DOF) is to exercise administrative supervision over the SEC so as to synchronize economic policies, making the SEC accountable to DOF. The DOF holds meeting with the SEC monthly and the voice of the SEC can be brought up only through the DOF, not directly to the Cabinet, the Congress or the President except when such bodies choose to call on the SEC from their side. Consequently, there are currently four bodies to which the SEC is made accountable, i.e., the President, the Congress, the DBM, and the DOF. It is advisable that the SEC’s operational independence and accountability be further rationalized and clarified. Particular such measures may include making the SEC accountable directly to the Cabinet, which should make the exercise of</p>

	influence, if exists, more transparent and, therefore, can be avoided.
<b>Principle 3.</b>	The regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers.
Description	Section 5 of the SRC provides adequate powers to the SEC, including authorization of market participants (Section 5.1.c and m), direct surveillance of the market and market participants (Section 5.1.e), ability to obtain information about the market, market participants, financial products, customers and parties involved in securities transactions (Section 5.1.d, g and l). The SEC also has authority to communicate with other regulatory bodies (section 5.1.h). It has a power to conduct investigation including criminal cases (Section 5.1.l) although the case needs to be referred to the law enforcement authority and prosecuted by it. It has a power to impose sanctions (Section 5.1.f) and intervene the market (Section 5.1.i). Section 6 indemnifies the commissioners and staff in the good faith discharge of their functions and powers. Sections 36, 40 and 47 also provide powers of the SEC specifically with respect to: a) exchanges and other trading markets, b) SROs, and c) securities ownership. The SRC is also designed to provide adequate resources for the SEC; i.e., Section 75 of the SRC provides that the SEC is authorized, “in addition to its annual budget,” to retain and utilize P100 million from its income (i.e., registration fees, penalties imposed, etc.). As discussed in the comment for Principle 2 above, however, implementation of this financing system remains to be tested over time. The SRC reorganized the SEC to focus more on enforcement activities in the securities market and industry rather than administration of corporate disputes and rehabilitation. This reorganization calls for a shift in the required expertise mix which cannot be achieved over night. The SEC is currently in the process to rebuild a new capacity and appropriate staff competency to meet the need of the new organization.
Assessment	Implemented
Comments	<p>A basis for the calculation of budget allocation for the SEC has been clarified and justified on the basis of the new salaries of the commissioners and staff, which are made comparable to those of the BSP (sections 4 and 7), and other fixed cost and depreciation of the assets. The P100 million additional income retained can be used to build human and system capacity which is critical to enhancing the competency of the SEC in the spirit of the SRC.</p> <p>SEC-iRegister, an on-line electronic filing system for registration of companies, has recently been introduced to reduce the burden of paper processing in the SEC. Thereafter, the on-line electronic filing will be extended to other reports and disclosures to be filed to the SEC, thus enabling the SEC to devote more resources to supervision and enforcement. The system may be made self-sustainable by charging fees for use of the system by publicly held companies or PSE listed companies which are required of stricter disclosure. The companies should actually be saving otherwise required time, cost and efforts of documentary filing.</p> <p>So far, staff training has been obtained in a rather ad hoc manner when some external opportunities arise and when some bilateral aid was made available. Staff training in the domestic market was obtained on an on-the-job basis from the market participants (particularly for enforcement staff). Such efforts are useful and should be continued. At the same time, the SEC has now been secured of own resources to establish a more systematic in-house staff training program. The premises of the SEC needs to be enhanced to meet basic safety requirements such as a need of proper fire escapes, sprinklers, etc. and offer adequate security for the computer systems.</p>
<b>Principle 4.</b>	The regulator should adopt clear and consistent regulatory processes.
Description	Empowered by Sections 5(g) and 72 of the SRC, the SEC issued IRR (i.e., SRC Rules) in January 2001 which provided detailed standards, forms and procedures for the regulated to adopt, file and follow to comply the SRC. General criteria for registration and authorization are included the SRC and its IRR. The IRR also provide in its Annexes various forms to be filled and filed with the SEC for registration and authorization purposes. Various sections of the SRC and the SRC Rules and the other NBFIs laws and corresponding rules issued by the SEC provide circumstances under which applications for registration or authorization may be rejected or

	<p>such license or authorization may be suspended or revoked (e.g., SRC Sections 13 and 15 regarding registration of issues, Section 29 regarding registration of market professionals, etc.). Section 5(c) generally provides the SEC with a power to take such actions. However, the SEC is required to give due notice and have hearing of the aggrieved. Similarly, Section 54 requires due notice and hearing before the SEC imposes administrative sanctions, which the SEC actually practices. Section 4.5 of the SRC provides basic procedures of the SEC’s decision making, which is supplemented by SRC Rule 4.5 with clarification of procedures for regular meetings and special meetings. The SEC is also preparing a Manual of Procedures, which provides day-to-day operational procedures of each department of the SEC. The Manual is not meant to be confidential but not designed for public circulation. The draft already exists but is currently continuously updated as the new institution of the SEC is being built.</p> <p>The SEC has improved the procedures to adopt new rules and regulations; i.e., it circulates a memo circular to the affected market participants and industry for consultation and posts consultative rules in the website for public comments. After the consultative process, the new rules and regulations are published in two newspapers of general circulation in the country. 15 days after the publication, they become effective as stipulated by Section 72.4 of the SRC. The SRC Rules, as well as the SRC itself, are available for the public through the SEC website. The most recently, the SEC issued Circular No. 4 on Procedures in the Enforcement of the Corporation Code, the SRC and other Existing Laws Implemented by the Commission. It not only clarifies the regulatory processes but also expected to effectuate enforcement significantly. The Memorandum of Agreement (MOA) between the SEC and the BSP issued in June this year also clarified the lead role and cooperative relationships between the two authorities in jointly regulating the NBFIs.</p> <p>While Section 53 provides the SEC with investigative authority, in subpoenaing witnesses or the investigated to testify or produce affidavits, the SEC shall notify in writing to the subpoenaed of the purpose of such investigation. The SEC issues Annual Report in which it publishes, among other things, accomplishments of each core department during the year including key regulatory and enforcement actions it took. In addition, the SEC issues Quarterly Bulletin which contains opinions of the SEC about inquiries. The SEC holds weekly press conference in which journalists may ask any questions including those about ongoing investigations, regulatory programs. Issues discussed during the conference are reported in newspapers and other public media.</p> <p>Section 70 of the SRC provides that the SEC’s order may be appealed in the Court by any person aggrieved by the order by petition for review. Sections of the SRC, other NBFIs laws and their IRRs noted above regarding rejection of application for registration or authorization or suspension and revocation of those require notice and hearing prior to the SEC taking such actions. It conducts educational campaigns for issuers and intermediaries to promote understanding of the new requirements of the SRC. It also conducts educational campaigns for investors to promote better understanding of securities investment opportunities and investors’ rights in doing so.</p>
Assessment	Implemented
Comments	<p>The new procedures have been being established after the issuance of the SRC. Market participants need to familiarize themselves with the SEC’s regulatory processes for which the SEC needs to continue to provide some education. The SEC is encouraged to disclose the Manual of Procedures when completed if the information contained in it will be administrative rather than strategic in nature. The procedures for industry and public consultation for the purpose of adopting new rules and regulations may be more formally defined as part of the Manual. Procedures for investigation and enforcement could contain confidential strategic information depending on the way those are designed. The SEC is praised to disclose Circular No. 4 on Procedures in the Enforcement since the nature of the information contained in it is administrative, and its disclosure only enhances clarity of the operations of the SEC.</p> <p>A process by which the regulations and supervisor procedures of Pre-Need Plans (against section 16 of the SRC) were formulated by the SEC allegedly lacked some clarity. However, appropriateness of the SEC’s having regulatory authority over the Pre-Need Plans itself has</p>

	<p>been an issue of policy discussion in the government, and the regulatory authority is likely to be transferred shortly to the Insurance Supervisory Commission. Not to be backward looking, this specific case of regulatory processes with respect to the Pre-Need Plans is not factored in this assessment. Lending Investors, which said to number 6,000, are another group of financial service entities for which the SEC is informally made responsible (with the promulgation of the Central Bank Act, the responsibility to regulate NBFIs without quasi-banking functions, etc. has been transferred to the SEC and lending investors were included among those transferred under the SEC). However, there is no law to govern the business. In addition, they are small single proprietorships which are not registered at the SEC. The SEC gave them an option to transform themselves into Financing Companies through capitalization/merger and corporatization. However, they are neither interested nor able to do so since it requires P10 million capital in case of a Financing Company in Metro Manila. Currently, a Lending Company Act bill is in reading in the Congress. When it passed, the responsibility to regulate them may be transfer to the Department of Trade and Industry (DTI).</p>
<b>Principle 5.</b>	The staff of the regulator should observe the highest professional standards including appropriate standards of confidentiality.
Description	<p>SRC Rule 6.2 further provides the Rues of Conduct for Commissioners, Officers and Employees. It provides detailed and comprehensive rules and procedures for avoidance of conflict of interest including disclosure of financial interest. Staff in positions with discretionary authority is particularly required to be free from “any” conflict of interest which is to help ensure procedural fairness. Section 66 of the SRC provides basic rules for handling of commercially sensitive information filed with the SEC. SRC Rule 66.3 further provides rules for confidential treatment of such information filed with the SEC. Section 66.5 provides a basic rule for disclosure of such information to a foreign enforcement authority for the purpose of regulatory cooperation.</p> <p>While Section 6.1 of the SRC indemnifies the commissioners and staff of the SEC in the bona fide discharge of their functions and powers, Section 6.2 of the SRC holds them responsible for negligence, abuse or acts of malfeasance or failure to exercise extraordinary diligence in the performance of their duties. The judicial review of the SEC orders provided by Section 70 of the SRC which enables any person aggrieved by an order of the SEC to appeal the order to the Court should promote adherence of the commissioners and staff of the SEC to the Rules of Conduct. There is no reported case of serious abuse or violation of this principle since the enactment of the SRC. More generally, the commissioners and staff are subject to rules stipulated in Chapter 9 General Principles Governing Public Officers of the Administrative Code. The above rules of the SRC and the SRC Rules are made consistent with the provisions of the Administrative Code but designed more specifically for the SEC commissioners and staff.</p>
Assessment	Implemented
Comments	While the general rules of indemnification of the commissioners and staff or the SEC are clear, some additional clarification might be useful specifically regarding their indemnification in disclosing confidential or commercially sensitive information to other regulatory authorities for the purpose of regulatory cooperation in case the disclosure leads to damages or losses to the party which filed the information with the SEC and sues the SEC or its commissioner or staff for the damage or losses. MOUs which the SEC is to agree upon with other regulators, domestic or foreign, should also give appropriate reference to handling of such information by the counterpart so as to control potential liabilities to the SEC.
<b>Principle 6.</b>	The regulatory regime should make appropriate use of Self-Regulatory Organizations (SROs) that exercise some direct oversight responsibility for their respective areas of competence, and to the extent appropriate to the size and complexity of the markets.
Description	Building a self-regulating market is part of the expressly stated objectives of the SRC. Section 39 of the SRC defines the role of SROs and types of organizations that can apply for an SRO status. Currently, the PSE is the only formally recognized SRO under Section 39. In fact, the registration requirements for an Exchange stipulated in section 33.1.a) of the SRC requires it to

	<p>“enforce compliance by its members with the provision of the SRC, the SRC Rules, and rules of the Exchange”. Section 33.2.d) on imposition of sanctions on members in case of non-compliance and e) on fair rules of entry and access (i.e., contestability of membership at entry or access) required of an Exchange are also essential requirements for an SRO. Similarly, section 42.2 of the SRC effectively requires any authorized clearing agency to be an SRO. SRC Rules 33 and 42 as well as 39 and 40 further provide detailed provisions for an Exchange and a Clearing Agency and other SROs, respectively.</p> <p>Against these backgrounds, the PSE assumes primary oversight responsibilities over its member brokers and dealers and stipulates Rules and Regulations Affecting Members and Code of Conduct and Professional Ethics for Traders and Salesmen (in addition to Rules and Regulations on Trading, Clearing and Settlement, Fees and Commissions and Listing). The rules and regulations on Clearing and Settlement are included under the rules of the PSE to comply with Section 42 of the SRC because the PSE currently owns a controlling stake in the Securities Clearing Corporation of the Philippines (SCCP). Although the PSE oversees listed companies’ compliance with the PSE rules, the SEC assumes the primary responsibility for enforcement of disclosure obligations under the SRC. On the basis of SRC Rule 39, the PSE has Compliance and Surveillance Group which has three departments including the Compliance Audit Dept. (CAD), the Special Investigation Dept. (SID) and Market Surveillance Dept. (MSD). The CAD conducts special and annual audit of member brokers and dealers and supervises operations of suspended member brokers and dealers. It supervises members’ compliance with its Net Capital Rule on the basis of section 30.2 and 49 of the SRC and SRC Rule 49.1-1. SRC 49.1-1 requires daily calculation of net capital and the results are currently reported monthly (except for the case where a broker dealer falls short of a required level, in which case it is required to report daily). The SID investigates investor complaints and other suspected abuses and violations of the SRC, the SRC Rules and the PSE Rules, participates in formulation of rules and interpretation of the SRC and builds and manages a database of past investigated cases. The MSD surveys and monitors the activities in the market and is currently upgrading its stock watch system. When the MSD detects abnormal market movements of shares of a company, the SID requests member brokers and dealers to report the beneficiary buyers and sellers of the shares within three days.</p>
<p>Assessment</p>	<p>Partially implemented</p>
<p>Comments</p>	<p>The PSE’s SRO status was once suspended by the SEC in March 2000 due to alleged trading irregularities arising from the BW scandal. There was then massive resignation of the staff of its Compliance and Surveillance Group over protests on the investigation of the BW case. Provisions of the SRC related to Exchanges and other SROs well reflect lessons learned from this experience. Section 33 of the SRC included provisions requiring demutualization of the PSE and associated restructuring of its governance mechanism from a variety of angles. The new rules of governance required of the PSE is sound and, when fully implemented, should significantly enhance the PSE’s credibility as an SRO. In the current depressed market, the broker dealers are fighting for survival, and it is certainly a difficult environment for the SRO to impose penalties and sanctions on its member broker dealers. However, the SCCP is imposing fines on broker dealers for failed trades. Those which are habitually erring in timely settlement or found to be of high risk are referred by the SCCP to the PSE’s Compliance and Surveillance Group (CSG). The PSE in fact imposed a trading limit on the activity of the broker referred. These actions by the PSE and the SCCP not only ensure safe settlement of the trades and systemic stability of the market but also promote the enforcement culture. To ensure sound self-regulatory motivation and proper incentives of the PSE and its members, implementation of diversification of the PSE ownership is awaited. Separation of the CSG from the PSE to become an independent SRO is also currently considered. The idea is similar to that of separating NASD Regulation Inc. from the Nasdaq in the United States. Creation of a separate SRO only for the PSE would be an expensive option for the small market. However, if it could be combined with SRO functions required of the expected Fixed Income Exchange (FIE) and the Commodity Futures Exchange (CFE) to create a super SRO for all exchanges, it may be worthy of consideration.</p>

