



**Republic of the Philippines**  
**SECURITIES AND EXCHANGE COMMISSION**  
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We are pleased to update you on what SEC has done on the implementation of the IOSCO Principles which has been the subject of the Financial Sector Assessment Program (FSAP) report. This update comes by way of an answer to the World Bank 2001 Assessment relating to the Philippine's compliance with the IOSCO Objectives and Principles of Securities Regulation.

Since the 2001 report, SEC has worked extensively on those projects rated by the World Bank as Partially Implemented (PI), to wit:

1. **Principle 6:** The Regulatory regime should make appropriate use of Self-Regulatory Organization (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.

A. Listing of PSE Shares

To effect the full demutualization of the Philippine Stock Exchange (PSE), the SEC mandated the listing of its shares in the Exchange which took place in December 2003. Currently, broker ownership has been reduced from 100% to 60% of the total stockholder base, with 40% now being owned by non-brokers. In view of the possible conflict of interest that may arise if the PSE, as an SRO, will administer and monitor the listing and trading of its own shares and enforce compliance with the provisions of the Code, the SRC Rules, and the relevant PSE rules, an MOU was signed by the respective Chairpersons of the SEC and PSE designating the SEC to perform direct

regulatory, supervisory and enforcement functions over the listing and trading of PSE shares.

The demutualization has helped us achieve the following objectives:

- Eliminated the perception that the Exchange is an “old boys’ club”
- Broadened ownership base
- Professionalized management
- Improved corporate governance

While no separate corporation is organized for the PSE’s Compliance and Surveillance Group (PSE-CSG), its management group, the Governance Committee, is headed by independent director and composed of both non-broker and broker representatives and a non-broker President. Consequently, the urgency for a separate corporate roof for CSG is not present. In the meantime, CSG reports simultaneously to the independent Governance Committee and the SEC.

Strict implementation of the principles of corporate governance further requires that majority of the PSE’s Board of Directors are independent directors with the different sub committees headed by independent directors.

#### B. Establishment of the Fixed Income Exchange

The PSEC continues to spearhead efforts towards the establishment of a fixed income exchange, which will provide a platform for the secondary trading of government securities, commercial papers and asset-backed securities issued by companies. The exchange will be the Philippines’ first official electronic market for public and private debt instruments. Presently, the SEC is coordinating closely with the Bankers Association of the Philippines (BAP) in the drafting of the Fixed Income Exchange Rules. The Fixed Income Exchange will be operational by the third quarter of this year.

#### C. Formulation of Alternative Trading System (ATS)

Development of innovative securities trading and other trading markets in the financial sector due to the advancement of information technology and the globalization of financial markets led the Commission in formulating rules on ATS in accordance with Section 37 of the SRC. The ATS will be operational this year with a proposal from the Development Bank of the Philippines to use the system for trading short term commercial papers.

2. **Principle 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.

A. SEC Manual of Operations

Each department at the SEC has its own Manual of Operations which is in place and currently being implemented.

B. Advance Warning and Control System (AWACS)

SEC's Market Regulation and Compliance and Enforcement Departments are now using the Advance Warning and Control System (AWACS), an Asian Development Bank (ADB)-funded real time market surveillance engine which aims to protect the integrity of the market from fraud and abusive trading practices, particularly price manipulation associated to trades occurring in the financial market. A total of 187 letters were sent to various brokers/dealers who were required to submit the names of the beneficial owners in view of the sudden rise/drop in the price/volume of 32 listed issues.

C. Conduct of Thematic audits of Broker Dealer firms

SEC has conducted since 2002 100% thematic audits to check Broker Dealer compliance with the Securities Regulation Code and its Implementing Rules and Regulations.

In latter part of 2002, SEC conducted a 100% desk audit of firms to check compliance with the Chinese Wall Rule and the independence of the compliance function. Firms were given until 29 August 2003 to resolve their violations of the Chinese Wall Rule. Out of 125 firms that were sent letters, 111 resolved the issue and corrected/cancelled the applications of persons with conflicting positions, while there are 15 remaining conflicting position issues left to be resolved before the issuance of the 2004 license.

In the fourth quarter of 2003, SEC conducted a thematic audit jointly with the Philippine Stock Exchange's Compliance and Surveillance Group (PSE-CSG) of all 135 registered broker firms. The Thematic Audit focused on the Rules related to Customer Protection which include, among others, (1) Securities Inventory Count; (2)

Review of Reserve Requirement; (3) Review of Customer Accounts; and (4) Review of Books and Records.

D. Anti-Money Laundering Act (AMLA)

The SEC created the Task Force AMLA composed of representatives from the different associations and market participants, including PSE, to assist the Anti-Money Laundering Council (AMLC) in formulating operating and audit procedures needed in the implementation of AMLA which procedures have been acted favorably by the AMLC.

The SEC has created the AMLA desk and has designated the Directors of the Market Regulation Department and the Compliance & Enforcement Department to man the desk.

SEC has also participated in the consultative meetings with the Asia Pacific Group to evaluate Philippine compliance with the FATF's Anti-Money Laundering requirements.

