

Certification Seminar for
Associated Persons

**CODE OF CORPORATE GOVERNANCE
FOR BROKER DEALERS**

Market Regulation Department
23 May 2008

Securities and Exchange Commission

General Outline

- Background
- What is corporate governance?
- Corporate Governance Framework
- SEC's Code of Corporate Governance: Leading Practices in Good Corporate Governance
- Role of the Associated Person in promoting good corporate governance

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Legal and Regulatory Framework

- Corporation Code of 1980 – main law governing the corporate sector
- General Banking Law of 2000 – governs the regulation, establishment and management of banks
- Securities Regulation Code of 2000 – governs the regulation of the Philippine capital markets and the securities industry.

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What is corporate governance?

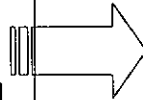
Refers to a system whereby shareholders, creditors and other stakeholders of a corporation ensure that management enhances the value of the corporation as it competes in an increasingly global market place (SEC's Code of Corporate Governance, 2002)

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Why is Corporate Governance Important?

Corporate Governance –

- Promotes and maintains investors confidence
- Broadens and deepens access to capital
- Promotes efficiency and improves profitability
- Strengthens social responsibility



Outcome

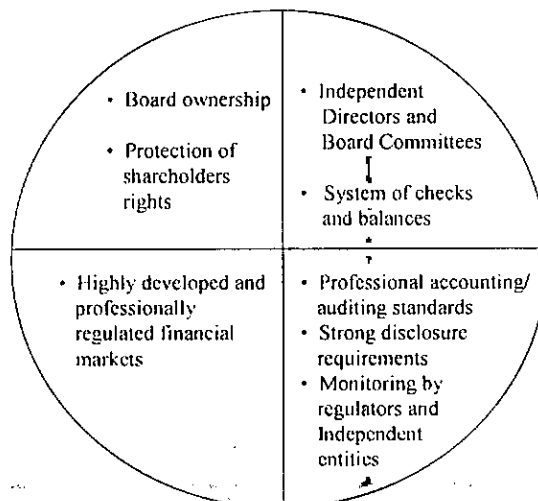
- Reduced vulnerability of markets to external shocks
- Broader welfare gains to society

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What are the Critical Elements of Corporate Governance?

Corporate Ownership and Control

Corporate Financing



Corporate Management

Disclosure, Transparency and External Audits

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Principle of corporate governance is enshrined
in Section 2 of the SRC

State Policy:

The State shall establish a socially conscious, free market that regulates itself, encourage the widest participation of ownership in enterprises, enhance the democratization of wealth, promote the development of the capital market, protect investors, ensure full and fair disclosure about securities, minimize if not totally eliminate insider trading and other fraudulent or manipulative devices and practices which create distortions in the free market.

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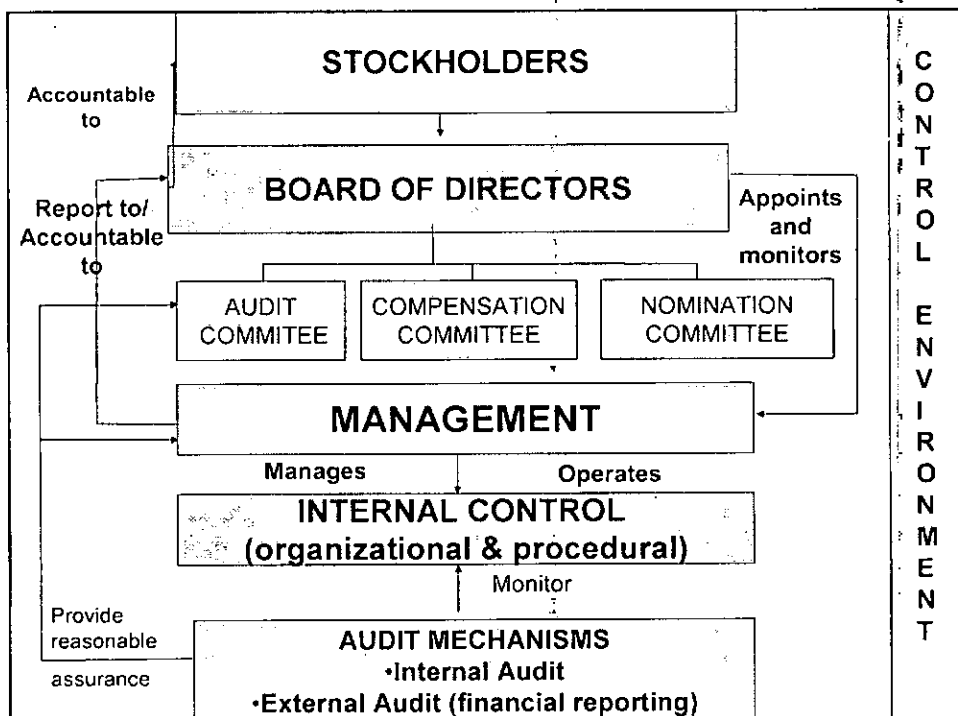
**What are the fundamentals to good corporate
governance?**

- Accountability
- Transparency
- Predictability
- Participation

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CORPORATE GOVERNANCE FRAMEWORK

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Definition of Terms

- **Internal Control**

- process effected by a company's Board of Directors, management and other personnel
- designed to provide reasonable assurance regarding the achievement of objectives in:
 - (1) the effectiveness and efficiency of operations,
 - (2) the reliability of financial reporting, and
 - (3) compliance with applicable laws, regulations, and internal policies.