	<p>The CSG is working on enhancing its self-regulatory capability. The MSD tested and debug its new automated market surveillance system. It corrected the arbitrary price band set for all securities and now sets such for shares of each individual companies to detect abnormality in share price movements. It was necessary because standard deviations in share price movements significantly differed depending on the nature of underlying business. The new system has also built in a tool to analyze the trading volumes, cross sales, trade concentration and accumulation in conjunction with the price movements. The CAD hopes to increase the frequency of reporting of net capital by the members. Some members, particularly large investment houses, have electronic accounting and risk management capabilities and capable of reporting it daily if required. However, many other smaller firms do not have such a capability. The CAD is encouraged to explore jointly with the members ways to monitor net capital daily. Use of the PCD's computation and account management capability by smaller brokers through outsourcing may be useful to achieve it. The SID can also build and operate, jointly with the members and the SEC, an interactive system to register profiles of individual licensed professionals (similar to the Central Depository of Registry of the United States and comparables systems of other countries).</p> <p>Overall, the self-regulatory arrangements score well. The assessment should be changed to "Implemented" as soon as the ownership diversification of the PSE is implemented.</p>
<b>Principle 7.</b>	<p>SROs should be subject to the oversight of the regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.</p>
Description	<p>Section 39 provides the SEC with power to register, license and regulate an SRO and supervise, examine, suspend or discontinue its operations. It provides requirements including certain mechanisms of governance, fairly contestable membership, fair representation, fair treatment of members, etc. that an applicant for an SRO status must satisfy and procedures of application. SRC Rules 39.1-1.11 provides reporting requirements of an SRO to the SEC. SRC Rule 39.1-1.10 provides rules based on which the SEC disciplines an SRO. The mechanisms of governance required are a particular strength of the SRC and its Rules which are designed to control conflict of interest, thus enhancing credibility of a registered SRO. Section 40 empowers the SEC to supervise operations of registered SROs. Section 40.3 requires that rules of an SRO or amendments to those be approved by the SEC. Section 40.4 empowers the SEC to require an SRO to make specific changes to its rules. Section 40.5 empowers the SEC to suspend or revoke an SRO status, expel a member of an SRO, or remove a director or an officer of an SRO if it finds violation of SRC, its Rules or SRO rules. Section 40.6 provides that an SRO is authorized to discipline or penalize its member (Section 40.6) and required to notify the SEC of the action (Section 40.7). An aggrieved member may appeal to the SEC (Section 40.7). Section 40.6 and 7 further provide fair and clear procedures of due notice and hearing of the accused in the disciplinary procedures of an SRO and the SEC's role in overseeing the process. Further, Section 53 of the SRC and SEC Circular No. 4, 2001 provide that if the SEC determines that the PSE is unable to adequately and effectively fulfill its enforcement duties, it may order the PSE to provide it with all its investigative materials and take control of an investigation. SRC Rule 39.1-1.12 provides that the SEC and SROs meet at least monthly to discuss coordination of their regulatory and supervisory activities. The PSE's Rules and Regulations, in particular its Chapter IV on Rules and Regulations Affecting Members, are generally designed to be fair for all members. Section 17, Article IX of Book V of the PSE Rules provides for confidentiality of information.</p>
Assessment	Implemented
Comments	<p>The SRC and its Rules are well elaborated with respect to the SEC's oversight of an SRO. The PSE is currently reviewing its Rules and Regulations to have them consistent with the SRC and SRC Rules. While the PSE as an SRO conducts routine and special audit on all its members, the SEC not only reviews the audit reports submitted by the PSE but also conducts random oversight audit on the brokers. The monthly meetings between the SEC and the PSE are attended by SEC Chairman and/or commissioners and high level staff and all members of the board of the PSE. The meeting discusses various issues in depth and make</p>

	<p>decisions/agreements on some important issues including the demutualization, election of a new PSE president, spin-out of the Compliance and Surveillance Group, business plan for SCCP, etc. as well as any problems. However, the SEC is encouraged to develop a strategy to consistently implement SRO provisions of the SRC in an environment of emerging competition among Exchanges which are to be for-profit corporations. The Commodity Futures Exchange (CFE) is expected to reopen while a Fixed Income Exchange (FIE) is expected to be established soon. In addition, the SRC (Section 37 as well as 32.2.a) envisages emergence of Alternative Trading Systems (ATs) or Electronic Communication Networks (ECNs). Competition can also realistically come from overseas (e.g., Singapore where some Philippine IT firms were listed). The potential competition may force Exchanges to lower the self-regulatory standards in order to attract members and listings, or otherwise, make the members of the Exchange reluctant to commit themselves to self-regulation as some members of the PSE appear to be. In sorting out feasible and not feasible self-regulatory responsibilities for Exchanges as competing, for-profit private corporate bodies, it will be useful for the SEC to consider differences between a “trade association” and an SRO. A trade association sets rules and business conventions among its members to facilitate the members’ fair business dealings among themselves but does not assume a responsibility to protect interest of clients of the members as an SRO should. Unlike an Exchange, an industry association is generally expected to be a unique body for each industry branch. For such an industry association, fair contestability of membership at entry is an indispensable element in order to ensure credibility of the body as an SRO, because without it, an industry association can become a monopolistic industry cartel preventing new entrants. The SEC has been monitoring the market and conducting analysis manually by using Technistock, a market-related database system operated by a private information vender. The SEC and the PSE are encouraged to ensure the SEC’s direct access to the market surveillance information when the Surveillance and Compliance Group of the PSE develops a new surveillance system. The PSE is also encouraged to establish fair and transparent internal rules for the staff of the PSE, especially of the CSG in addition to those for the members.</p>
<p><b>Principle 8.</b> The regulator should have comprehensive inspection, investigation and surveillance powers.</p>	
<p>Description</p>	<p>Section 5 of the SRC generally provides the SEC with comprehensive powers including inspection, investigation and surveillance of the market participants and markets. Section 5.(d) generally provides the SEC with a power to regulate, investigate or supervise the activities of persons to ensure compliance. Section 5.(e) empowers the SEC to supervise, monitor, suspend or take over the activities of exchanges, clearing agencies and other SROs. Section 53 provides that the SEC has discretionary authority to initiate and conduct investigation of any violation or potential violation of the SRC, the IRR, SEC orders or SRO rules. Section 52 of the SRC and corresponding SRC Rules require registered market participants to keep records of assets, liabilities, transactions, contracts, etc. and avail those to inspection by the SEC. Section 5.(l) empowers the SEC to issue subpoenas and summon witnesses to appear in any proceedings of the SEC (including submission of affidavits) and in appropriate cases, order the examination, search and seizure of all documents, papers, files and records, tax returns, and books of accounts of “any entity or person” under investigation. Section 53 empowers the SEC to conduct investigation at its discretion to protect investors. Other various sections of the SRC and the SRC Rules provide respective details of the SEC powers. An exception to this rule is books and records of banks which are protected under the Bank Secrecy Law. While there is the Memorandum of Agreement (MOA) between the SEC and the BSP which enables the two regulators to cooperate in inspection of NBFIs and their banks, the Bank Secrecy Law also binds the BSP. The Anti-Money Laundering Law adopted in September this year now prohibits anonymous accounts. Anti-Money Laundering Council, in which the SEC participates together with the BSP and the Insurance Commission, has prepared IRR for the law. SRC Rule 52.1-6 on Customer Account Information Rule permits numbered accounts without names of the customers. However, the rule requires broker dealers to keep on file the names with a written statement signed by the customer showing that the customer owns the account. The SEC can verify “anytime” who the beneficiary owners are into the records of the brokers. The IRR may</p>

	require some amendments to the SRC and its Rules. such as SRC Rule 30.2-6 on Supervision. In fact, the Model Internal Supervision, Control and Compliance Procedures for broker dealers, investment houses and banks engaged in broker dealer operations (issued in August 2001), which substantiates the rule, already included procedures to detect and handle money laundering in its Chapter III, Section H.4.
Assessment	Implemented.
Comments	Overall, the SEC's powers to inspect and investigate are comprehensive and strong. The SEC's on-going effort to upgrade its MIS capacity for electronic filing of records and surveillance of the market should continue to enhance the effectiveness of the inspection and investigation. The electronic filing system for companies (SEC-iRegister) has recently been launched. The PSE is due to complete the to the upgrading of its surveillance and monitoring system. The SEC should require the PSE to provide with a terminal to access the surveillance system. Currently, the SEC has a trading terminal of MakTrade and manually analyze price and volume movements by using Technistock, a market-related database system operated by a private information vendor. . Market intermediaries are working on enhancing their internal account management systems, which should facilitate further enhancement of the SEC and the PSE's surveillance and investigation activities. The Philippine Central Depository (PCD) is discussing with its participants (including custodian banks) creation of sub-accounts, thus ensuring a name registry within its system although it currently permits nominee accounts. The Philippine Association of Stock Transfer Agents (PASTRA) is also working on its Automated Direct Registry (ADR) system. These developments will further enhance the transparency of the market and effectiveness of the inspection, investigation and surveillance by the SEC.
<b>Principle 9.</b>	The regulator should have comprehensive enforcement powers.
Description	Section 5 of the SRC provides the SEC with comprehensive enforcement powers with respect to all types of market participants and the market including those governed by the other NBFIs laws as well as the SRC itself. Section 5.(c) empowers the SEC to approve, reject, suspend, revoke or require amendments to registration statements, and registration and licensing applications. Section 5.(f) empowers it to impose sanctions for the violation of laws and the rules, regulations and orders issued by it. Section 5.(g) provides the SEC with a power to issue, approve, amend and repeal rules and regulations and supervise compliance with those. Section 5.(i) provides the SEC with a power to issue cease-and-desist orders to prevent fraud or injury to the investing public. Section 64 further provides the manner in which the SEC may issue cease and desist orders In particular, the SEC can issue such an order "without a prior hearing", if in its judgment after investigation or verification, the act or practice is or will be fraudulent or cause grave or irreparable damages to the investing public. Section 36 provides powers of the SEC specifically with respect to Exchanges and other trading markets including a power to suspend trading. Section 5.(j) empowers the SEC to punish for contempt of the SEC. Under Section 5.(k), the SEC can compel any registered company to call a general shareholders' meeting under its supervision. Sections 24 to 27 defines and prohibits fraud, manipulation and insider trading. Section 54 defines Administrative Sanctions, and Sections 56 to 61 define Civil Liabilities in connection with: a) False Registration Statement, b) Prospectus, Communications and Reports, c) Fraud in Securities Transactions, d) Manipulation of Securities Price, e) Commodity Futures Contracts and Pre-need Plans, and f) Insider Trading. The Bank Secrecy law requires a court order in order for the SEC to obtain bank records. However, the Anti-Money Laundering Law now provides the SEC a power to freeze bank accounts which are linked to securities transactions which are investigated.
Assessment	Implemented
Comments	The Anti-Money Laundering Law provided an important addition to make the SEC's enforcement power fully comprehensive. Further substantiation of the SEC's enforcement powers is to be provided in IRR for the law which has been prepared by the SEC as well as the BSP and the Insurance Commission for approval by the Congressional Oversight Committee.
<b>Principle 10.</b>	The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.

Description	<p>Because of the BW scandal as a key background of the reform, strengthening of the enforcement by the SEC is a primary objective of the SRC reform. Under the authority of the rules noted in the assessment against Principles 8 and 9 above, the SEC carries out routine and special inspections of brokers and dealers, investment houses, financing companies, mutual funds, Pre-Need Plans, exchanges (i.e., the PSE), the central depositories (i.e., the PCD) and the clearing house (i.e., the SCCP) which are all required to periodically file financial reports with the SEC. Whether or not to give an advance notice for a special inspection depends on the purpose. The SEC sets inspection priorities based on perceived risks and/or complaints and maintains the inspection records. However, the coverage of institutions is quite broad as compared to the capacity of the SEC as there are a total of over 450 registered NBFIs to supervise (excluding lending investors) in addition to issuers. With regard to the PSE member intermediaries, the PSE as an SRO acts as the primary supervisor and carries out periodical inspections of the members. All the PSE members are inspected in a 2 year cycle. The SEC, on the other hand, carries out selective inspections, which serves two purposes; i.e., to affirm a) the results of the examination of the intermediaries, and b) reliability of the SRO's inspection work. The expected transfer of the responsibility to supervise Pre-need Plans to the Insurance Commission should enable the SEC to focus more on the remaining institutions. Recently, the SEC adopted Circular No. 4, 2001 on Procedures in the Enforcement of the Corporate Code, SRC and other Existing Laws Implemented by the SEC. It provides internal investigation procedures to clarify the difference between formal and informal investigations, the role of the Compliance and Enforcement Department (CED) in the conduct of investigations and cooperation with other departments, the difference between on examination for cause and on investigation and attendant powers and confidentiality concerns. The PSE is enhancing its surveillance methods. The SEC can and does take a variety of administrative corrective actions against results of the inspections, based on the enforcement powers provided under the SRC. If a fraud is suspected, it can and does initiate investigation and refers to the Department of Justice for prosecution. The indemnification under section 6 of the SRC provides the commissioners and staff of the SEC with more confidence and security in enforcing the laws and regulations. The on-going computerization in the SEC, which has been partially completed, should substantially reduce the burden of handling documentary information and effectuate the SEC's monitoring of the market and its participants. The PSE conducts market surveillance and monitors conduct of the member intermediaries. The SEC is yet to gain direct access to the PSE surveillance system.</p>
Assessment	Partially implemented
Comments	<p>The progress with the on-line electronic filing of company registration is encouraging, and further computerization for electronic filing of reports and disclosure documents is awaited. The assurance of the extra budgetary allocation also will likely enable the SEC to create a systematic in-house trading program to enhance skills of the staff in inspection, investigation and enforcement. The inspection and investigation manuals and procedures developed with assistance from international donor agencies will be useful in creating such an in-house training program. While these developments and efforts indicate a good prospect for an "Implemented" assessment in the foreseeable future, the SEC still experiences difficulties gathering sufficient information with respect to violations where intent must be proven. The SEC finds particularly difficult to prove intentional violations that involve conduct which may, on its face, appear to comply with SEC/PSE rules, but clearly violates the spirit of the rules. This is a common difficulty found in jurisdictions with a civil code legal tradition where forms of violations need to be specified in the law. This provides loopholes for creative violator to work around. To overcome it, a system of securities jurisprudence needs to be strengthened in the Philippines. The SEC hopes to learn from other civil code jurisdictions and works with the PSE to draft more comprehensive rules and issue more interpretative releases to clarify unethical conducts. The SEC also needs to educate the public on market practices which constitute manipulation. The SEC has successfully imposed fines in administrative procedures (e.g., 21 cease-and-desist orders issued) and referred cases to the Department of Justice for criminal prosecution. However, it is yet to successfully prosecute criminally a securities enforcement case although it</p>

