

A. THE PREDECESSOR CMDP BLUEPRINT, 2005-2010

1. Background

The predecessor *Capital Market Development Plan (CMDP): Blueprint for Growth and Expanded Contributions to the Philippine Economy* covering the period 2005 to 2010 was formulated in 2005 to coincide with the Arroyo administration. The CMDP Blueprint 2005-2010 espoused nine policy goals and eleven strategic objectives. It was approved for implementation by the Department of Finance (DOF) in October 2006.

The nine policy goals collectively were directed towards providing an enabling policy environment where, among others, Philippine capital market institutions will grow their business and contribute increasingly to national economic growth by becoming more efficient and competitive, thus reducing the overall cost for corporations, regardless of size, to raise long-term capital through public offerings of equity or debt instruments.

The eleven strategic objectives comprising the Blueprint were spread over four clusters according to the lead institution(s) in pursuing the suggested reforms. Strategic Objectives 1-3 set forth the National Government's support for the Blueprint's recommendations, its role in overseeing the implementation of the Blueprint through 2010, and its commitment to pursue macroeconomic goals and tax reforms designed to stimulate personal savings and long-term investment through the capital market. Strategic Objectives 4-5 focused on the key capital market institutions and various business strategies and reforms intended to accelerate their growth and efficiency in allocating savings to Philippine issuers seeking long-term capital. Strategic Objectives 6-9 included a series of legal and regulatory reforms that financial regulators needed to ensure effective oversight and enforcement capabilities, strengthen investor protection and align the framework for financial regulation with current global standards or best practices. Strategic objectives 10-11 focused on investor education and corporate governance that require a joint effort by financial regulators and principal capital market institutions.

From these Strategic Objectives, priority activities to be undertaken during the Plan period constituted the CMDP Blueprint Action Plan for 2005-2010. The SEC as the government agency tasked with the responsibility of monitoring the status of implementation of the CMDP Blueprint Action Plan, regularly submitted to DOF quarterly monitoring reports on the CMDP Blueprint accomplishments.

2. Significant Accomplishments

Following are some significant accomplishments on reform initiatives indicated in the predecessor CMDP Blueprint, 2005-2010. In the aspect of legislation, the Philippine Congress enacted the Credit Information Systems Act (RA 9510) creating the Credit Information Corporation as a central database of borrower information and allowing banks to assess credit worthiness of borrowers; the Real Estate Investment Trust (REIT) Law (RA 9856) as a way of expanding the range of traded products; the Lending Company Regulation Act of 2007; the Personal Equity and Retirement Account (PERA) Law (RA 9505) as a tool for developing the private pension fund accounts; and the Financial Rehabilitation and Insolvency Act (RA 10142) which lapsed into law in July 2010.

The competitiveness of the Philippine Stock Exchange was enhanced by extending trading hours, which was implemented in October 2011. The size of the minimum “board lot” in selected securities was rationalized and short-selling restrictions were modified. There was enhanced listing on the Exchange as evidenced by 10 new listings from 2008 to 2010. The PSE pursued internal organizational reforms including strengthening the independence of its Compliance and Surveillance Group which was restructured as the new Market Regulation Division, which was later spun off as a separate but wholly-owned subsidiary to further ensure its independence. The Securities and Exchange Commission approved the PSE Securities Borrowing and Lending Guidelines. The corporate regulator also allowed listing by way of introduction (LBWI). In 2010, the PSE also reinstated the Minimum Public Ownership (“MPO”) rule, which requires all listed companies to maintain a ten percent (10%) public float.

The Philippine Dealing Exchange (PDEX) registered as an exchange in March 2005 and the inter-dealer market began operations at the same time. SEC registered PDEX as a self-regulatory organization (SRO) over the inter-dealer market. The SEC also approved the expansion of the SRO authority of PDEX for all its members in the PDEX trading system. The SEC approved the PDEX Rules which covers among others, trades below Php10 million to be entered in the Auto Order Board. To stimulate the development of the corporate debt market, the SEC approved PDEX rules to expand eligible trading participants to include investment houses.