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Definition of Terms

- **Internal Control Environment**

- the framework under which controls are developed, implemented, alone or in concert with other policies and procedures, to manage and control a particular risk or business activity or combination of risks or business activities to which the company is exposed.

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SEC's Code of Corporate Governance:
Leading Practices in Good Corporate
Governance
SEC Memorandum Circular No. 2 (Series of 2002)

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Board Governance

- Board of Directors – the collegial body that exercises the corporate powers of all corporations formed under the Corporation Code. It conducts all business and controls or holds all property of such corporation.
- Board is primarily responsible for the governance of the corporation.
- Board needs to be structured so that it provides an independent check on management.

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Board Governance (cont'd)

- Composition
 - Executive
 - Non-executive
 - Chairman/CEO
 - Independent director - shall be at least 2 or 20% of the number of the Board, whichever is lesser

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Independent Director

Refers to a person other than an officer or employee of the corporation, its parent or subsidiaries, or any other individual having any relationship with the corporation, which would interfere with the exercise of independent judgment in carrying out the responsibilities of a director.

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Independent Director (cont'd)

SRC Rule 38

Apart from his fees and shareholdings, is independent of management and free from any business or other relationship which could, or could reasonably be perceived to, materially interfere with his exercise of independent judgment in carrying out his responsibilities as a director in any covered company and includes, among others, any person who:

- A. Is not a director or officer of the covered company or of its related companies or any of its substantial shareholders except when the same shall be an independent director of any of the foregoing;

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Independent Director (cont'd)

SRC Rule 38

- B. Does not own more than two percent (2%) of the shares of the covered company and/or its related companies or any of its substantial shareholders;
- C. Is not related to any director, officer or substantial shareholder of the covered company, any of its related companies or any of its substantial shareholders. For this purpose, relatives include spouse, parent, child, brother, sister, and the spouse of such child, brother or sister;

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Independent Director (cont'd)
SRC Rule 38

- D. Is not acting as a nominee or representative of any director or substantial shareholder of the covered company, and/or any of its related companies and/or any of its substantial shareholders, pursuant to a Deed of Trust or under any contract or arrangement;
- E. Has not been employed in any executive capacity by the covered company, any of its related companies and/or by any of its substantial shareholders within the last five (5) years;

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Independent Director (cont'd)
SRC Rule 38

- F. Is not retained, either personally or through his firm or any similar entity, as professional adviser, by that covered company, any of its related companies and/or any of its substantial shareholders, within the last five (5) years; or
- G. Has not engaged and does not engage in any transaction with the covered company and/or with any of its related companies and/or with any of its substantial shareholders, whether by himself and/or with other persons and/or through a firm of which he is a partner and/or a company of which he is a director or substantial shareholder, other than transactions which are conducted at arms length and are immaterial.

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Multiple Board Seats -- determining the number of directorships

OPTIMUM NUMBER IS RELATED TO THE CAPACITY OF A DIRECTOR TO PERFORM HIS DUTIES DILIGENTLY IN GENERAL.

To consider

- The nature of the business of the corporation;
- Age of the director;
- Number of directorship/active memberships and officerships in other corporations or organizations;
- Possible conflict of interest.

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Board Governance (cont'd)

Qualifications

- Legal requirement;
 - Education;
 - Competence;
 - Integrity/probity;
 - Assiduousness
-
- Holder of at least one share of stock which is recorded in the company's books;
 - Company may provide for more qualifications

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Board Governance (cont'd)

SRC Rule 38, 6 (B) and Code of Corp. Governance

Disqualifications:

- Criminal conviction (judicial or administrative)
- Misconduct
- Insolvency

Temporary Disqualifications:

- Refusal to disclose business interests
- Frequent absences in meetings
- Dismissal/termination from directorship in another corporation for cause;
- Under preventive suspension by the corporation;
- He becomes an officer or employee of the corporation where he is such member or becomes any of the persons under Part I of the SRC Rule 38.1
- If his beneficial equity ownership exceeds 10%

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Board Governance (cont'd)

Duties and Responsibilities of the Board

General

1. Fiduciary
2. Characterized by accountability, transparency and fairness;
3. Assumes certain responsibilities to different constituencies; or
4. Lays down the company's vision/mission, policies
5. Monitors and oversees management action.