	has investigated many securities law violations (e.g., six suspected boiler room operations involving officers of Mendez Prior, Dukes and Co. Inc., Evergreen, the Barclays Group, Goldberg and Price Richardson Corp). The SEC forged a cooperation agreement with the National Bureau of Investigation (NBI) in April this year to intensify the enforcement effort against boiler room activities. The SEC also plans to work with two international donor agencies to gain hands-on assistance in bringing successful enforcement actions and develop an enforcement training program.
<b>Principle 11.</b>	The regulator should have authority to share both public and non-public information with domestic and foreign counterparts.
Description	Section 5.(h) generally empowers the SEC to request or require assistance of enforcement agencies of the government, civil or military as well as any private legal or natural person in the implementation of its powers and functions. Section 66 defines commercially sensitive and non-public information filed with the SEC, and its Section 66.4 prohibits disclosure of such information. However, Section 66.5 empowers the SEC to provide assistance for any foreign enforcement authority empowered to provide reciprocal assistance. The assistance includes the disclosure of any information filed with or transmitted to the SEC if the requesting authority is conducting a securities- or commodity-related investigation. The SEC can provide necessary information regardless of whether an investigated matter constitutes a violation of the Philippine law. The indemnity provided for the commissioners and staff under Section 6.1 of the SRC applies only to the case of the good faith discharge of their official functions and duties. Section 6.2 holds those who willfully violate the SRC or are guilty of negligence, abuse or malfeasance in the performance of their duties liable for any loss or injury suffered by the SEC or other institutions. The liability may be applied to cases of inappropriate disclosure of confidential information including those involving conflict of interest. The SEC is a member of the Inter-Agency Task Force including the BSP, the Bureau of Internal Revenue, and the Department of Justice, which facilitates information sharing among the domestic agencies. Congress recently passed the Anti-Money Laundering Act (AMLA) which enables the Anti-Money Laundering Council (AMLC), in which the SEC participates together with the BSP and the Insurance Commission, to freeze bank accounts related to suspicious securities transactions or securities fraud. Suspicious securities transactions are required to be reported to the SEC regardless of their size. Chairman of the SEC, who is a member of the AMLC, can then advise the AMLC to freeze related bank accounts.
Assessment	Implemented
Comments	The legal framework provides the SEC with clear and comprehensive authority to share information with domestic and foreign regulators. The AMLA defines suspicious transactions for the purpose of prohibiting money laundering. Its IRR issued by the AMLC requires reports of suspicious transactions “regardless of the amount.” The AMLA can provide protection for a bank officer(s) against liabilities which could arise from the Bank Secrecy Law if he/she/they disclose bank account information to the SEC. The SEC can share the information it gains with a court order with other authorities without risking the commissioners and staff to be subject to civil liabilities. Currently, the PCD’s account structure identifies individual investor accounts held by member broker dealers as nominees although identities of the investors are not disclosed unless investigative needs arise. The PCD provides backoffice support for small broker dealers which cannot afford to have own electronic account management systems. Whether to require recording of identities of every investor in the PCD is currently under consideration.
<b>Principle 12.</b>	Regulators should establish information sharing mechanisms that set out when and how they will share both public and non-public information with their domestic and foreign counterparts.
Description	The SEC signed with the BSP a Memorandum of Agreement to clarify each other’s regulatory responsibilities and lead role of each with respect to specific financial institutions, services and circumstances such as ownership by banks in certain NBFIs. Through the MOA, loopholes and overlaps have been filled and rationalized, and the regulated institutions now understand clearly what they are expected to comply with by whom. The SEC is a member of an inter-agency task

	<p>force including the BSP, Bureau of Internal Revenue and the Department of Justice which was created to deal with the failures of five investment houses linked to banks. The task force facilitates the SEC's information sharing with the other domestic agencies at the high level. The Anti-Money Laundering Council (AMLC) consisting of Governor of the BSP and Chairmen of the SEC and the Insurance Commission now provides a permanent place for the three financial supervisory authorities to communicate and exchange information under the Anti-Money Laundering Act (AMLA). The three authorities have jointly drafted the IRR for the AMLA. Improvements needed are related primarily to the need to develop MOUs with foreign regulators and other enforcement bodies. A model MOU had been drafted which is designed to permit a wide range of assistance and cooperation subject to legal and regulatory restrictions of each other's jurisdiction. It appears to permit assistance to be provided for purposes of, among other things, detection of market manipulation and authorization of market participants and professionals. The specific nature of assistance and/or cooperation is to be specified in a letter of request. The SEC has recently received clearance from the Department of Foreign Affairs to enter into an MOU with other regulatory agencies and is currently finalizing an MOU with the BAPEPAM of Indonesia.</p>
Assessment	Partially implemented
Comments	<p>Finalization of the MOU with BAPEPAM is awaited. The Taiwanese securities regulator approached the SEC to agree on an MOU. It also seems important to agree on the same with the Monetary Authority of Singapore since some Philippine companies have been listed and traded in the stock exchange of Singapore. The SEC and the PSE also plan to clarify in writing (i.e., MOU) how exactly the regulator and the SRO communicate (e.g., which individuals to communicate for what) and cooperate in investigation. The assessment can be considered as "Implemented" when the on-going efforts materialize.</p>
<b>Principle 13.</b>	The regulatory system should allow for assistance to be provided to foreign regulators who need to make inquiries in the discharge of their functions and exercise of their powers.
Description	<p>Subsection 66.5 empowers the SEC to provide assistance for any foreign enforcement authority authorized to provide reciprocal assistance. The assistance includes the disclosure of "any" information filed with or transmitted to the SEC if the requesting authority is conducting a securities- or commodity-related investigation to determine violation of securities or commodity laws. This clearly includes non-public, commercially sensitive or confidential information regarding a licensee, a listed company and beneficial shareholders. Assistance that can be provided includes requesting cooperation of holders of information and summoning witnesses to testify in any proceeding of the SEC and/or to produce affidavits, as provided by Section 5.(h) and (l) of the SRC. The "any" information is understood to include that regarding regulatory processes of the SEC. The types of information may also include banking and brokerage records. The SEC provides such information regardless of whether an investigated matter constitutes a violation of law of the Philippines. However, the SEC's access to banking records is limited by the Bank Secrecy Law. The Bank Secrecy Law requires a court order in order for the SEC to obtain information regarding bank accounts.</p>
Assessment	Implemented
Comments	The SEC has been informally providing assistance even to those without reciprocity clauses.
<b>Principle 14.</b>	There should be full, accurate and timely disclosure of financial results and other information that is material to investors' decisions.
Description	<p>Disclosure requirements are another area which was purposely strengthened under the SRC and have been The disclosure requirements in the SRC and the IRR are modeled after those in the United States. Section 8 of the SRC requires registration of securities and disclosure of information about the securities prior to sale to the public. Section 9 defines exempted securities which include those issued or guaranteed by the government. However, bank shares are not exempted. Section 10 provides that the registration requirement is exempted for issuance to the existing shareholders without payments, conversion of existing securities, private placement to fewer than 20 persons or to any number of professional institutional investors as defined by Section 10.(l). SRC Rule 8 provides further details of the registration requirement. SRC Rule</p>

8.1-1 provides rules for delivery of Prospectus for the public issuance of securities which are required to be registered. It includes filing of Preliminary Prospectus with the registration. SRC Rule 8.3-1 provides restrictions and requirements for advertisement, road shows, etc. prior to effectiveness of the registration.

Section 12 of the SRC and Annex C of SRC Rule 12 provides procedure for the registration and detailed disclosure requirements including: i) description of the business including information on company formation and by-laws, ii) description of the securities, iii) financial information, iv) management and certain securities holders including directors and other officers and their compensations, shareholdings and related transactions; v) registration statement and prospectus provisions, vi) exhibits to be included. Regarding the requirement of description of securities, the issuance of options requires disclosure of information specific to the instrument (e.g., the terms of the plan, names or beneficiaries or eligible participants). The issuance of preferred shares requires, among other things, description of the sinking fund and the shares' rights and preferences. Debt issuers are required to state its satisfaction of a requirement to have net worth exceeding P25 million and have been in business at least three years. They are also required to state whether unsecured bonds are to be issued. Investment companies and Oil and Mining companies are required of special information disclosure.

Section 17 provides requirements of periodic reports and current reports on material events by the issuers of securities which are required to be and have been registered except those which have less than 100 shareholders or assets less than P50 million. However, any issuers whose securities are listed on the Exchange must meet the reporting requirements. In fact, companies listed on an Exchange must file with the Exchange all reports filed with the SEC (Section 17.3 of the SRC). PSE may require, based on its listing rules and full disclosure policy, further information to be disclosed. Annual report to be filed with the SEC must contain a balance sheet, profit and loss statement and statement of cash flow and be audited by an independent certified public accountant. Such issuers must also file with the SEC interim fiscal (quarterly) reports and current reports on material events. The issuers are also required to distribute information or a proxy statement which contain information which will help the shareholders make voting decisions (SRC Rule 17.1(b)). The SRC Rules provide in its Annexes various SEC forms (e.g., SEC Form 17-A for Annual Report, SEC Form 17-Q for Quarterly Report, SEC Form 17-C for Current Report, etc., etc.) to be filled and filed with the SEC. Section 18 provides a requirement of reporting of holding or acquisition of 5 percent or more equity securities. As provided by Section 66 of the SRC and SRC Rule 66.3, however, the issuer can request the SEC's confidential treatment of trade secrets or other sensitive strategic business information (such as merger negotiation, etc.) to be withheld from disclosure although such request is subject to review by the SEC.

The SEC may reject or revoke registration statement and refuse registration after due notice and hearing if the issuer, among other things, made false or misleading representation of material facts (Section 13). It can review, approve and order amendments to registration statement (Section 14). The SEC can suspend the registration if the information filed is or become materially misleading, incorrect inadequate or incomplete or fraudulent (Section 15). It then requests relevant further information from the issuer and considers whether the registration should be revoked. Section 13.4 also provides that the SEC can issue an order to the issuer and/or broker dealers which are participating in the issue to suspend an offer pending any investigation. The SEC is required to state the grounds for such actions in the order. Such an order, however, is kept confidential (i.e., not to be published) while binding on the issuer and the broker dealers. Until the order is lifted or set aside by the SEC, any sale thereof shall be void. Hence, the grounds for rejection, revocation or suspension may be civil, administrative or criminal.

An investor is provided under Section 56 of the SRC with private rights of actions to bring a civil law suit against, among others, the underwriter, the auditor as well as the issuer and/or its directors in case the investor believes to have suffered from damages / losses due to inadequate and/or misleading disclosure (in prospectus, etc.). Section 57 holds civilly liable the issuer, the underwriter and the auditor, etc. to investors who suffered damages for such reasons. The PSE

	Rules and Regulations (V. Rules on Listing) hold the lead underwriter which is a member of the PSE responsible for conducting due diligence to ensure the issuer's compliance with the contents and procedures of disclosure. More generally, duties of directors, officers to the company and its shareholders are defined in Corporation Code (Title III of the Code).
Assessment	Implemented
Comments	<p>The legal and regulatory requirements are sound. The SEC needs to improve its enforcement of the new requirements and standards and educate the regulated persons on those for more effective implementation of the full disclosure regime. Staff skill also needs to be improved particularly with regard to detection of financial fraud. While the SRC and its IRR include disclosure requirements for exchange-listed companies, the PSE ensures that such requirements are met by its listed companies. Thus, the SEC has authority to delay listing at the PSE when a listed-issuer is not in compliance with the SRC or the IRR. In reality, however, the PSE as an SRO directly exercise such control.</p> <p>The SEC plans to develop brochures and guidelines on areas of disclosure which raise compliance issues (e.g., beneficial ownership, timing of disclosure of material corporate events). The SEC recently helped conduct the successful first seminar on full disclosure. It was well attended and considered highly successful by the participants (issuers and underwriters) in enhancing their understanding of new disclosure requirements and standards under the SRC and the IRR. The SEC intends to conduct more such seminars to alert the issuers and underwriters on their obligations. SRC Rules can also provide some clarification regarding circumstances under which either the issuer or the underwriter or the auditor is not liable for damages incurred by investors while the other(s) is/are. For example, if the issuer did not honestly disclose material information which the underwriter could not reasonably find out about, only the issuer may be held liable. Likewise, if some misleading information was included due to a fault by the underwriter but not the issuer, only the underwriter may be held liable.</p>
<b>Principle 15.</b>	<b>Holders of securities in a company should be treated in a fair and equitable manner.</b>
Description	<p>Corporation Code and Chapter VI (Sections 19 through 23) of the SRC provides provisions for protection of shareholders interest. Firstly, Corporation Code provides, among other things, various shareholders' rights including i) dissenter's right of appraisal, ii) pre-emptive rights, iii) right to require an extraordinary shareholders' meeting, iv) right to bring legal actions against directors, v) cumulative voting of shares, vi) a requirement of super majority votes (2/3) for certain significant corporate actions such as major corporate restructuring, v) right to appoint an external auditor or legal counsel. The requirement of cumulative voting provide better chance for a group of minority shareholders to appoint a director to represent their interest in the Board. In addition, Section 38 of the SRC requires any listed or publicly held company to have at least two independent directors. The SRC further empowers the SEC to require a registered exchange to adopt rules governing the duties of officers and directors of listed companies to all of their shareholders including minority shareholders.</p> <p>Section 19 of the SRC and SRC Rule 19.1 provide rules for mandatory tender offer for publicly held companies. An investor or a group of investors who acquired or intends to acquire at least 15 percent at one time or 30 percent in a 12 months period or more than 50 percent in any time span is required to make a tender offer to buy from any shareholders of equity securities of a target company at a price firmly offered which is better than the current market or the highest price at which the bidder acquired the shares in the past six months. This requirement ensures that minority shareholders will be offered fair chance to sell their holdings for the attractive price. A tender offer must be kept open at least 20 business days but should be closed in 60 days, during which the shareholders can consider the offer. A bidder is required to make a public announcement of his/her intension with terms of the offer through two newspapers of general circulation or other mass media. Letters of solicitation may also be sent directly to existing holders of the securities. If more than solicited number of shares are tendered, the bidder is required to buy on a pro rata basis to treat the willing sellers equitably. If the bidder decides to increase the price while the offer is open, it is required to offer the higher price even for those who have already tendered for the previous lower price. When a tender offer becomes</p>