The Fixed Income Broker Internet Order System (FI-BIOS) was launched to extend market reach outside of the national market center. To bring liquidity to the secondary debt market, the SEC approved the repurchase program rules of the Philippine Dealing Systems & Holding Corp (PDS) group. The SEC encouraged the participation of key actors in regional initiatives to promote capital market integration. In regional market initiatives, the SEC actively participated in the Asian Bond Market Initiative (ABMI) which aims to develop efficient and liquid bond markets in Asia, enabling better use of savings for Asian investments.

In anticipation of the growth of the domestic securitization market with the enactment of the Securitization Law in 2004, the BSP issued in 2005 the risk-based capital treatment of banks’ exposures to structured products and securitization structures. To further the development of the domestic securities market, the BSP issued procedural guidelines in investing in credit-linked notes, structured products and securities. On clearing and settlement, the Monetary Board approved in 2008 the removal of certain fees paid by participating banks and non-bank financial institutions in the Philippine Payments and Settlements System (PhilPass). It implemented the electronic payments via settlement banks for coupon and maturity payments for issues with the Philippine Depository Trust Corporation (PDTTC) as the appointed paying agent. The Name on Central Depository (NoCD) account can be implemented in PDTTC’s new depository system which was launched in June 2009.

Towards migration to scripless environment, the SEC established a task force composed of its operating departments to study the feasibility of a uniform identification system for individual investors. Towards migration to partial dematerialization of initial public offerings (IPOs) and future securities issuances, the SEC approved on February 26, 2009, the Revised Rules on Lodgment of Securities which require applicant companies to electronically lodge its registered securities with the PDTTC or any other entity authorized by the SEC without any jumbo or mother certificate. Towards migration to full dematerialization, the SEC approved the PDEX Rules which include an admission

criterion that securities must be issued in a dematerialized form in order to be eligible for electronic settlement and comply with the required settlement procedure of PDEX.

To enhance investor protection, the SEC, through its Speakers' Bureau conducted public seminars and student orientations sessions on matters relating to the capital and financial markets and institutions. The SEC has proposed amendments to the Securities Regulation Code to reinforce its regulatory powers. The SEC has strengthened its coordination with local law enforcement agencies. To further enhance corporate governance in the domestic capital markets, the SEC has issued the Revised Code of Corporate Governance in July 2010. The SEC has prescribed the adoption of International Accounting Standard and International Standards for Auditing in SEC's rules and regulations. SEC assessed the implementation of International Financial Reporting Standards (IFRS) for the top 100 of ordinary corporations for statements submitted in 2006.

To further harmonize and enhance collaboration on financial sector, the member-agencies of the Financial Sector Forum (FSF) signed the FSF Memorandum of Agreement (MOA) on Information Sharing in April 2006; Philippine Deposit Insurance Corporation (PDIC) and Bangko Sentral ng Pilipinas (BSP) signed the bilateral MOA in 2005 on the examination of banks; PDIC and BSP also signed a Memorandum of Understanding (MOU) to synchronize the approval processes for mergers, consolidations and acquisitions. The IC signed a MOA with BSP and SEC.

On the other hand, the following specific targets in the CMDP Blueprint 2005-2010 were not accomplished as planned, mainly due to resource constraints: (a) development of rules and educational materials to address risks involved in day trading; (b) conduct of a brief study of the public offering process for corporate debt; (c) formulation and issuance of a regulatory framework for securities custodians; (d) conduct of a feasibility study of straight through processing (STP) for equities; and (e) study the feasibility of introducing standardized system of investment ratings for the major types of securities products such as mutual funds, individual stocks and bonds.

B. BROAD DEVELOPMENT CHALLENGES AND OPPORTUNITIES FOR THE PHILIPPINE CAPITAL MARKETS

At the beginning of the plan period, the Philippine capital markets, particularly those linked to the global markets, remain vulnerable to abrupt swings in global investor sentiments. In terms of size, the capital market remains thin, as evidenced among others, by the limited number of listed companies. Broadening the investor base and improving bond market liquidity remain key policy challenges for deepening emerging local equity and bond markets. The Philippines needs to continue strengthening macroeconomic management and macro-prudential supervision to attract stable and long-term capital flows.