E. Compliance with international practices on good corporate governance

SEC monitored strict compliance with the Manuals on Corporate Governance (i.e., designation of compliance officers, independent directors, creation of board committees)

SEC has designed and implemented a Self-Rating System on Corporate Governance which was made applicable to issuer companies and market participants with secondary licenses. We are right now drafting procedures by which we can validate the answers submitted to the Commission.

F. Implementation of the information systems following the IT roadmap set in the SEC's updated Information Strategic Systems Plan (ISSP).

SEC came out with the **SEC-iRegister**, SEC's Web-based company registration system. Since its official launching in June 2002 until 31 December 2003, the total number of name verification transactions is 477,336 and the total number of reservations has reached 132,957.

SEC is currently working on the general conceptual framework of the SEC-iReport to the ITECC E-Government Implementation Committee which resulted in the

Committee's decision to endorse the SEC-iReport project to the DBM for the availment of the E-Government Fund facility in the amount of PhP 86.866 Million.

3. **Principle 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.

A. Various Memoranda of Agreement (MOA)

SEC signed a Memorandum of Agreement (MOA) with the BSP that defines each agency's respective responsibilities and expedite the detection, investigation and prosecution of investment scams.

SEC is applying to become a signatory to the IOSCO Memorandum of Understanding on Consultation and Cooperation and the Exchange of Information.

SEC signed the Memorandum of Understanding (MOU) between the Philippine SEC and the Capital Market Supervisory Agency of Indonesia (BAPEPAM) on June 5, 2002.

SEC has cooperated with the Department of Trade and Industry (DTI), in promoting Anti-Scams awareness campaign:

- Disseminated 'Citizen's Manuals' and other relevant information materials for the guidance of investors and the general public.
- Translated SEC's 'Citizen's Investment Alert' pamphlets into Cebuano, Ilocano, and Ilonggo.
- Coordinated with certain government and private institutions for the placing of anti-scams posters and brochures in their offices.

B. Proposal for the Establishment of a Financial Supervisors Forum (FSF)

SEC is currently studying, together with the Bangko Sentral ng Pilipinas (BSP), Office of the Insurance Commission (OIC), and the deposit insurer Philippine Deposit Insurance Corporation (PDIC), the establishment of the FSF. As envisioned the FSF will serve as the institutionalized multilateral inter-agency forum that will provide an overall coordinating framework for the current focused and specialized bilateral MOAs that Sec, OIC, and PDIC have with BSP. Such a forum also serves the important purpose of mitigating against the risk of gaps in the supervisory oversight process. The focus of FSF would be to facilitate consultations and the exchange of information

among its members on all matters that related to the supervision and regulation of financial institutions, within the constraints of existing charters and confidentiality laws.

C. SEC Chairman's Membership in the Anti-Money Laundering Council (AMLC)

The SEC Chairman is, by virtue of the Anti-Money Laundering Act (AMLA), an automatic member of the AMLC whose mandate relates to Anti-Money Laundering and Combating of the Financing of Terrorism.

3. **Principle 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.  
**Principle 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.  
**Principle 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.  
**Principle 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.

Congress has not yet passed the Revised Investment Company Act (RICA). Feeling the urgent need to respond to the developments in the mutual fund industry, the SEC officers, during its Corporate Planning Workshop in February 2004, agreed to draft the amended rules to the present Investment Company Act (RA 2629) and incorporate therein international best practices and standards.

New policies adopted by the SEC in 2003 include, among others, the harmonization of registration requirements pertaining to investment company advisers and certified investment solicitors under the SRC and the Investment Company Act, and the regulation of distributorship arrangements between investment companies/advisers and registered broker dealers such as in the case of Sun Life Asset Management Company, Inc. and Bank of the Philippine Islands.

4. **Principle 25.** The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.

As discussed in principle 16 above (discussion no. 1), in recognition of the need to develop other trading systems, the SEC has or is in the process of developing rules that

would govern the Fixed Income Exchange and the Alternative Trading Systems, both of which will be regulated by the SEC.

5. **Principle 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.  
**Principle 28.** Regulation be designed to detect and deter manipulation and other unfair trading practices

As discussed in principle 10 above (discussion no. 2), the AWACS that SEC is using can make an independent monitoring and surveilling of the equities market and thus can validate the reliability of the PSE findings and its effectiveness as an SRO.

Included in the SEC's mandate is the audit of PSE regulatory function as an SRO and the imposition of penalties and sanctions, if necessary, for non-compliance.

6. **Non inclusion of the third objective of the IOSCO principles in the state policy of the SRC (Section 2)**

While the SRC does not include in its State Policy the third objective of the IOSCO principles which is the reduction of systemic risk, we believe that there are sufficient measures that found in the SRC and its implementing rules and regulations that address the same, to wit:

- a. Sec. 36.5 on the establishment of the trust funds for the purpose of compensating investors for the extraordinary losses or damage they may suffer due to business failure, fraud or mismanagement with the persons with whom they transact.
- b. Sec. 42.2 (f) on the establishment and oversight of a fund to guarantee the prompt and accurate clearance and settlement of transactions executed on an Exchange.
- c. Sec. 49 on the minimum net capital requirement
- d. There are provisions in the Rules of the Securities Clearing Corporation of the Philippines (SCCP) that require the full collateralization of negative difference between the acquisition value as against the current market value of the aggregate securities transactions of the broker.