	<p>imminent, a target company is prohibited to take pre-emptive actions unless approved by its general shareholders' meeting. If any investor, including insiders of the target company, becomes aware of a potential tender offer before its announcement, the investor is not permitted to buy or sell the securities prior to the announcement. Otherwise, it is considered as insider trading.</p> <p>Decisions on other negotiated corporate mergers or acquisitions which result in change of control need to be made on the basis of super majority vote at the general shareholders' meeting. Agenda for the shareholders' meeting must be communicated to the SEC 25 working days before the meeting and to the shareholder by proxy and information statement 15 working days (SRC 17.1(b), Section 20, SRC Rule 20). Shareholders also need to be notified by means of proxy statement which must explain terms of a proposal of such corporate events on which voting is required. Other cases where notification to shareholders may be required include acquisition or disposition of significant assets, changes in the issuer's certified accountant, resignation, removal or election of the registrant's directors or officers, legal proceedings, changes in securities, default upon senior securities, change in fiscal year, etc. (SEC Form 17-C). Audited financial statements are not required specifically for the purpose of facilitating shareholders to vote on particular event. However, such reports are provided at the time of shareholders' meeting. Directors are required to report such information to the SEC, and the SEC avail it to the public. In case of an acquisition, pro forma financial statement and information statement are required to be filed with the SEC and distributed to the shareholders regardless of whether the transaction is settled cash or exchange of securities (SRC Rule 17.1(b), SRC Rule 68.7).</p> <p>The issuers are required to publicly disclose the identity and ownership position of major shareholders in: i) registration statement/prospectus, ii) annual report, iii) proxy statement information, iv) report of more than 5 percent shareholder (Section 18 and SEC Form 18-A), and v) statement of beneficial ownership (more than 10 percent as required by Section 23 and SEC Forms 23A/B). Shareholders owning more than 5 percent are also required to disclose their identities publicly as well as at shareholders' meetings. Together with the 10 percent beneficial ownership disclosure requirement provided by Section 23, the requirement is provided to, among other things, forewarn shareholders of creeping takeovers and guide them in making investment decisions. In addition, at the time of election of directors at a shareholders' meeting, incumbent directors, nominees and top four most highly compensated executive officers are required to disclose their identities.</p> <p>In pursuant to Section 34 of the SRC, the SEC has adopted Customer First Policy to prevent front running. It requires broker dealers to execute customer orders ahead of their proprietary transactions of the same price. The PSE's MakTrade has now been reconfigured to ensure execution of customer orders ahead of the proprietary orders of the same broker dealer. Section 5.(k) of the SRC empowers the SEC to compel any registered company to call a general shareholders' meeting under its supervision, enabling it to act directly to protect minority shareholders' interest.</p> <p>Section 12 of the SRC requires public disclosure of compensations of CEO, directors and other key officers of the publicly held companies (top five including CEO individually and the rest collectively). Section 23 of the SRC requires disclosure of transactions in securities by directors, officers and principal shareholders of the company.</p>
Assessment	Implemented
Comments	<p>The SEC's power to compel any registered company to call a general shareholders' meeting under its supervision is an extraordinarily strong power of the SEC of the Philippines not commonly found in securities regulators of other jurisdictions. It gives a great responsibility as well as power to protect interest of minority shareholders. The SEC actually can sue a registered company, the directors, underwriter, auditor, etc. on behalf of its shareholders upon receipt of an appropriate complaint(s). Based on Section 63 of the SRC, court can also award attorney's fee when a small shareholder(s) wishes to sue the issuer, etc., which provides effect similar to class action. Overall, the SRC and its Rules provide adequate protection to shareholders. However, enforcement may be enhanced by the SEC and particularly the PSE.</p>

	<p>Recently, the SEC has approved Code of Corporate Governance which is mandatory for all corporations whose securities are registered or listed.</p> <p>In addition to the need to improve the enforcement effort, one of the main impediments to improving minority shareholders rights is the limited public float of securities in the Philippines. A majority of companies listed on the PSE are controlled by a small number of shareholders, most of who comprise family members. Until the market has developed to a point where there are tangible financial benefits to listing and to making publicly available a larger percentage of outstanding securities, it will be difficult to change the share ownership structure. Thus, minority shareholders have little chance of influencing decision making at these companies.</p>
<b>Principle 16.</b>	Accounting and auditing standards should be of a high and internationally acceptable quality.
Description	<p>SEC Form 12-1 required for registration of an issue requires inclusion of consolidated balance sheets of the past two years and income and cash flow statements of the past three years audited by an independent CPA(s). Rules and procedures for filing of the financial statements with SEC Form 12-1 are provided in SRC Rule 68.1.b. and c.. At the time of listing, the PSE requires in its Rules and Regulations financial statements for the last three years audited by “independent auditor”. The independent auditor is understood to be an independent CPA as defined in SRC Rule 68 though the PSE Rules do not make specific reference to the SRC Rule definition. Section 17 requires that a company which has sold securities requiring registration with the SEC or a public company (i.e., a company which has listed any class of its securities on an Exchange for trading or has assets of at least 50 million pesos with 200 shareholders each holding at least 100 shares) file with the SEC an annual report which includes balance sheet, income statement and a statement of cash flow which are all audited by independent CPA. At the time of listing, the PSE Rules require financial statements for the past three years of operations which are audited by independent auditor. As required by SRC Rule 17 and SEC Forms 17-A and 17-C, public companies must disclose reasons for changes of their external auditors. To clarify the duties of a company’s directors and officers to keep adequate records to be reviewed by an accountant or auditor, Sections 56 and 57 of the SRC imposes civil liabilities on management of public companies for the inaccuracy of financial information.</p> <p>The Statements of Financial Accounting Standards (SFAS), SRC Rule 68 and its Annexes J and K address requirements for the financial statement which include, among other things,; i) balance sheet, income statement and cash flow statement, ii) consolidated financial information, iii) business combinations, iv) intangible as well as tangible assets, v) leases, vi) income taxes, vii) employee benefits, viii) provisions and contingencies, and ix) financial instruments (including derivatives). Those also address investor concerns such as Earnings per Share (EPS), interim (quarterly) financing reporting and related party transactions. The SFAS provides objectives, elements (assets, liabilities, revenues, expenses, etc.), qualitative characteristics (e.g., relevance, reliability, materiality, comparability, completeness, etc.), recognition/measurement of compliance with the SFAS as well as assumptions of going concern, accrual accounting, etc. for the financial statements for capital raising and financial reporting.</p> <p>The SFAS is set by the Accounting Standard Council (ASC) of the Philippine Institute of Certified Public Accountant (PICPA) and approved by the Board of Accountancy of the Professional Regulation Commission (PRC) of the government. However, Section 68 of the SRC empowers the SEC to make, amend and rescind accounting rules and regulations. SRC Rule 68 specifically recognizes in its section 1.b.v. four sets of accounting rules; namely, those set by: i) the SEC, ii) the Accounting Standards Council (i.e., SFAS), iii) the International Accounting Standards Committee, and iv) those of historical practices in the Philippine. It then expressly stipulates that those are in descending order of authority. Thus, the SEC rules are to override any others and the SEC serves to resolve disputes over interpretation of the GAAP. The SEC recently issued Memo Circular approving the adoption of seven SFASs to SRC Rule 68.</p> <p>Oversight over accountants and accounting firms is a responsibility of the Board of</p>

	<p>Accountancy of the PRC, and the SEC does not have authority to directly regulate or supervise accountants. However, the SEC has authority to review financial statements filed by public companies and challenge application of accounting standards. It can directly impose administrative sanctions on accountants in case of misrepresentation of material facts or failing to conduct proper due diligence of an issuer of securities (under Section 54 of the SRC). The SEC can also refer such cases to the Board of Accountancy which can further penalize the accountant with revocation of its license. In addition, affiliation of CPAs with PICPA in which the SEC is represented also help ensure proper application of the SFAS. The ASC publishes comments on pronouncements regarding application of accounting standards. Further more, the recently promulgated Code of Corporate Governance, which is to be enforced by the SEC, specifies responsibilities of external and internal auditors and stipulates specific manners in which independence of external auditors is secured. The SEC is working with the Board of Accountancy and the PICPA to improve compliance and discipline of auditors and accountants who fail to adhere to these standards.</p> <p>The SFAS includes the Code of Ethics for CPAs which addresses: a requirement and criteria of independence of auditors, authorization of auditors (i.e., CPA), use of due professional care, proper planning and supervision of the audit, understanding of the internal control system of the audited, and a need to obtain evidence that financial statements are free of material misstatements. The SFAS also requires that auditor's report to disclose in footnotes: i) exceptions to application of accounting standards, ii) material uncertainties and iii) going concern issues. A requirement of continuous auditing education has been eliminated this year.</p>
Assessment	Implemented
Comments	<p>The SEC is in the process to implement the International Accounting Standards (IASs) and has a specific plan to do so by year 2005. The SEC is currently revising SRC Rule 68 to incorporate seven revised SFASs which adopted six IASs. Improvements are also needed with respect to enforcement of compliance with the standards and quality of audits and the need for better coordination between the SEC and the Board of Accountancy in detecting and disciplining accountants for violation of accounting and auditing standards.</p> <p>The requirement of audited financial statements at the time of registration and issuance of securities is hard to find in the SRC and the IRR. Prospectus is required to include only abbreviated financial statements summarized from full hedged, audited financial statements. SRC Rule 12 requires, at the time of issue, only "non-financial" statement portions of annual, quarterly and current reports. SRC Rule 12-2 is not explicit about "requirement" of financial statements while Part V of Annex C for SRC Rule 12 only "implicates" in its (B)(5) that Item 12 of SEC Form 12-1 requires detailed financial statements. The explicit requirement is provided in SRC Rule 68.2.b. and c.. However, the rule is supposed to be a place to substantiate the generic power of the SEC to provide accounting rules as provided by Section 68 of the SRC. The SRC and the IRR could be amended to make this important requirement clearer in Section 12 of the SRC and corresponding Rules.</p>
<b>Principle 17.</b>	The regulatory system should set standards for the eligibility and the regulation of those who wish to market or operate a collective investment scheme.
Description	<p>The Investment Company Act (ICA) adopted in 1960 sets out eligibility standards for marketing and operation of a collective investment scheme (CIS). The Act addresses the operator's: fitness and properness, honesty and integrity, human and technical competence, adequacy of financial capacity, capacity to discharge powers and duties, and adequacy of internal management and control. Employees of the operator or the marketer are required to pass a qualifying examination given by the CMD in addition to satisfying the similar fitness and properness standards before they operate or market CISs. The operator is required to publicly disclose qualifications and eligibility of its employees and itself. Operation of a CIS by an authorized operator is subject to fine and suspension of the operation. The operator is required to report to the SEC periodically and currently on material changes in its management or organization.</p> <p>Provisions of the ICA regarding conduct of the operator are designed to address conflicts of</p>

	<p>interest arising from the principal and agency relationship between the investors and the operator of a CIS. Those are primarily designed to control related party transactions and include principal transactions between a CIS and its affiliates (e.g., broker dealer, investment house, etc.), transactions where a CIS and its affiliates jointly participate, soft commission or fees to affiliates, lending and borrowing to or from affiliates, purchase of an affiliate's securities or securities underwritten by an affiliate, employees transacting for their own accounts, etc. To control such transactions, the ICA expressly prohibits particular transactions. The SEC also reviews and approves certain transactions and activities. The operator is required to keep records and disclose such transactions when permitted. Investors also have a right to approve certain such transactions before execution. An independent custodian or trustee can also review such transactions. Investment Company Association of the Philippines (ICAP) also sets a Code of Conduct for its members. Currently, a CIS is permitted to issue only one class of securities (i.e., common equity), and therefore, there is no need to control conflicting interest among different classes of securities holders in a CIS. A CIS is required to hold shareholders' meeting at least once a year.</p> <p>The Market Regulation Dept. of the SEC inspects CIS operators annually and reviews internal control and management, compliance with the ICA and its IRR and that with the CIS's own control policies and procedures. The SEC can issue a cease-and-desist order, suspend and/or revoke the license, and impose fine in case of breaches of the ICA and its IRR. CIS operators are allowed to delegate administrative matters and custody of investments and securities to other bodies with appropriate competency. However, the operator remains responsible for the actions or omissions of the delegate. Thus, the operator is required to ensure that the delegate is competent in the functions delegated and to disclose the delegation arrangements and identities of the delegates to the investors. The operator is also required to design and implement procedures to monitor, control and evaluate performance of the delegate. Sub-delegation is restricted and required of approval by the SEC. Changes in the delegation and sub-delegation arrangements require prior approval by the SEC.</p>
Assessment	Partially implemented
Comments	<p>The existing ICA provides most of the necessary elements of investment company regulation. However, it requires clarification and rationalization in its variety of parts in order to be brought up to sound international practices. It also does not allow foreign investors in investment companies to elect their representative(s) for the Board of Directors of the investment companies. While this is not a criterion of this assessment, it discourages foreign participation in this potentially important business for long-term savings mobilization. The proposed law called the Revised Investment Company Act (RICA), which has been drafted and is being considered by the Congress, is to address this issue. It is also to provide clarification and more detailed provisions and rationalize the provisions of the existing ICA. For example, the new RICA is to group all provisions related to affiliated party transactions (i.e., a core of CIS regulation to control conflicts of interest and agency problems) under its Chapter IV and strengthen those. It is also to bring Investment Advisor within the framework of related parties regulation while the ICA does not capture investment advisors despite the fact that investment advisors contract for management of assets of investment companies. Passage of RICA, when materialized, will bring to the SEC authority to regulate investment advisor.</p> <p>The SEC hopes that the new RICA will be passed by the Congress soon. The SEC received assistance regarding regulation of investment companies from the Canadian International Development Agency (CIDA) in mid-June of last year. This assistance included the help of a consultant who reviewed the existing ICA and its IRR and helped the SEC address gaps through the new legislation and/or rulemaking. Full implementation of this Principle is dependent upon passage of the RICA and issuance of corresponding IRR by the SEC.</p>
<b>Principle 18.</b>	The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.
Description	The existing ICA provides in its Section 4 definition of investment company and in Section 5 classification of investment companies. Under the ICA, investment company is a corporation