The CMDP Blueprint Action Plan for 2013-2017 considers the following broad development challenges and opportunities at the national and sectoral levels.

1. Economic Environment

During the preparation of this Blueprint, the country's monetary environment remains favorable both for businesses and consumers. Economic indicators such as inflation, interest rates, external debt as a percentage of Gross Domestic Product (GDP), and Philippine gross international reserves are all trending towards the positive side. The country's macroeconomic gains were eventually recognized by global credit rating agencies, the latest being Standards & Poor's which raised the country's investment credit rating by a level to BB+ from BBB-, inching the Philippines to minimum investment grade status. The Philippines also scored well in global competitiveness indices such as the ranking in the World Bank's Doing Business Survey where it jumped by 30 places to 108th of 189 economies in 2013. These factors led the country's overall GDP growth reaching 7.2% in 2013, better than the 6.0 to 7.0 target for the year.

During the press conference held at the Philippine Statistics Authority (PSA) on 30 January 2014, National Economic and Development Authority (NEDA) Secretary General Arsenio M. Balisacan reported that in the fourth quarter of 2013, the country's GDP grew by 6.5 percent making it one of the best performing economies in the Asian region, second only to China, which grew by 7.7 percent.

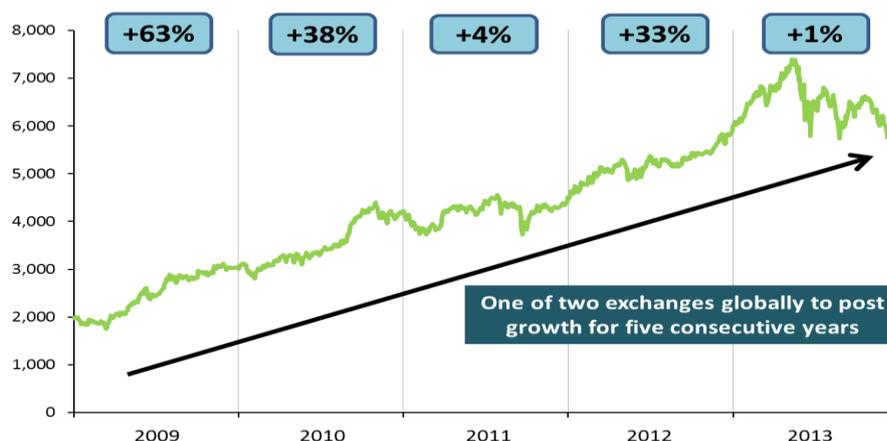
Several factors converged to support the local market's climb to further heights. On the supply side there was the robust performance of the services and industry sectors which contributed 3.6 percent and 2.8 percent, respectively in the full-year GDP. A robust household/private consumption and a remarkable performance in external trade characterized the demand side. There was also the presence of a stable business environment depicted by manageable inflation rate and low interest rates.

2. Equities Market

Riding on the momentum of a stellar performance both by the stock market and the domestic economy in the preceding year, the benchmark index continued its run en route to a new record high in 2013. The PSEi hit uncharted territory 31 times before reaching its highest mark of 7,392.20 points on May 15. A string of positive news augured well for the market headlined by three credit rating upgrades, impressive economic performance, improved global competitiveness and benign inflation environment.

The run was however cut short in the succeeding months thereafter, as the US Federal Reserve announced the tapering of their quantitative easing program and local weather disturbances. The PSEi ended the year at 5,889.83 points, slightly higher by 1.3 percent from the 5,812.73 close in 2012. Meanwhile, the broader PSE All Shares index closed the year lower at 3,614.32 points, down by 2.3 percent from the 3,698.98 close in 2012.