## **Other Initiatives of the Philippine SEC**

### **A. Drafting of Amendments to the Implementing Rules and Regulations of the Securities Regulation Code**

The present SRC-IRR has been amended to incorporate international best practices in securities regulation while considering the Philippine experience in the securities and broking business. The provisions of the amended IRR are directed at achieving the following objectives:

- Strengthening of the Compliance function of broker firms;
- Practice of good corporate governance
- Compliance and enforcements of the requirements of the AMLA
- Empowering of the Exchange, particularly, its Compliance and Surveillance Group, as an SRO

The Commission has approved the proposed Rules and Regulations on December 30, 2003 and published in the newspaper of general circulation on February 13, 2004.

### **B. Promotion of the Principles of transparency and disclosure**

Realizing that the enforcement of accounting rules has been lacking in the past, the SEC has started to strictly monitor compliance with accounting rules to ensure the development of a credible and transparent capital market. In coordination with the UP College of Business Administration, the SEC reviewed the 2001 financial statements (FS) of 131 listed companies. The results of the review clearly showed that compliance with accounting standards require improvement. A number of listed companies had significant violations that made their FS materially misleading while many listed companies committed disclosure violations. There is an ongoing review of the 2002 FS filings, this time including samples not only from listed companies but also from other public companies such as pre-need, investment houses, and finance companies. The results for the portion completed thus far indicate that compliance with accounting rules has improved.

SEC implemented the IAS\_based Disclosure Checklist for the review of 2002 Financial Statements and issued opinions on accounting and audit matters raised by public.

Furthermore, SEC has implemented the regulation requiring the accreditation of external auditors of listed and public companies as well as market participants and companies which are holders of secondary licenses. Accreditation of external auditors of listed and

public companies has started in 2002 and for external auditors of market participants and companies with secondary licenses, it will start for the calendar year 2004.

### C. Investor Education

Last year, a series of **Investor Information Seminars** was held in key cities nationwide. The Seminars were intended to promote the importance of informed investing and motivate the public to take personal responsibility for their investment decisions and financial security.

**A Citizen's Manual** has been prepared and is being disseminated in English, setting out in simple, understandable terms, SEC's processes and other most-sought after information. A 'Citizen's Investment Alert' is also being disseminated in English and Pilipino, Cebuano, Ilocano, and Ilonggo.

In May 2003, the SEC launched **1-908-1-ASKSEC**, a Hotline service which provides automated responses to most frequently asked questions. Callers who wish to file a complaint or inquire about companies that have been closed down, also have the option to speak with an SEC representative during office hours. The Hotline Service, which can accommodate up to 12,000 calls daily, is a convenient facility that can be accessed from anywhere in the Philippines, anytime of the day.

A **nationwide Anti-Scams Awareness Campaign** has likewise been launched in coordination with the DTI. Anti-scams posters and brochures were provided to partners in government and the private sector, for dissemination to the public.

Finally, to broaden the reach of the Commission's investor information campaign, the SEC has launched three **30-second infomercials** on how to avoid investment scams which were produced for broadcast on television and radio, as well as in movie theaters and public transportation. MRD coordinated with the different market participants and the Philippine Information Authority (PIA) for the production of the infomercials.

### D. Compliance with international practices on good corporate governance

Compliance with the principles of good corporate governance, originally required of listed and public companies, has now been extended to all market participants and companies with secondary licenses. For this purpose, SEC monitored firm strict compliance with their respective Manuals on Corporate Governance (i.e, designation of compliance officers, independent directors, creation of board committees).

SEC has designed and implemented a Self-Rating System on Corporate Governance which was made applicable to issuer companies and market participants with secondary licenses. SEC is currently working on the procedures in validating the firms' responses to the Self-Rating system.

E. Legislative Enactments

Philippine Congress has enacted the following laws affecting the capital market:

1. The Documentary Stamp Tax (DST) law rationalizing the imposition of the DST, among others, exempts from DST secondary trading of securities and securities used for securities borrowing and lending;
2. Special Purpose Vehicle (SPV) law seeks to (1) develop and maintain a sound financial sector for the country; (2) address the non-performing asset problems of the financial sector; (3) encourage private sector investments in non-performing assets; (4) eliminate existing barriers in the acquisition of non-performing assets; (5) help in the rehabilitation of distressed businesses with the end in view of contributing to economic and value added; and (6) improve the liquidity of the financial system which can be harnessed to propel economic growth.
3. The amendments to the Anti –Money Laundering Act (AMLA) include, among others, lowering the threshold of the submission of covered transaction reports, authority the BSP to inquire into bank deposits as supervising authority, inclusion of the definition of “suspicious transaction,”

We hope this would help you in appreciating the progress that the SEC has achieved since 2001.

Very truly yours,

(Sgd) **LILIA R. BAUTISTA**  
**Chairman**