	<p>issuing securities which is engaged primarily in the business of investing, reinvesting or trading in securities. By their size and purposes, they fall under the definition of Public Company. In addition to the requirement of registration provided by Section 24, investment companies as public company are required to comply with all the registration and disclosure requirements required of corporations issuing securities to the public under Sections 8 and 12 of the SRC. They are required to be registered with the SEC (Corporate Finance Dept.) and file Form 12-1 just as any corporation issuing securities to the public is required to. In addition to the requirement of Section 9 of the ICA, investment companies are now subject to Section 38 of the SRC and required to have at least two independent directors in their board. Independent directors are required to be independent of all affiliated companies of the investment company (duties of independent directors).</p> <p>In terms of legal classification, there are two types of investment companies under the ICA. One is Open-end company, the other is Closed-end company. Open-end company is offering for sale redeemable securities. Whereas closed-end company is offering non-redeemable securities which are thus traded in the secondary market. Most investment companies in the Philippines (there are 19 currently) are open end companies. The prospectus is also required (by IRR 35-1.(d).(1)) to classify the investment company as one of the three categories depending on the risk and growth objectives (i.e., aggressive, growth-oriented or conservative), terms of debt securities invested (i.e., short, medium or long term), area of focus (e.g., securities of companies engaged in real estate, etc.) and mode of investment (e.g., common shares only, convertible preferred shares, loans with warrants, etc.)</p> <p>Rights of the shareholders specific to the invested investment companies and limitations to those are required to be set out in the Prospectus (SRC Rule 12) and Articles of Incorporation and By-Laws (Corporation Code). In particular, the Articles of Incorporation of open-end companies are to provide for the waiver of pre-emptive rights of shareholders (IRR 35-1.(b).(1).(D)). Other basic rights follow those given to any shareholders of a public corporation (e.g., rights to attend shareholders' meetings, voting rights, etc.) as stipulated in Sections 17 and 20 of the SRC.</p> <p>The requirement of segregation of assets of the investment companies from those of the operator and other affiliates and that of use of an independent custodian are implied in Section 16.(f) of the ICA. The custodian must be a bank with trust functions (ICA Rule 35-1.(h).(1)). However, the custodian's responsibility to supervise the activities of the investment company is not expressly stipulated. Delegation of custodian function by the custodian may be permitted although no specific provision of ICA or IRR expressly provides such rules. However, it must be disclosed in the registration statement with reasons and in the prospectus, and the registration statement needs to be approved by the SEC. Even if the function is delegated, the delegator is to be held responsible for the delegated functions.</p> <p>Section 28 requires maintenance of accounting records. The register of shareholders of an investment company is maintained by a transfer agent which may be the custodian bank. Every investment company is required to issue and file Annual and Quarterly reports with the SEC (Section 27.(d) of the ICA). The annual report must be audited. However, the auditors are not to be held responsible for reporting to the SEC any irregularities or non-compliance.</p>
Assessment	Partially implemented
Comments	<p>The ICA needs some tightening and fine tuning. For example, the requirement of segregation is not entirely clear. Section 16.(f) reads as the SEC is to issue IRR or Order to provide a specific segregation requirement. However, no such IRR or Order is found. Likewise, the requirement to transfer agent to maintain a register of shareholders is not entirely clear. Rules for delegation of functions are also not provided. RICA will address, among other things, segregation of client assets, and its passage by the Congress is awaited. The SEC is encouraged to provide further detailed provisions after the issuance of RICA. However, many detailed rules needed may be provided by the SEC even based on the existing ICA.</p>
<b>Principle 19.</b>	Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor

and the value of the investor's interest in the scheme.	
Description	<p>Section 24 of the ICA and Sections 12 of the SRC and corresponding IRR regarding registration of securities require the disclosure to the investors of all matters material to the value of an investment company in the prospectus. ICA Rule 35-1.(d) requires statement of types of investment companies in terms of risks, growth potential, terms, etc. in the prospectus which needs to be approved by the SEC as part of the registration statement. In particular, Section 21 of the ICA prohibits investment company's guaranteeing obligations. The SEC has a power to refuse to register and suspend an offering if the registration statement or prospectus is found to be unsatisfactory (Sections 13 and 15 of the SRC).</p> <p>As required by Section 24 of the ICA and Section 12 of the SRC, a prospectus is required for offering of investment company shares. The sections require disclosure of all material information. The requirements are irrespective of whether the offering is made through the internet. Either English or Tagalog or both is used for the prospectus although there is no specific requirement as to the language used.</p> <p>Along with the prospectus, brochures and/or advertisement documents are permitted to be used for marketing of an investment company. The same disclosure standards are applied to such marketing documents as to the prospectus. The prospectus is to contain all the conventional information expected from a public issue of securities but including some investment company-specific information such as the legal constitution, the investment policy, the fees and charges, the independent third parties and their responsibilities, etc.. However, these are not specifically and expressly required in the ICA or the IRR. As provided in SRC Rule 8.1-1 on Prospectus Delivery Rule, prospective investors must be offered the prospectus before the completion of an application form or the conclusion of a contract to purchase shares in an investment company. Use of an application form without prior provision of an offering document is subject to SEC sanctions which may be monetary fine, suspension or revocation of registration as provided by Sections 13, 15 and 54 of the SRC. SRC Rule 17 requires that the prospectus be kept up-to-date. Prior notification to the SEC is required of changes to information in the prospectus (SRC Rule 14 and Section 12 of the ICA). In particular, changes in investment policy must be voted for by shareholders. For changes which do not require prior shareholder approval, there is no specific requirement of sufficient advance notice, however.</p> <p>Section 27 of the ICA, Section 17 of the SRC and SRC Rule 17 provide a requirement to file annual and quarterly reports with the SEC and made available to shareholders and prospective investors. The annual report is required to be audited by independent auditor. Both annual and quarterly reports are required to contain certain information including accounting information, interests redeemed or repurchased, etc.. Key accounting standards to be adopted are stipulated in SRC Rule 68. ICA Rule 35-1.(e).(3) also requires daily publication of net asset value in two newspapers of general circulation. The rule 35-1.(e).(4) provides rules for valuation of net assets.</p> <p>Section 17 of the SRC and SRC Rule 17 require timely and accurate disclosure of material events to the shareholders (e.g., the merger or restructuring, the termination, changes of operating parties, etc.). Such disclosure is required to be made within five days from occurrence.</p>
Assessment	Partially implemented
Comments	Improvements are needed for, among other things, requirements for disclosure of sufficient information to evaluate investments and powers to enforce disclosure requirements, which are expected to be addressed by the RICA. While items for disclosure are well specified in SRC Rule 17, the ICA and the IRR do not expressly provide investment company-specific information requirements. The proposed RICA will incorporate the concept of full disclosure to complement the full disclosure requirements of the SRC. The SEC received TA in mid-June last year to upgrade the law.
<b>Principle 20.</b>	Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme.
Description	ICA Rule 35-1.(e).(4) provides basic rules for the net asset valuation. The rule 35-1.(e).(3)

	<p>requires daily publication of the net asset value in two newspapers of general circulation. Prospectus must also specify redemption policy and fees. The CIS operator is responsible for valuation of the assets and its publication. Independent external auditing is required only for the annual report but not for the daily valuation.</p> <p>ICA Rule 35.(e).(5) requires that payments for redemption be made within seven business days. Fees and charges are disclosed in the prospectus although there is no specific and explicit regulatory requirement as such.</p> <p>There is no specific rules or mechanisms of pricing control (e.g., regular reconciliation, periodic audit) to identify and rectify error, omissions or misplacement of assets. Nor are there any rules for addressing pricing errors such as: materiality benchmarks, benchmark triggering compensation, circumstances calling for enforcement actions, dispute resolution mechanism.</p> <p>ICA Rule 35-1.(e).(6) provides that the SEC may suspend or defer the redemption of open-end companies whenever necessary or appropriate in the public interest or for the protection of investors. This enables the SEC to intervene a possible run on an open-end fund and prevent a market panic. Investment company can also apply for the suspension or deferral by the SEC although there is no specific provision as such in the ICA or its IRR. There is no limit imposed by regulation on the amount of redemption allowed to be deferred on a daily or periodic basis. However, the SEC has a power to demand, delay or stop the deferral or suspension of redemption rights.</p>
Assessment	Partially implemented
Comments	<p>More detailed standards for asset valuation need to be developed. The existing Investment Company Act addresses the issue. However, the accounting practices need to be standardized (e.g., amortization). Improvements are needed for, among other things, requirements for valuation and disclosure of the value of interests in a CIS, capacity to enforce disclosure requirement, and requirements for pricing and redemption of units. The custodian bank may be required to control pricing and valuation by providing its net asset valuation to check the accuracy of the operator's valuation. Some rules may also be given to specify circumstances under which closed end funds may repurchase its shares. The SEC is waiting for passage of the RICA. In addition to the TA received in June 2000, the SEC is also working with the investment company industry to develop standards for net asset value calculation. While not a criterion of IOSCO Principles assessment, exchange trading of open-end investment companies may be considered.</p>
<b>Principle 21.</b>	<b>Regulation should provide for minimum entry standards for market intermediaries.</b>
Description	<p>The legal infrastructure for regulating market intermediaries has been enhanced in the SRC which, among other things, raises capital requirements (initial and ongoing), provides a disciplinary bar to registration, provides for indefinite registration, and clarifies that all regulated intermediaries must register under the new law.</p> <p>Investment Houses (Presidential Decree 129), Broker Dealers (SRC), Financing Companies (Financing Company Act of 1998) are primary NBFIs authorized and regulated by the SEC. Among them, the Investment Houses and Broker Dealers are the primary securities market intermediaries while the Financing Companies are essentially credit institutions without deposit taking. Among them, Investment Houses and Financing Companies are eligible for quasi-banking and trust licenses which are to be given by the BSP. The quasi-banking function is defined as borrowing from the public (i.e., more than 19 creditors). If they are licensed by the BSP for quasi-banking functions, they are to be supervised also by the BSP. Such borrowing from the public is considered as a "deposit substitute," and the borrowing intermediary is to be made subject to, among other things, the reserve requirement. The NBFIs can also be owned by or affiliated to Universal Banks or Commercial Banks, which can also be a ground on which the BSP exercises supervisory authority over them. Universal Banks themselves have the power of the Investment Houses (Section 23 of the General Banking Law) in themselves, and, therefore, can conduct all the securities business under its own roof, in which case they have to be registered as such with the SEC. So far, however, most Universal Banks have chosen to do the business through subsidiaries Investment Houses or Broker Dealers.</p>

	<p>Objectives of the licensing are generally stated in the PD 129 but not expressly stated in the SRC. However, those are implicit in the entry and revocation standards provided by the IRRs for the SRC (SRC Rules 28, 29 and 30) and the PD 129 (Rules and Regulation Section 3). PD 129 requires minimum paid-in capital of P300 million to establish an Investment House while SRC Rule 28 requires P100 million for a Broker Dealer. The entry standards other than the initial capital requirements include, among other things, adequate net capitals (SRC Rules 28.1-1 and 49.1-1), adequate operational system, proper book and records (Section 52 and SRC Rules 52.1-1 to 52.1-10), internal control, risk management and supervisory systems (SRC Rule 30.2-6), fit and proper directors (no record of criminality or violation of the Corporation Code in the past years) and professional qualification requirements for “Associated Person (i.e., a compliance officer)” and sales staff (SRC Rule 28.1.4) including the need of such associated person and staff for registration, a track record, etc.. The licensees are subject to on-going supervision of the SEC and the BSP as appropriate. Disciplines for violations of the law, and procedures governing default and financial failure are also provided (SRC Rules 29 and 33.2(d)-1). In addition, the PSE has imposed similar requirements under its rules. Those requirements are all available for the public through the laws and regulations some of which are available through the websites of the SEC, the BSP and the PSE.</p> <p>Sections 28.8 and 29 of the SRC provide that, after due notice and hearing, the SEC can refuse to license an applicant if it determines that prescribed conditions of the SRC and the IRR are not satisfied. Conditions for refusal can include a violation of SRO rules, conviction of any fraudulent acts or financial laws or rules and regulations of authorities in other jurisdictions although as a general rule, the SEC does not depend on judgments made by other jurisdictions. The entry standards must be met on an on-going basis in addition to other on-going requirements. If a licensee falls short of the requirements, the SEC can suspend or revoke the license or impose limitations on the activities to be carried out or sanctions, etc..</p> <p>The SEC also issued Model Internal Supervision, Control and Compliance Procedures to be adopted by Broker Dealers, Investment Houses and Universal Banks to comply with SRC Rules 30.2-6. SRC Rule 28.1-4 also provides a requirement of registration of “Associated Person” who is a compliance officer. Salesmen and Associated Person must pass qualifying examinations (i.e., Certified Securities Representative Exam and Certified Associated Person Exam) and meet other fit and proper tests including minimum 3 years of experience. All registered information is available for public view at the premises of the SEC. In particular, the names and addresses of registered Broker Dealers, Salesmen and Associated Person and orders of the SEC is recorded in the Register of Securities Market Professional and made available for public view at the premises of the SEC.</p> <p>Section 28.10 of the SRC and SRC Rule 28.1-1.5.n requires every broker dealer or person registered to report to the SEC on any changes (SEC Form 28-BDA) and keep the record current.</p>
Assessment	Implemented
Comments	<p>The scope of the SEC’ regulatory responsibility with respect to the variety of financial institutions is somewhat overly broad relative to its capacity and resources. Currently, the SEC is also to regulate Pre-Need Plans while the SEC’s regulatory authority over Lending Investors and Money Changers is somewhat unclear. For example, most, if not all, Lending Investors are single proprietorships and, therefore, not registered at the SEC as corporation or partnership. Instead, they are registered at the Department of Trade and Industry (DTI). In addition, there is no law to govern the business of Lending Investors. SEC’s power to regulate Pre-Needs is given by Section 16 of the SRC, and the SEC has issued the New Rules on the Registration and Sale of Pre-Need Plans in addition to SRC Rule 16.1-1 Transition Rule for Pre-Need Plans. However, the business of Pre-Need Plans is more similar by nature to that of insurance companies. The authority to regulate Pre-Needs is now expected to be transferred to the Insurance Commission. Even the Financing Companies are essentially credit institutions and not important intermediaries of the securities market while the business of Money Changers and Money Transmitters may be considered as “banking functions.” Further rationalizations of the</p>