Figure 1 - PSEi Performance, 2009-2013



Source: PSE

As of end-2013, the PSE was the fifth fastest growing exchange among selected Asian exchanges based on year-on-year expansion in total value turnover. The PSE however ranked lower based on growth of number of listed companies (8th), domestic market capitalization (10th) and capital raised (11th).

Figure 2 - YOY Growth Rate of Selected Stock Market Indicators, 2013 v. 2012

Exchange	Domestic MCAP	Rank	Total Value Turnover	Rank	Capital Raised	Rank	No. of Listed Companies	Rank
Japan SE Group - Tokyo	30.6%	1	82.1%	1	4.3%	7	48.4%	1
Shenzhen SE	26.3%	2	62.9%	2	-9.8%	9	-0.3%	12
The Stock Exchange of Thailand	-9.1%	11	59.9%	3	-36.2%	14	4.8%	4
Shanghai SE	-2.0%	8	43.6%	4	-15.0%	10	-0.1%	11
Philippine SE	-5.2%	10	34.2%	5	-19.6%	11	1.2%	8
Indonesia SE	-19.0%	14	22.6%	6	74.9%	2	5.2%	3
Hong Kong Exchanges	9.5%	4	19.6%	7	24.1%	5	6.2%	2
Bursa Malaysia	7.2%	5	18.9%	8	-30.9%	13	-1.1%	13
Singapore Exchange	-2.7%	9	9.7%	9	55.0%	3	0.0%	9
HoChi Minh SE	0.0%	7	0.0%	10	0.0%	8	0.0%	10
Taiwan SE Corp.	11.9%	3	-8.0%	11	49.0%	4	3.1%	5
National Stock Exchange India	-9.8%	12	-9.0%	12	7.4%	6	-1.6%	14
Korea Exchange	4.7%	6	-15.4%	13	89.9%	1	1.6%	7
BSE India	-9.9%	13	-23.4%	14	-27.7%	12	2.0%	6