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Board Governance (cont'd)

Specific Responsibilities of the Board

- Installs a process of selection;
- Determines the company's purpose/value/ strategies and policies;
- Ensures compliance with all relevant laws and regulations, best business practices;
- Adopts internal checks and balances;
- Identifies stakeholders and provide investors' relations program;
- Provides appropriate technology and systems rating to account for available resources;
- Attends meetings and be vigilant and active.

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Board Governance (cont'd)

Duties and responsibilities of a Director

1. Conduct fair business transactions/no conflict of interest
2. Devote time and attention
3. Act judiciously
4. Exercise independent judgment
5. **Have a working knowledge on statutory/regulatory requirements**
6. Observe confidentiality
7. Ensure the continuing soundness, effectiveness and adequacy of the company's control environment.

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Board Governance (cont'd)

Board Meetings And Quorum Requirement

- Board members should attend regular and special meetings of the Board in person. Teleconference allowed.
- Independent directors should always be in attendance but absence will not affect quorum attendance if duly notified.
- Corporations, at the end of the fiscal year, will submit to the Commission, a sworn certification, as to attendance.

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Board Governance (cont'd)

Remuneration of the Board Members & Officers

- Procedure for developing policy
- Non-involvement of director in deciding own remuneration
- Disclosure in reports

Board Committees

- (1) Audit/Risk Management
- (2) Nomination
- (3) Compensation

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Audit Committee

- composed of at least three (3) Board members
- preferably with accounting and finance background
- one of whom shall be an independent director and another should have related audit experience.

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Audit Committee (cont'd)

Functions:

- a. Provide oversight over the senior management's activities in managing credit, market, liquidity, operational, legal and other risks of the corporation.
- b. Provide oversight of the corporation's internal and external auditors;
- c. Review and approve audit scope and frequency, and the annual internal audit plan;
- d. Discuss and coordinate with the external auditor regarding the regular audit of the company;

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Audit Committee (cont'd)

- e. Responsible for the setting-up of an internal audit department and consider the appointment of an internal auditor as well as an independent external auditor, the audit fee and any question of resignation or dismissal;
- f. Monitor and evaluate the adequacy and effectiveness of the corporation's internal control system;
- g. Receive & review reports of internal/external auditors and regulatory agencies to ensure compliance and adopt of corrective measures, if necessary;
- h. Review the quarterly, half-year and annual financial statements before submission to the Board

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Audit Committee (cont'd)

- i. Responsible for coordinating, monitoring and facilitating compliance with existing laws, rules and regulations.
- j. Evaluate and determine non-audit work by external auditors and their compensation;
- k. Establish and identify the reporting line of the chief audit executive. Ideal is to have the audit executive report directly to the Audit Committee functionally.

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Nomination Committee

- Composed of at least three (3) members, one of whom should be an independent director

Functions:

- (a) review and evaluate the qualifications of all persons nominated to the Board as well as those nominated to other positions requiring appointment by the Board, and
- (b) provide assessment on the Board's effectiveness in directing the process of renewing and replacing Board members.

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COMPENSATION & REMUNERATION COMMITTEE

- Composed of at least three (3) members, one of whom should be an independent director.

Functions:

- (a) Establish a formal and transparent procedure for developing a policy on executive remuneration and for fixing the remuneration packages of corporate officers and directors;
- (b) Provide oversight over remuneration of senior management and other key personnel ensuring that compensation is consistent with the corporation's culture, strategy and control environment.

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Role of the Corporate Secretary

- Filipino citizen
- Considered an officer of the corporation
- Expectations on the Role of the Corporate Secretary are enumerated in the Code of Corporate Governance

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Supply of Information

Kind of information

- Complete/adequate
- Accurate
- Timely

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Accountability and Audit

1. Restrictions
External auditor **cannot** be the internal auditor at the same time.
2. Rotation of external auditors/managing partners
– **every 5 years**
3. Selection Process for External Auditor
4. Accreditation of External Auditors
(SEC Memorandum Circular No. 13, Series of 2003)

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Stockholders' Rights and Protection of Minority Stockholders' Interests

- Voting rights
- Pre-emptive right
- Power of Inspection
- Right to Information
- Right to Dividends
- Appraisal Right

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DISCLOSURE AND TRANSPARENCY

Material Information

Every act or event which may reasonably be considered to materially affect the issuer's securities or investors' decision in respect thereto

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DISCLOSURE AND TRANSPARENCY

General Principles:

- Fairness
- Accountability
- Transparency

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Evaluation System

- Ideal Evaluation System-
Self rating form & Validation
- Designation of the Company's Compliance Officer
for BD - Unless another person is designated, the Associated Person shall be the Compliance Officer tasked to monitor practice of good corporate governance
- Adoption of a Manual of Corporate Governance

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ROLE OF THE ASSOCIATED PERSON IN PROMOTING GOOD CORPORATE GOVERNANCE

- An effective compliance function is part of risk management and a good element of internal control. This in turn is a sound principle of good corporate governance;
- The Board of Directors must have access to timely information in order to govern well. The AP can assist in making sure this is achieved.

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THANK YOU

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