	<p>scope of the SEC’s regulatory responsibility seems to be necessary in order to permit the SEC to focus on its core responsibility as the securities market regulatory and supervisory authority unless the Philippines should decide to create an integrated financial sector supervisor for the increasingly conglomerating/universalizing financial sector as a whole.</p> <p>The SEC is encouraged to make efforts to ensure the public’s easy access to the information regarding eligibility and qualification of intermediaries, their management and staff available for public view. The SEC is encouraged to avail the Register of Securities Market professionals through the internet to enhance accessibility to the information by the public (e.g., CDR or other similar systems of the National Futures Association of the US and others). While a licensed Broker Dealer is “required” to be a member of an SRO, it appears that SRC Rule 28.1-1.5 is referring generally to industry associations as SRO since, otherwise, all licensed Broker Dealers “must” be members of the PSE, which is not the case. The SEC may wish to clarify this point in the rule.</p>
<b>Principle 22.</b>	There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.
Description	<p>Section 4 of Presidential Decree No. 129 (PD 129) and Section 3 of the Basic Rules and Regulations to Implement the Provisions of PD 129 issued by the SEC provide the minimum entry standards for Investment Houses including the unimpaired paid-in capital of P300 million. Authorization of Broker Dealers is largely a business of re-authorization of the already existing Broker Dealers under the SRC which was issued in July 2000. SRC Rule 28 provides that P100 million unimpaired paid-in capital is required of the PSE member Broker Dealers which conduct market making. The brokerage-only PSE members are given time to meet the P100 million requirement till such time that they have chance to divest out of the PSE through its demutualization. Non-PSE member Broker Dealers, which deal only in proprietary shares, are required to have P5 million only. Government Securities Eligible Dealers (GSEDs) are also licensed by the SEC.</p> <p>SRC Rule 28.1-1.5 requires Broker Dealers (i.e., institutions with broker dealer business functions including Broker Dealers, Investment Houses and Universal Banks) to maintain Net Capital of P5 million or 5 percent of aggregate indebtedness whichever higher. “Net capital” is defined in SRC Rule 49.1-1.4 as the net worth of a Broker Dealer based on mark-to-market valuation and adjusted for: unrealized gains/losses, subordinated debt, revocable deposit for future equity subscription, fixed/illiquid assets, short positions in securities, etc.. In addition, 15 percent of surplus or indebtedness in the proprietary securities accounts and 100 percent of the carrying value of securities/indebtedness without market are to be deducted, which provide a buffer for risk. “Aggregate indebtedness” is defined as total money liabilities including money borrowed, money payable against securities borrowed and those failed to receive, the market value of securities borrowed, customers’ and non-customers’ free credit balances, and credit balances in customers’ and non-customers’ accounts having short positions with some exceptions. However, the Net Capital Rule does not takes into account activities of affiliated companies.</p> <p>Broker Dealers are required to calculate their Net Capital positions daily (SRC Rule 49.1-1), and the PSE members are required to report those monthly in writing (in Financial Operations or FINOP report which need not be audited) to the SEC and to the PSE for the members. When a Broker Dealer falls short of 120 percent of the required Net Capital or its aggregate indebtedness exceeds 1,700 percent of its adjusted Net Capital, the firm is required to report to the SEC within 24 hours and daily. The moment a firm falls short of the required level, it is required to cease the operation and infuse capital by way of equity capital or subordinated loan agreement. Examination of PSE member Broker Dealers are conducted by the PSE while the SEC also selectively examines some of them. It serves two purposes; i.e., i) ensuring proper examination of important or critical intermediaries, and ii) ensuring that the PSE is properly playing its role as an SRO. Investment Houses are not examined by the PSE but by the SEC.</p>
Assessment	Implemented
Comments	The Net Capital Rule is based primarily on balance sheet items of both short-term and long-

	<p>term nature reflecting concerns for both solvency and liquidity. Mark-to-market valuation is applied for the calculation while liquidity of certain assets and liabilities and off-balance sheet items are taken into account. Hair cuts are applied to illiquid assets to account for the risk depending on marketability of assets in question. Those include shares and securities of affiliates held for strategic purposes.</p> <p>The SEC plans to improve the monitoring of the net capital positions by computerization to achieve daily reporting/monitoring. It is also committed to taking enforcement actions. It is reviewing rules and procedures of the Securities Investor Protection Fund (SIPF) to ensure that in the event of insolvency of a brokerage firm, the SIPF is adequate and that customers are timely compensated. In addition, the SEC mandated the Securities Clearing Corporation of the Philippines (SCCP) to execute a “credit ring agreement (see Principle 24)” with its participants. However, the Rule is formulated for broker dealer business functions only. It is recommendable that the Net Capital Rule take into account not only the securities of affiliated companies but also their activities.</p>
<p><b>Principle 23.</b></p>	<p>Market intermediaries should be required to comply with standards for internal organization and operational conduct that aim to protect the interests of clients, ensure proper management of risk, and under which management of the intermediary accepts primary responsibility for these matters.</p>
<p>Description</p>	<p>The SRC clarified the protection available by requiring associated persons(e.g., supervisory personnel) of brokers and dealers to register with the SEC, imposed attendant liability thereon, provided the SEC with rulemaking power thereunder, and expanded the types of sanctions available for violation of such standards.</p> <p>Section 30 of the SRC and SRC Rule 30.2-6 provide a requirement and basic rules for sound internal control and supervision. Associated Person, which every licensed Broker Dealer must have, is responsible for supervising compliance with such rules and procedures (“Compliance Officer” in case of Investment Houses without broker dealer functions). This requirement will soon be extended to other market intermediaries. SRC Rule 28.1-4 also provides a requirement of registration of “Associated Person”. Associated Person must pass qualifying examinations (i.e., Certified Associated Person Exam) and meet other fit and proper tests including minimum 3 years of experience. The SEC also issued in August this year Model Internal Supervision, Control and Compliance Procedures to be adopted by Broker Dealers, Investment Houses and Universal Banks to comply with SRC Rules 30.2-6. Such internal control system and procedures are required to be evaluated periodically by the Associated person and as part of the PSE member inspection as well as the supplementary SEC oversight audit. The Associated Person reports to the management of the firm while the PSE’s Compliance Audit Department (CAD) reports to its Business Conduct and Ethics Committee and to the Market Regulation Department of the SEC. The Associated Person is to conduct such internal assessment daily while the PSE inspects all its members (200 Seats though not all filled) in an about two year cycle. The PSE submits to the SEC its examination calendar of the year by January 15 every year.</p> <p>SRC Rules 28.1-1.5 and 52.1-10 provides, among other things, a requirement of segregated accounts for clients and the firm and safekeeping of client’s assets. SRC Rule 32.2(a)-2 requires Best Execution of customer orders. Section 34 of the SRC and SEC Order on Customer First Rule prohibits front running by Broker Dealers. Now the PSE MakTrade ensures by its system design priority execution of customer order ahead of the member’s proprietary orders. Having ensured the effectiveness of this mechanism, the SEC now permits dealing operations by brokers under the SRC. However, Section 34 of the SRC and SRC Rule 34.1-2 requires segregation of broker and dealer functions. SRC Rule 34.1-3 further requires “Chinese Wall” to segregate the functions and control information flows between the two. The Model Internal Procedures also include further details for the Chinese Wall. The Ethical Standards Rule also includes rules for handling of conflicts of interest including those among clients as well as with the Broker Dealer.</p> <p>Other important rules for intermediaries include sub-rules of SRC Rule 30 (i.e., Rule 30.1 on</p>

	<p>Monitoring of Affiliated Transactions by Broker Dealer, Rule 30.2-1 on Ethical Standards Rule, Rule 30.2-2 on Confirmation of Customer Orders, Rule 30.2-3 on Client Agreement, Rule 30.2-4 on Suitability Rule, i.e., (together with SRC Rule 30.2-1.2.d, Know-Your-Client rule), and Rule 30.2-5 on Commissions and Charges for Services Performed by Broker Dealer). SRC Rule 24 also provide in its sub-rules 24.1(b)-1 on Manipulative Practices, 24.1(d)-1 on Advertisements and Communications with the Public, and 24.2-3 on Prohibition of Guarantees against Loss. SRC Rule 52 provides in 52.1-8 on Customer Account Statements and 52.1-9 on Customer Complaint Rule. The rule 30.2-3 requires that a Client Agreement, which specifies in details terms of the contract including identities of the client and the Broker Dealer, the nature of the services, fees, etc. as well as risk disclosure, be signed before transacting or providing any services. In case of subscription of a public offering, the prospectus must also be provided for the client. The rule 30.2-2 provides executed transactions be reported immediately to the clients and be followed by a Confirmation Advice the following day. The rule 52.1-8 requires quarterly statements of accounts be sent to the clients. As part of the Ethical Standards Rule, SRC Rule 30.2-1.d together with SRC Rule 30.2-4 provides an obligation of an intermediary to obtain information from its client including the financial circumstances and investment objectives of the clients. Customer Account Information Form (CAIF) and Client Agreement (CA) provided for clients also include additional information regarding the intermediary including proprietary trading activities, businesses in which the firm is engaged, overall risk profile (position limit), margin trading, principal trading with customer (counterparty exposure, etc.</p>
Assessment	Implemented
Comments	<p>In August 2001, Compliance Audit Dept. (CAD) of the Compliance and Surveillance Group of the PSE audited 23 member broker dealers. Out of the 23, it found two firms fully compliant with all requirements. Rules which are more often violated include SRC Rule 50-1 on Purchases and Sales in Cash Account (11 violations), SRC Rule 52.1-6 Customer Account Information Rule (9 violations), SRC Rule 52.1-7 Order Ticket Rule (9 violations), SRC Rule 30.2-2 Confirmation of Customer Orders (8 violations), SRC Rule 34.1-2 Segregation of Broker and Dealer Function Affiliation and Practices (7 violations), SRC Rule 52.1-1 Books and Records Rule (4 violations), SRC Rule 30.2-3 Client Agreement (3 violations), SRC Rule 49.2-1 Customer Protection Reserves and Custody of Securities (3 violations), SRC Rule 52.1-8 Customer Account Statement (3 violations), SRC Rule 49.2-1 Net Capital Rule (2 violations), SRC Rule 52.1-10 Quarterly Securities Counts by Broker Dealers (2 violations), SRC Rule 24(b)-1 Manipulative Practices (1 violation), SRC Rule 28.1-4 Registration of Salesmen and Associated Persons of Broker Dealer (1 violation), SRC Rule 48.1-1 Margin Rule (1 violation), and SRC Rule 30.2-6 Supervision (1 violation). Due to the depressed market, many broker dealers are struggling to survive and losing attention to their internal control. The SEC and the PSE are taking corrective actions against those. It is noteworthy that the Model Internal Supervision, Control and Compliance Procedures include rules for Detection of Money Laundering.</p>
<b>Principle 24.</b>	<p>There should be a procedure for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk.</p>
Description	<p>On the basis of Section 33.1.(d) of the SRC, SRC Rule 33.2(d)-1 provides for Protection of Customer Accounts in Case of Business Failure of an Exchange Member. Under the rule, an Exchange is required, based on an order of the SEC, to suspend failed intermediary's membership, immediately arrange for another member to take over the outstanding contracts relating to securities and simultaneously notify the SEC of such suspension and take-over. The Exchange is to notify customers of the failed member that their accounts have been transferred to another member, and provide such customers with the opportunity to re-transfer their accounts to another member of their choice. The Exchange is to settle the failed member's liabilities to customers through the sale of the member's seat or trading rights, liquidation of the paid up capital, etc. If there are still outstanding liabilities to the customers after such settlement, the Exchange is to transfer those to the Securities Investor Protection Fund</p>

	<p>(established under Section 36.5 of the SRC), so inform the customers and advise on procedures for claiming compensation for the uncovered losses. The Rules and Regulations for the Implementation of the SIPF provides such procedures.</p> <p>On the other hand, Section 29 of the SRC and SRC Rule 29 provide for Protection of Customer Accounts where the SEC suspends or revokes registration of broker dealer. Under the circumstance, the Exchange is to immediately arrange for another member to take over any outstanding contracts relating to securities, simultaneously notify the SEC in writing of such transfer and any affected customers of the fact, and provide such customers with the opportunity to re-transfer their account to another broker dealer of their choice. If the suspended/revoked broker dealer is not a member of an Exchange, the SEC is to notify affected customers of the suspension/revocation and require that they transfer their account to another broker dealer. The Net Capital Rule provides opportunities for the SEC and the Exchange to monitor the solvency of intermediaries and intervene before any intermediary become fully insolvent. The SRC provides full autonomy for an Exchange to act on member's insolvency under the supervision of the SEC.</p>
Assessment	Implemented
Comments	The SIPF is funded with monthly member contributions of P10,000 plus one 0.0002 percent of each member's gross trading volume. The SIPF is to cover up to P100,000 per customer. The SIPF has so far not been mobilized to act on a broker dealer insolvency.
<b>Principle 25.</b>	The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.
Description	<p>The SEC authorizes establishment of an Exchange through the registration requirement under Section 33 of the SRC, and the registration is a requirement for any market participants to use the Exchange (Section 32.1 of the SRC). Section 32.2(a) and (b) leave a possibility for the SEC to permit Electronic Communication Network (ECN) type market. However, the SEC may require such a market to be administered by an SRO to ensure investor protection and fair footing with a registered Exchange(s). Section 33.2 of the SRC and SRC Rule 33.1 provide criteria for the registration and require filing of SEC Form 33. An eligible applicant for registration must be able to comply and enforce compliance by its members with the SRC, the IRR and the rules of the Exchange. It must file the organizational charts, rules of procedures and ethics and a list of its officers and members. It also must have a capacity and procedures to deal with a failure of a member.</p> <p>To be registered, the applicant must be a stock corporation. It must also be engaged solely in the business of operating an Exchange although a holding company for an Exchange is permitted by SRC Rule 33.2(b). Section 33.2(d) of the SRC requires an ability and willingness to discipline a member in case of violation of the just and equitable principles of fair trade. Procedures for such disciplining, the denial of membership, and the prohibition or limitation of access must be fair and equitably applied (Section 33.2(e)). Section 33.2(c), (f), (g) and (h) provide core rules of ownership and governance of the Exchange to ensure that it operates fairly for all members while balancing different interests. In particular, it is meant to protect interest of investors over that of member brokers and dealers. 33.2(j) requires equitable allocation of reasonable fees for members, issuers and other users of the Exchange. These are among the critical conditions for sound self-regulation. In addition, 33.2(i) and (k) requires transparency of transactions and prevention of fraudulent and manipulative acts on the Exchange. Finally, 33.2(l) requires transparent, prompt and accurate clearance and settlement. These are some of the critical technical competencies of a trading market.</p> <p>Other conventional competency requirements for a trading system operator including the market structure, standards applicable to direct users, rules for listing and trading and financial soundness are provided as part of the requirements as an SRO (SRC Rule 39.1-1). However, a requirement of a backup system is included in neither the requirements for a registered Exchange nor those for an SRO. Neither the SRC or the IRR provide elaboration on the possibility of differentiated market access and specific types of market permitted such as organized membership exchange, inter-dealer market, telephone market, electronic trade</p>