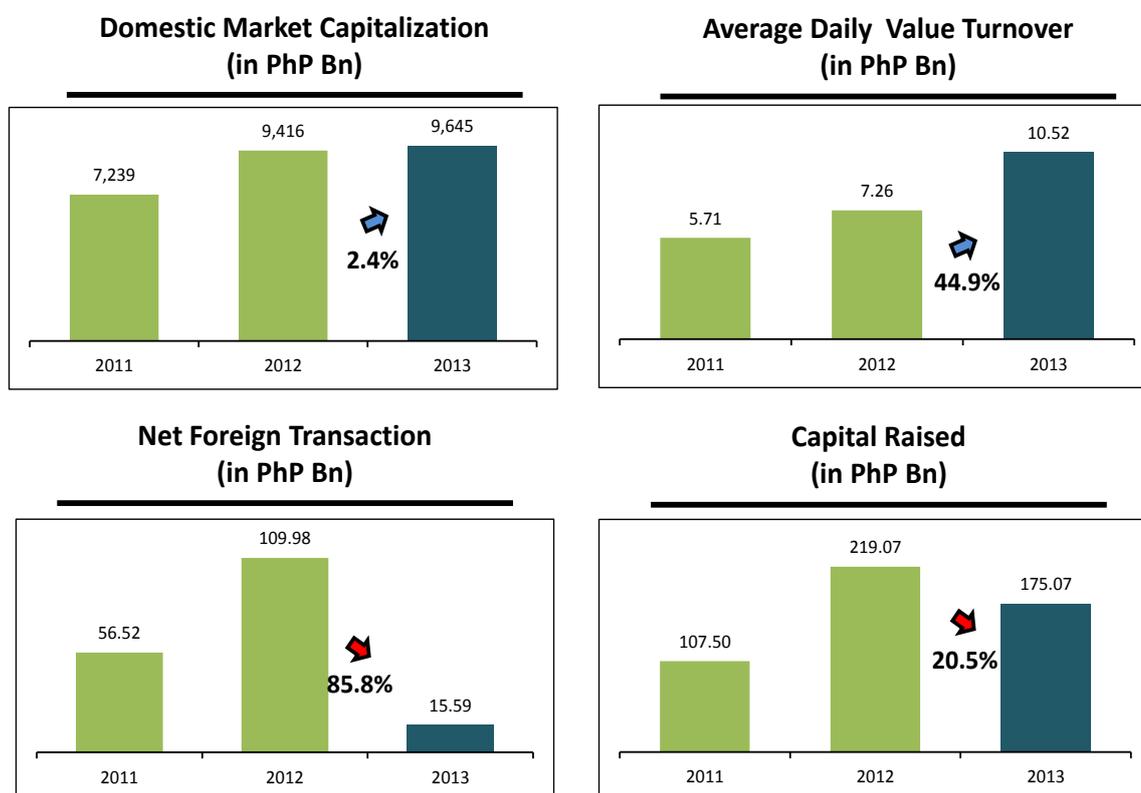
Source: PSE

Stock market indicators across the board remained on an uptrend (see Figure 3). By the end of 2013, total market capitalization expanded by 9.2 percent to Php 11.93 trillion from Php 10.93 trillion a year ago. Domestic market capitalization meanwhile rose by 2.4 percent to Php 9.65 trillion from Php 9.42 trillion year-on-year.

Total value turnover surged by 43.7 percent to Php 2.55 trillion in 2013 from Php 1.77 trillion the previous year while average daily value turnover grew by 44.9 percent to Php 10.52 billion from Php 7.26 billion in 2012. Foreign investors were also net buyers in 2013 in the amount of Php 15.59 billion, albeit 85.8 percent lower than the Php 109.98 billion net buying figure registered in 2012, reflecting continuing investor confidence in the local market.

While capital raising declined by 20.5 percent to Php 175.07 billion in 2013 from Php 219.07 billion year-on-year, the year still marked the highest capital raised through initial public offering (IPO) at Php 60.98 billion. The Exchange welcomed in its roster of listed companies 10 new ones – the most number since 2008. Eight companies conducted initial public offerings while one listed its shares by way of introduction. Moreover, the PSE welcomed the listing of First Metro Philippine Equity Exchange Traded Fund, Inc., the first exchange traded fund introduced in the market. It was also during 2013 where the PSE welcomed its largest IPO in history, Robinsons Retail Holdings, Inc., at Php 28.12 billion.

Figure 3 - Stock Market Highlights



Source: PSE

The PSE's Services Index was the best-performing sector in 2013, growing by 8.2 percent at 1,866.04 points from 1,724.65 points in 2012, followed by the Holding Firms Index with a 5.4 percent growth to 5,429.48 points. Meanwhile, the Mining and Oil Index was down by 38.6 percent to 11,917.94; followed by the Financials Index (6.4 percent to 1,428.00 points); the Property Index (4.3 percent to 2,205.45); and the Industrial (2.1 percent to 8,690.37 points).

In line with the development objective of strengthening the integrity and enhancing the competitiveness of the equities market, factors that limit the full potential growth and competitiveness of the local stock market were identified, including the limited menu of product offerings and services in the stock exchange, high transaction costs that serve as disincentive to trading in the equities market, and low investor confidence.

2.1 Enhance Exchange competitiveness

The challenge is to enhance the competitiveness of the Philippine stock market vis-a-vis its regional counterparts which is expected to be attained through the development of new products such as Exchange-traded Funds (ETFs) and derivatives like futures and index-based options, offering of new services such as Online Service Bureau for PSE's trading participants, and the adoption of a regulatory framework for said products and services.

Another means to boost the competitiveness of the local stock market is to reduce the friction costs associated with trading. In a study involving twelve (12) stock exchanges, it was shown that the Philippines has one of the highest frictions costs of trading of equity securities, which costs include trading fee, clearing fee, broker's commission, and stock transaction tax, in case of a sale transaction.

The Philippines ranks fifth in terms of friction costs, with 77 basis points per side of the transaction, next to the National Stock Exchange of India, Shenzhen Stock Exchange, Indonesia Stock Exchange and Bursa Malaysia. Singapore, on the other hand, has the lowest friction cost with 4.75 basis points per transaction side. (See Figure 4 on next page).

To address this issue, a study will be conducted with a view to rationalizing non-tax friction costs relating to equity securities transactions in the primary and secondary market, such as underwriting, registration, listing, clearing, depository, and transfer agent fees and brokers' commission.

As to the tax on primary issuances and secondary trading of equities, the Tax Technical Working Group is proposing the passage of a bill, known as "The Financial Sector Tax Neutrality Act", which provides, among others, for the abolition of the IPO tax and lowering of the stock transaction tax to $\frac{1}{4}$ of 1% or .25 basis points of the gross selling price or gross value in money of the shares of stock sold.

Another important means of enhancing competitiveness is the proposed unification of the equities and fixed income exchanges. This is aimed at achieving significant cost savings in maintaining exchanges and better pricing of assets. The consolidation is part of the continuous plan to enhance the financial market architecture and speed up the participation of the Philippines in the regional market.

Figure 4 - Total Friction Cost on Secondary Trading of Equity Securities per Jurisdiction

EXCHANGE	STAMP DUTY*	STOCK TRANSACTION TAX**	COMMISSION	CLEARING FEE*	TRADING FEE*	TOTAL PER SIDE (in BP)	TOTAL PER SIDE EXCL. COMMISSION (in BP)
Bursa Malaysia	10 BP or fractional part of value of securities ¹	None	Fully negotiable ²	3 BP of transaction value	70 BP ³	83.00	83.00
Ho Chi Minh SE	None	10 BP	Maximum of 45 BP	No data	No data	55.00	10.00
Hong Kong Exchanges	10 BP on the value of the transaction	0.3 BP per transaction	Fully negotiable	None ⁴	0.5 BP	10.80	10.80
Indonesia SE	None	1.8 BP of the value per transaction	Maximum of 130 BP ⁵	0.9 BP of the value	3 BP ⁶	135.70	5.70
Korea Exchange	None	30 BP	Fully negotiable	0.04446 BP of trade value	0.22763 BP of trade value	30.27	30.27
National Stock Exchange India	None ⁷	10 BP per transaction ⁸	Maximum of 250 BP ⁹	US\$0.033 ¹⁰	Rs. 3.00-3.25 per lakh of trade depending on the value of the trade (estimated at about 0.33 BP)	260.33	10.33
Philippine SE	None	50 BP	25 BP to 150 BP	1 BP	1 BP	77.00	52.00
Shanghai SE	10 BP of the traded value ¹¹	None	No data	No data	No data	10.00	10.00
Shenzhen SE	100 BP of the traded value for seller	6.96 BP of the traded value per transaction ¹²	Maximum of 30 BP	No data	No data	136.96	106.96
Singapore Exchange	None	None	Fully negotiable	4 BP on the value of the contract ¹³	0.75 BP on the value of the contract	4.75	4.75
Stock Exchange of Thailand	None ¹⁴	None	20 BP or 25 BP ¹⁵	0.1 BP ¹⁶	0.5 BP	20.60	0.60
Taiwan Stock Exchange	None	30 BP	Maximum of 14.25 BP	No data	0.65 BP	44.90	30.65

*For both buyer and seller unless stated otherwise.

**For seller only unless stated otherwise.

¹ Remitted to the maximum of RM200

² Fully negotiable for inter-broker and institutional trades, online routed retail trades (via ECOS), trades executed less than a board lot, and trades where cash upfront has been given prior to the execution of the trades. For same day buy and sell orders, commission rate is 15 BP of contract value. Retail trades valued above RM100,000 are charged a commission rate of 30 BP of contract value. Retail trades valued below RM100,000 are charged a commission rate of 60 BP of contract value.

³ For below RM100,000 amount of transaction. For transactions worth RM100,000 and above, 30 BP is charged.