	<p>matching system, electronic bulletin board, proprietary trading system, automated order routing system provided by an intermediary or other third party.</p> <p>The SEC considers trading and settlement procedures a responsibility of the PSE as an SRO rather than of the SEC. The SEC does not have a specific oversight program for the PSE. The SEC should audit an Exchange also in terms of its proper handling of errors, cancellation of trades, disputes resolution and appeal procedures, unmatched trades, modification of orders, and operational failures. An Exchange should provide the SEC with information on those. An Exchange should also be required to avail audit trail for the SEC's review. Their record keeping system and capability themselves should be a subject of SEC audit. However, the SEC and the PSE hold monthly meeting where directors of the PSE and the chairman and commissioners/senior staff of the SEC meet and discuss various issues extensively. Official communications and orders from the SEC are documented in letters to the PSE which are disclosed while detailed minutes of the meeting are not disclosed.</p> <p>Sections 32.2, 33 and 37 of the SRC appears to accommodate innovative market structures such as ECNs. Currently, only the PSE is an authorized Exchange while reopening of a Commodity Futures Exchange is under consideration. There is also a Fixed Income Exchange (FIE) being planned by the Bankers' Association. There is considerable chance that the FIE, when established, will adopt more open but differentiated or discriminating access to the market and its information. Currently, only factor of differentiation appears to be adequacy of Net Capital of the participants.</p> <p>The basis for the SEC to assert jurisdiction over an Exchange is comprehensive and includes: i) the physical location of the Exchange, ii) physical component located in the jurisdiction, iii) legal entity without physical presence, iv) legal entity and physical presence without domestic customers, or foreign system which could be directly or indirectly (i.e., through intermediary's order routing system) can be accessed by customers located inside the jurisdiction of the Republic of the Philippines.</p> <p>If an applicant for an Exchange license wishes to apply also for an SRO license, it may do so by filing SEC Form 33-SRO under Section 40 of the SRC. Currently, the PSE is the only authorized SRO. While the PSE has been corporatized and due to go public to complete the demutualization in near future, its SRO responsibilities are to remain. In fact, implementation of the corporatization and associated introduction of non-broker directors to the Board of the PSE were a key condition to restore its once suspended SRO status. Such a governance reform has enabled and will further enable better control of conflicts of interest of what used to be a member-driven club. SRC Rule 33.2(c) provides for a possibility to adopt a holding company to own an Exchange as a corporation and for separation of ownership and participation in the Exchange and associated reform of the board of directors of the PSE. The rule also provides the same ownership and governance rules as provided by part of Section 33.2 of the SRC (i.e., majority of the members of the board must consist of independent directors and persons who represent the interest of issuers, investors and/or other market participants not associated with any broker dealer or member of the Exchange. No person can own voting shares of an Exchange more than 5 percent, and no industry or interest group can own such shares more than 20 percent, to ensure diversification of control interest).</p> <p>Suspension or halt of trading is to be exercised by the PSE and not by the SEC under the current framework. The SEC should retain the option to directly intervene the market when deemed necessary (e.g., leak of price sensitive information). The SEC should review to ensure that the PSE's position limits and margin rules are prudent and its rules to encompass the timing of disclosure (e.g., after the market is closed) of price sensitive information.</p>
Assessment	Partially Implemented
Comments	<p>Modern market regulation requires consideration of complex policy issues. It is not clear whether the current regulatory framework for an Exchange is a result of such consideration; i.e., there are some unconventional but sound measures and some other unconventional and unsound measures, aside from conventional ones. Generally, the SEC's control over the PSE as a trading market is somewhat loose while that over it as an SRO is tight. For example, the requirements</p>

	<p>for registration of an Exchange do not expressly include establishment of listing standards. The SEC seems to see it as a prerogative of an Exchange. Other conventional requirements for a trading system operator such as market structure or the type of market, standards applicable to direct users and product types are covered as the criteria for an SRO. It is more appropriate to cover those as part of requirements for a registered Exchange rather than an SRO. Currently, a requirement that a registered Exchange must be an SRO eliminates a possibility of a registered Exchange escaping from those. However, appropriateness of this cross requirement itself may need to be reviewed as the demutualized PSE and other new exchanges start competing for profit. A requirement of a sound backup arrangement should also be expressly required.</p> <p>The regulatory framework could elaborate more on the access criteria and market structure. While the current framework seems flexible to accommodate or reject any access rules as long as it is an registered Exchange which is an SRO, it is not clear where the SEC’s policy stands with respect to possible differentiated market access for different types/levels of participants in the prospective Fixed Income Exchange, for example. The Bureau of Treasury is trying to reform the primary market and GSEDs and plans to introduce different levels of market participants such as Market Makers, Dealers and Agents. In this context, there may emerge an issue of whether or not to permit direct access by clients of GSEDs (e.g., insurance companies, mutual funds). It is possible, if not likely, that the Fixed Income Exchange will have to offer only limited access for the institutional investors. The SRC and particularly the IRR may need to provide general but sound rules to guide such differentiation of access so as to ensure that the market will be efficient without sacrificing fairness and transparency.</p> <p>While the general (i.e., non-specific) definition of an Exchange may be intended to accommodate various innovative forms of exchanges, the regulation can provide more aspects or qualities of a sound market. The regulation could define more clearly the concept of Exchange in order to differentiate better an Exchange and other quasi organized market. The Fixed Income Exchange is likely to be an electronic, virtual market without physical presence. The omission of the listing standards from the required elements may accidentally work well for the advantage in regulating the market in the future. That is because the demutualization for profit and the self-regulation may come to conflict when the inter-market competition intensifies domestically and/or internationally. However, a clearer conceptual definition of an organized Exchange is still needed.</p> <p>Where a market outsources core operational responsibilities or functions, the SEC should be informed of the arrangements.</p> <p>With the expected development of the debt market, interest rate derivatives are likely to be an important instruments with real demand for use especially given the fact that a requirement of market making is likely to be adopted by the Bureau of Treasury.</p>
<b>Principle 26.</b>	<p>There should be ongoing regulatory supervision of exchanges and trading systems, which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.</p>
Description	<p>The SEC conducts continuous oversight over the PSE. All trading rules of the Exchange are reviewed by the SEC for consistency with the SRC. The registration criterion (Section 33.2.(d) and corresponding Rules) requires a registered Exchange to enforce its rules onto the members. The PSE has reconfigured its MakTrade to ensure implementation of the Customer First Rule for execution of trades, which is a commendable achievement. The SEC has reviewed the rules and the system and approved it. The new system and rules allow more flexible and less stringent internal control requirements for market participants without sacrificing investor protection.</p> <p>The SEC currently does not have monitoring access to the PSE’s surveillance system. However, the SEC has recently approved the Rules of the Exchange governing unusual trading conditions, and the PSE is currently upgrading the surveillance system subject to approval by the SEC. The existing system is arbitrary and inadequate (i.e., only price band and only one arbitrary price band, i.e., 50 percent ceiling and 40 percent floor, for all securities to flag abnormal movements in the market). The PSE is working on establishing a unique price band for each issuer/class of</p>

	<p>securities. The new system is also expected to be able to flag trade concentration among the market participants, accumulation of positions, volume as well as price movements including combined movements, etc. The new system and rules should provide the Exchange more flexibility to respond to unusual situations. The SEC should be provided with a terminal to monitor not only the market activities but also the PSE's surveillance activities.</p> <p>The SEC does not have clear authority to re-examine or withdraw registration of an exchange. Its authority to modify rules or order a registered Exchange to take particular actions is also not clear once it has registered it.</p>
Assessment	Partially Implemented
Comments	The SEC's oversight authority over the PSE is limited and inadequate. More generally, the SEC should gain more control in authorizing and supervising an Exchange when there will emerge more than one exchange competing for profit. When new exchanges with different trading algorithm and market structure emerge, different surveillance procedures will have to be developed for those markets.
<b>Principle 27.</b>	<b>Regulation should promote transparency of trading.</b>
Description	Section 33.2(i) generally but expressly requires the transparency of transactions as part of the registration requirements for an Exchange. The SRC and the IRR and most PSE rules promote public disclosure of information about trading on a real time basis. Moreover, there have been a number of information vendors which have officially interlinked with the PSE trading system for the purpose of providing "pre, post and real time" trading information. Some of these could even provide an integrated "front end" and "back room" services. The PSE is currently developing an "automated disclosure" system which could be accessed on-line by interested parties. Lack of funding has slowed its development. The system is expected in 2002.
Assessment	Implemented
Comments	While the price transparency of the current PSE system is adequate, there should be more specific rules of transparency which differently structured markets can adopt. For example, pre-trade price information should be accessed equally by all direct participants of an Exchange. However, the market should provide pre-trade anonymity with regard to the identify of the investors or intermediaries, while the market operator and the SEC should have access to the pre-trade information on the identity of the market participants for the purpose of surveillance. On the other hand, post trade price and volume information should be available widely for the public. Etc.
<b>Principle 28.</b>	<b>Regulation should be designed to detect and deter manipulation and other unfair trading practices.</b>
Description	<p>Section 24 of the SRC provides prohibition of manipulative practices (market cornering, misleading statements, etc.). SRC Rule 24.1(b)-1 substantiates the prohibition with further details. Section 26 of the SRC expressly prohibits fraudulent transactions. SRC 32.2(a)-2 provides broker's duty of Best Execution for customers. The SEC issued Customer First Rule to prevent front running. The PSE reconfigured its MakTrade to automatically ensure implementation of the Customer First Rule. Section 33.2(k) of the SRC generally but expressly requires a registered Exchange to prevent fraudulent and manipulative acts and practices and promote just and equitable principles of trade.</p> <p>The SEC has administrative powers to obtain compliance with the SRC and other laws it administer. Section 54 provides powers for the SEC to impose administrative sanctions against manipulative and fraudulent practices. Such sanctions include disqualification of officers, fine, etc. Sections 58 and 59 of the SRC provide Civil Liability for Fraud in Securities Transactions and for Manipulation, respectively. Section 61 provides Civil Liability on Insider Trading. Section 64 of the SRC provides the SEC with a power to issue Cease and Desist orders to halt or suspend trading. The surveillance function of the PSE can be outsourced (i.e., no legal restriction). However, the PSE directly surveys its market. The SEC currently uses Technistock, a market-related database system operated by a private information vendor, to survey the market movements, activities and conducts. The SEC has sufficient power to compel inspection of systems within the limit of Constitutional Rights. In addition to the reporting requirements</p>

	and listing criteria, the PSE also imposes market position limits and requires settlement price. The SEC can also force broker deals to liquidate positions. The SEC and the PSE as the SRO have information sharing arrangements, arrangements to provide assistance in inspection, investigation and surveillance.
Assessment	Partially implemented
Comments	The legal and regulatory prohibitions, administrative powers and civil liabilities are sound. The new market surveillance system of the PSE which is being tested currently and soon to be introduced reflects significant improvements to the existing system. However, the SEC needs to gain direct monitoring access to it. The SEC should have a clearly defined power to require the PSE and any prospective trading market operators to provide it with monitoring access to the surveillance systems and use the power.
<b>Principle 29.</b>	Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.
Description	<p>The PSE (its Compliance and Surveillance Group) as an SRO is required to maintain fair and orderly market (Section 40.3(c), 40.4(b)). The SEC also has a power to require the PSE as an SRO to maintain order in the market. Section 42.2(f) provides that a Clearing Agency must establish and oversee a fund to guarantee the prompt and accurate clearance and settlement of transactions executed on an Exchange with contributions from members, based on their trading volume and a relevant percentage of the daily exposure of the four largest trading brokers. The Securities Clearing Corporation of the Philippines (SCCP), to which all broker dealers are members, has a “fails management system” wherein any undelivered shares will have to be bought by making use of the Trade Clearing and Guarantee Fund (TCGF). In the same manner, any unpaid shares be sold in the market to close out the exposure. Incidental cost incurred is charged to the defaulting broker.</p> <p>There is also a “credit ring agreement” between the SCCP and its participants wherein the latter agree that they will contribute should the TCFG be insufficient to cover the deficiency incurred. Likewise, the SCCP has also installed other risk management measures such as: a) early settlement mechanism for volatile issues and/or brokers who are at risk, and b) brokers have the option to pay their obligations or deliver their shares ahead of settlement date to cover their negative market exposure. SCCP is required to report any breach or potential breach of its rules and material financial difficulty of its member immediately to the SEC. All these rules and arrangements of the SCCP are public information.</p> <p>Registered market participants and PSE members are required to comply with Margin Rule (SRC Rule 48.1-1) and Net Capital Rule (SRC Rule 49.1-1) which are set by the SEC on the basis of Sections 48 and 50 and 49 of the SRC, respectively. If a market participant does not make information on its exposure available, it can be imposed limitations on future trading, required to liquidate the position, revoked of trading privilege, or suspended from trading. Stock lending and borrowing is permitted based on the SB &amp; L Rules of the PSE.</p>
Assessment	Implemented
Comments	The SEC intends to soon amend requirements to increase the size of broker contributions to the Trade Clearing and Guarantee Fund (TCGF) to adequately reflect risk exposure. Improvements are needed also in short-selling, netting, securities borrowing, regulation and Securities Investor Protection Fund (SIPF)
<b>Principle 30.</b>	Systems for clearing and settlement of securities transactions should be subject to regulatory oversight, and designed to ensure that they are fair, effective and efficient and that they reduce systemic risk.
Description	The legal infrastructure for effectively regulating the clearance and settlement of securities and the reduction of systemic risk is provided for in rules adopted under the SRC, IRR and in related SEC Orders. Section 42 of the SRC and SRC Rule 42-1 stipulates a requirement of registration of Clearing Agencies (SEC Form 42-CA). Rules and Operating Procedures of the SCCP are approved by the SEC under the SRC and the IRR and available to the market participants. SRC Rule 40.5.1 provides the SEC’s powers over Clearing Agencies as well as