⁴ No charge if an Exchange trade. A fee of HK\$1 will be incurred for transactions concerning settlement instruction, investor settlement instruction, transfer instruction and stock segregated account transfer instruction.

⁵ For trade size of IDR0-34,999,999. Minimum commission is IDR160,000.

⁶ Minimum transaction fee is IDR20,000,000 per month as a contribution to the Exchange facility provision. Fees have to be paid to the Exchange account every month, or on the 12th day of the ff. month at latest. Late payments will be subjected with 100 BP of penalty for every one day delay.

⁷ None for electronic transactions. 25 BP stamp duty is charged for physical delivery.

⁸ For the actual delivery. A stock transaction tax of 2.50 BP is charged to transactions settled other than actual delivery, for seller only.

⁹ Maximum of Rs. 25 per contract.

¹⁰ For trades amounting to 0 to 35,000 trades per month.

¹¹ Paid by investors to tax authorities but collected by the ShSE.

¹² For "A" shares. An STT of 30.1 BP of the traded value per transaction is charged to "B" shares. Collected by SzSE.

¹³ Subject to a maximum of S\$600. Except for structured warrants which is at 5 BP of the contract value subject to a cap of S\$200.

¹⁴ An exemption is granted for transfers of registered securities where the Thailand Securities Depository is the registrar.

¹⁵ 20 BP for internet trades; 25 BP for broker-assisted trades.

¹⁶ Maximum amount of Baht350 for each trade order. TCH also collects a monthly fee of Baht15,000 per general member.

Lastly, to ensure the uninterrupted functioning of the entire system and the resiliency of the whole market infrastructure during contingencies, there will be a market-wide disaster recovery and business continuity program that will be reviewed and tested on a periodic basis.

2.2 Increase liquidity in the stock market

Public ownership of securities is believed to result in greater liquidity. Currently, all PSE-listed companies are required to maintain at least ten percent (10%) of their issued and outstanding shares in the hands of the public, as a condition for continuous listing.

The other key initiatives aimed at achieving this objective are the introduction of a market making program to ensure the availability of two-way quotes for stocks, enhancement of the rules on securities borrowing and lending in order to support the market players' settlement obligations and trading strategies, and the conduct of a study on algorithmic or high frequency trading.

2.3 Strengthen the clearing and settlement system

As an important component of the post-trading infrastructure and as an entity that stands as a counterparty for each trade, it is crucial for the clearinghouse to have a robust risk management framework. Towards this objective, the requirement of margin collateral to cover risk of clearing members' open positions will be explored as a measure to mitigate the clearinghouse's counterparty risk exposure.

Recognizing established market practices in other jurisdictions where participation in the clearinghouse is no longer limited to brokers, the accreditation of non-broker participants as clearing members will be studied. It is believed that this initiative will increase market efficiency by allowing brokers to devote all their resources to their core activities and permitting non-brokers with high capitalization and proven experience in trade settlement, such as banks, to perform clearing and settlement functions.

2.4 Intensify support for regional integration

Aware that participation in the Association of South East Asian Nations (ASEAN) integration will deepen its economic linkages with the rest of the ASEAN countries and, in the process, improve its global competitiveness, the Philippines remains committed to the ASEAN economic integration.

In furtherance of this strategic objective, the Philippines will participate in the creation and marketing of an ASEAN asset class. There is also an intention to pursue linkages of the trading, clearing and settlement, and depository systems but to ensure that investment inflows will be higher than the outflows, it is necessary to first augment the product offerings in the local stock market.

Complementary to the development of more exchange-traded products is the creation of an enabling regulatory environment for regional integration, such as the harmonization of requirements for the sale or offering for sale of securities in the host country and the streamlining of procedures for availing of tax relief under bilateral tax treaties.

2.5 Enhance corporate governance of listed companies

To set consistent standards for corporate governance across different industries, it is recommended that the regulators adopt a unified approach and harmonize their corporate governance requirements. Moreover, to ensure that the set standards are at par with global standards, it is proposed that the governance requirements for Philippine companies be benchmarked against those of other jurisdictions.