	<p>Exchanges and SROs. Registered Clearing Agencies (i.e., including SCCP, PCD) are required to file audited balance sheet and income statement annually. SRC Rule 42-2 requires a registered Clearing Agency to report to the SEC of any breach or potential breach of the Agency's rules by its members or operational/financial difficulties to the SEC immediately. In addition, the SEC is studying a need of inspecting the SCCP regularly.</p> <p>There are performance measures of the SCCP and PCD with respect to: i) trade matching and its time frame (daily), ii) transmission of transactions data by the market to the SCCP and PCD, iii) PCD for the purpose of immobilizing or dematerializing (before trading), iv) bookentry systems for the movement of securities and payments (PCD), and v) trade settlement and the time frame for settlement (T+3). Allocation of executed trades to clearing members is achieved in T+4.</p> <p>Risk management measures adopted by SCCP and PCD include: i) safeguard to protect securities, funds and related records, ii) safeguard to assure the integrity of electronic data, iii) DVP on a net-net basis, iv) Net Capital Rules, v) identification of monitoring of risks of individual failure and overall risk to the system on an on-going basis, vi) symmetric settlement of derivative pays and collects, vii) insurance coverage, and viii) permitted settlement funds.</p> <p>The SIPF adopted: a guarantee fund, a backup system, access to margin and other collateral. And liquidity facilities. The margin requirements are set by the SEC to cover the risk of default by a market participants as a result of market movements in individual instruments and changes in market volatility. SCCP uses intra-day settlements to cover volatility of derivatives trading. Both securities and cash are netted daily. The BSP is currently working on developing a RTGS system. Order and price (50 percent up and 40 percent down) limits are used to control participants' exposure and market volatility. Trading halt can be called to control the market but no automatic circuit breaker. Margin rules provide that broker can extend up to 50 percent of the transaction value. Brokers transactions are monitored by the CSG of the PSE and financial stability monitored by SCCP. Rules on short selling have been approved but not yet operational while the Securities Borrowing and Lending Rules are being formalized by the PSE.</p>
Assessment	Implemented
Comments	<p>The SEC recently amended requirements to increase the size of broker contributions to the Trade Clearing and Guarantee Fund (TCGF) to adequately reflect risk exposure. Improvements are needed also in short-selling, netting, securities borrowing, regulation and the SIPF.</p> <p>Impediments have been resistance of the brokers many of which are struggling to survive in the current depressed market. The SEC is working with the brokers to educate them on the need to incorporate international best practice standards and slowly convincing them to support the SEC's efforts. The SEC is slowly but surely winning the broker dealers to its side.</p> <p>The SEC is closely working with the PSE and the brokers to educate them on the need for centralized clearing and settlement, the importance of the TCGF and the rule of the SCCP. In addition, the SRC codified the rule and regulation of clearing agencies and the TCGF and provided the SEC with additional oversight powers. Last 17 April 2000, SCCP started imposing sanctions and collecting fines and penalties for settlement violations while on 01 May 2000, the SCCP commenced a Mark to Market Collateralization System. The SEC hopes by the end of September, the SCCP shall have executed a "credit ring agreement" with all its participants.</p>

**Table of observance of individual principles**

Table 3. Compliance with the IOSCO Objectives and Principles of Securities Regulation

Principle	Gradings				Comments and Corrective Actions
	I <sup>1/</sup>	PI <sup>2/</sup>	NI <sup>3/</sup>	NA <sup>4/</sup>	
1. The responsibilities of the regulator should be clear and objectively stated.	X				The MOA together with the SRC and the New Central Bank Act filled loopholes, rationalized the responsibility sharing arrangements and made those clearer to the regulated. The possible transfer of the responsibility to regulate and supervise Pre-Need Plans to the Insurance Supervisory Commission, if and when occurs, should further rationalize the responsibilities of the SEC.
2. The regulator should be operationally independent and accountable in the exercise of its functions and powers.	X				While the SEC operates independently and accountably in practice, the practice and the underlying laws could be made more consistent with each other.
3. The regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers.	X				Interpretation of the SRC to provide adequate resources for the SEC has been confirmed.
4. The regulator should adopt clear and consistent regulatory processes.	X				
5. The staff of the regulator should observe the highest professional standards including appropriate standards of confidentiality.	X				Key elements to ensure highest professional conducts of the staff have been provided in both the SRC and the IRR. The combination of the indemnity and the enhanced salary also provide strong incentives to comply.
6. The regulatory regime should make appropriate use of Self-Regulatory Organizations (SROs) that exercise some direct oversight responsibility for their respective areas of competence, and to the extent appropriate to the size and complexity of the markets.		X			The framework created by the SRC is sound. Diversification of the ownership of the PSE is awaited as the final step to complete full implementation. Establishment of the CFE and the FIE may call for a review of the self-regulatory policy, however.
7. SROs should be subject to the oversight of the regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.	X				The SEC is encouraged to develop a specific supervisory program for the PSE and forthcoming SROs.
8. The regulator should have comprehensive inspection, investigation and surveillance powers.	X				
9. The regulator should have comprehensive enforcement powers.	X				

10. The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.		X			The SEC is in the process to complete the staffing and MIS capacity building to fully implement the SRC which emphasizes enforcement. The assessment is near "Implemented."
11. The regulator should have authority to share both public and non-public information with domestic and foreign counterparts.	X				
12. Regulators should establish information sharing mechanisms that set out when and how they will share both public and non-public information with their domestic and foreign counterparts.		X			Finalization of the MOU with BAPEPAM and working relationships with the PSE is awaited. The assessment is near "Implemented".
13. The regulatory system should allow for assistance to be provided to foreign regulators who need to make inquiries in the discharge of their functions and exercise of their powers.	X				
14. There should be full, accurate and timely disclosure of financial results and other information that is material to investors' decisions.	X				
15. Holders of securities in a company should be treated in a fair and equitable manner.	X				Code of Corporate Governance has recently been issued and compliance with it has been mandated.
16. Accounting and auditing standards should be of a high and internationally acceptable quality.	X				
17. The regulatory system should set standards for the eligibility and the regulation of those who wish to market or operate a collective investment scheme.		X			Passage of RICA is awaited to bring investment advisors under the SEC regulation.
18. The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.		X			Passage of RICA is awaited to strengthen regulation of related party transactions. Passage of RICA is awaited to provide rules for segregation of clients' assets and delegation of functions.
19. Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme.		X			Passage of RICA is awaited to provide for requirements for disclosure of investment company-specific information and powers to enforce the disclosure requirements.
20. Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme.		X			Development of standards for net asset value calculation and accounting for amortization is awaited. Requirements for disclosure of the value of interests in a CIS, capacity to enforce disclosure requirement, and pricing and redemption of units need to be improved. Role of custodians may be strengthened, and circumstances under which closed end funds may repurchase its shares may be specified.

21. Regulation should provide for minimum entry standards for market intermediaries.	X				While the minimum standards are adequately provided, SEC's regulatory authority over different types of nonbank financial institutions needs to be rationalized.
22. There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.	X				SEC is introducing computerized monitoring of the net capital positions by to achieve daily reporting/monitoring. The Net Capital Rule could take into account not only the securities of affiliated companies but also their activities.
23. Market intermediaries should be required to comply with standards for internal organization and operational conduct that aim to protect the interests of clients, ensure proper management of risk, and under which management of the intermediary accepts primary responsibility for these matters.	X				
24. There should be a procedure for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk.	X				
25. The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.		X			The concept of Exchange could be defined more clearly. Market structure and access criteria could be elaborated.
26. There should be ongoing regulatory supervision of exchanges and trading systems, which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.		X			The SEC should develop a specific oversight program for the PSE and prospective trading markets. Its authority to reexamine and withdraw the registration should be clarified.
27. Regulation should promote transparency of trading.	X				
28. Regulation should be designed to detect and deter manipulation and other unfair trading practices.		X			SEC should gain direct monitoring access to the new market surveillance system developed by the PSE and those of prospective trading markets.
29. Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.	X				
30. Systems for clearing and settlement of securities transactions should be subject to regulatory oversight, and designed to ensure that they are fair, effective and efficient and that they reduce systemic risk.	X				

<sup>1/</sup> I: Implemented.

<sup>2/</sup> PI: Partially Implemented.

<sup>3/</sup> NI: Not Implemented.

<sup>4/</sup> NA: Not applicable.

### III. RECOMMENDED PLAN OF ACTION AND SUPERVISORY RESPONSE TO THE ASSESSMENT

#### A. Supervisory Response

37. **Principles relating to the regulators (CPs 1–5).** The SEC shall intensify the in-house training of its staff to enhance their skills on market surveillance, investigation and enforcement. The full computerization of our data is also going on. The Manual of Operations and Procedures for the staff is being reviewed and revised for simplicity and clarity.
38. **Principles of self-regulation (CPs 6–7).** The listing of the PSE is the second phase of demutualization. The Board is only waiting for the right time to go public. In the meantime, to implement the provisions of the SRC on the 20 percent ownership cap of broker dealers, the SEC has directed the PSE to offer its shares to institutional investors and has likewise suggested the ADB and the IFC to consider taking a stake in the Exchange. Discussions on ensuring the independence of the Compliance and Surveillance Group of the PSE (CSG-PSE) is being undertaken by the Market Regulation Department of the SEC. Although the PSE-CSG has already been incorporated as separate entity from that of the PSE, the PSE President has requested for the delay of the operationalization of the CSG-PSE as an independent SRO as the PSE tries to study ways of achieving full independence of the CSG while remaining part of the PSE organizational structure.
39. **Principles for the enforcement of securities regulations (CPs 8–10).** On April 16, 2002, the SEC has operationalized its on-line filing for the registration of companies. Thereafter, reportorial requirements shall be filed electronically. Even the net-capital requirements from broker dealers shall be electronically fined and analyzed by our MRD.
40. **Principles for cooperation in regulation (CPs 11–13).** The SEC recently acquired a favorable endorsement from the Department of Foreign Affairs (DFA) to enter into MOU with its counterparts. It is currently finalizing an MOU with Indonesia's BAPEPAM. Similar agreements with other regulators are being considered.
41. **Principles for issuers (CPs 14–16).** The SEC has recently approved the *Code of Corporate Governance* which shall be "mandatory" for all corporations whose securities are registered or listed, corporations which are grantees of permits/licenses and secondary franchise from the SEC and public companies.
42. **Principles for collective investment schemes (CPs 17–20).** The SEC hopes that the Revised Investment Company Act will soon be passed into law by this year. While the SEC is ready to appear any time before Congressional hearings, it has no control of what the priority Bills and schedule of our lawmakers are.
43. **Principles for market intermediaries (CPS 21–24).** The system to monitor Net Capital of brokers dealers is now being prepared by our MIS in cooperation with our MRD. The SEC hopes before the end of the second quarter, a system for testing shall be ready.

44. **Principles for the secondary market (CPs 25–30).** With the establishment and operationalization of the Fixed Income Exchange (FIE) and the revival of the Futures Exchange, the FSAP mission raised concerns that competition emerging among markets may raise doubts about credibility of their self-regulatory functions. The mission has thus suggested that the SEC provide key benchmarks through Rules and/or Orders to define what its concept of Philippine capital markets is in an environment where various exchanges compete as for-profit businesses. The SEC shall take note of this suggestion and will see to it that the mission’s concerns will be properly addressed.

### **B. Recommended Action**

45. Overall, the Philippines scores very well against the IOSCO Principles thanks to the conscious efforts having been made in the recent past. Some improvements are needed in the areas of collective investment schemes and secondary market regulation. Remaining issues in other areas are either currently being addressed or relatively minor.

Table 4. Recommended Actions to Improve Compliance with the IOSCO Objectives and Principles of Securities Regulation

Subject	Recommended Action and Time-Frame
Principles relating to the regulator, (CPs 1–5)	In-house training of the SEC staff to enhance their skills on market surveillance, investigation and enforcement should be strengthened. The Manual of Operations and Procedures for the staff currently reviewed and revised may be used to develop the training program. Computerization of electronic filing of company registration has been introduced. Further progress with computerization of the SEC’s regulatory reporting and monitoring is awaited.

Principles of self-regulation (CPs 6–7)	Diversification of the PSE’s ownership away from dominance by broker dealers is awaited to enhance credibility of the PSE as an SRO. Measures could include private placement to institutional investors of appropriate standing as well as going public. Completion of a study is awaited on a possibility to retain the Compliance and Surveillance Group of the PSE (CSG-PSE) as part of the PSE while ensuring its independence.
Principles for the enforcement of securities regulation (CPs 8–10)	Completion of the on-going series of computerization of the data failing, management and analysis at the SEC is awaited to avail more human resources for enforcement activities and support effective enforcement with accurate, updated information which is readily retrievable and analyzable.
Principles for cooperation in regulation (CPs 11-13)	Finalization of an MOU with Indonesia’s BAPEPAM is awaited. Similar agreements with other regulators are being considered.
Principles for issuers (CPs 14–16)	Adoption of IASs should be implemented by 2005 as planned. Investor education efforts should be continued.
Principles for collective investment schemes (CPs 17–20)	The RICA needs to be passed by the Congress as soon as possible to correct the weaknesses in the existing ICA. Investment advisors should be captured. Requirements for segregation and valuation of assets and delegation of functions should be clarified.
Principles for market intermediaries (CPs 21–24)	Implementation of the electronic Net Capital reporting and monitoring system for brokers dealers is awaited to enable daily monitoring.
Principles for the secondary market (CPs 25–30)	The potentially emerging competition among the PSE, the FIE and the Futures Exchange which will all be for-profit corporations may undermine the credibility of self-regulation by them. The SEC is encouraged to strengthen the regulation of the trading market operators. It should establish a specific supervision program for a trading market operator as well as an SRO. SEC may wish to consider adopting a regulatory framework which accommodates trading markets with or without SRO functions. To do so, rationalization of requirements for an Exchange or a trading system and those for SRO may be necessary.