Furthermore, to promote the adoption of sound governance practices by PSE-listed companies, PSE is looking at launching a governance board for companies which comply with the highest standards of corporate governance.

2.6 Increase investor protection

To boost investor confidence in the stock market, several safeguards aimed at promoting transparency and protecting investors from fraud and unauthorized use of securities are proposed, such as the use of a facility capable of recording stock ownership at the investor level for retail domestic investors. The SEC will issue guidelines on the use of such facility as well as on the issuance and recording of scripless securities by transfer agents or the depository.

Furthermore, to encourage foreign investments in the country in the form of portfolio holdings, there is a proposal to relax the procedural requirements for claiming relief under relevant tax treaty, tax sparing, and tax exemption provisions. Currently, non-resident investors claiming preferential tax rates are required to file a tax treaty relief application on a per security and per dividend issuance basis. This requirement is onerous and may serve as a disincentive for foreign investors. It is, thus, proposed that non-resident investors be allowed to file a one-time application for the determination of applicable tax rates, which will then be the basis for withholding tax for each dividend payment.

2.7 Enhance regulatory capacity

It is recommended that regulators, both government and private, take part in periodic trainings and workshops to ensure that they are attuned to the latest product developments and international best practices in the capital market.

2.8 Introduce reforms to improve underwriting and distribution of equities.

In view of the concerns raised by local underwriters that foreign underwriters get significantly larger share IPOs in the country and domestic underwriters bear the sole responsibility for 20% allocation to Trading Participants and the 10% allocation to local small investors (“LSIs”), there is a proposal to study whether the 20% and 10% allocation to Trading Participants and LSIs, respectively, may be borne jointly by international and domestic underwriters on a pro rata basis, depending on the allocations received.

3. Fixed Income Market

During the formulation of this Blueprint, the total volume of trades at PDEX for the year 2013 amounted to Php 5.73 billion, a 13.34 percent increase from 2012. It is the highest aggregate annual trading volume in the 9-year history of PDEX. Trading volume

for the year 2013 peaked on March 18 at Php 115.34 billion, while it reached its lowest on October 1 at Php 1.64 billion. Average daily trading volume for the whole year was Php 23.69 billion.

In terms of the share of fixed income instruments in the PDEX trading volume, Government Securities accounted for 99.30 percent of all trading for 2013, comprising treasury notes (59.35 percent), retail treasury bonds (36.94 percent), treasury bills (2.86 percent), and special purpose treasury bonds (0.14 percent). Corporate bonds made up the remaining 0.70 percent. Bonds issued by the Philippine government have steadily increased in the past few years. In turn, the success of the government securities market has driven the expansion of the budding corporate bond market in the Philippines. Public issuance and listing of corporate bond issues have been growing at an unprecedented pace since 2009. One by one, corporations started to tap the market with public bond issuances and listings, with a number becoming regulars in the registered bond market.

The national and domestic agenda for reforms and priority activities in the fixed income market are described below:

3.1 National Agenda

The national agenda for reforms and development in the fixed income market consists of 5 priority activities, namely: (a) bond market liquidity enhancement; (b) development of private debt issues market; (c) institutionalization of hedge/protection markets; (d) strengthening clearing and risk management of securities and currencies; and, (e) regional cooperation. The details of these priority activities are explained below.

3.1.1 Bond market liquidity enhancement

3.1.1.1 Market Liquidity: The tax environment of tax issues is considered a major cause for segmentation of the market. In particular, the present market that has been organized has been limited to the segment of the community that is subjected to a final withholding tax on interest payments. Consequently, the tax-exempt sector of the market has been left outside of the organized market. This market segmentation has kept a large pool of securities liquidity away from the organized market. In government securities alone, tax-exempt investments account for as large as one third of the National Government's outstanding issue. This market segmentation can be alleviated by the introduction of systems that are capable of tracking purchase histories and accounting for taxes that should be levied against taxable entities on the basis of holding periods. In the US dollar-denominated government securities market, the organized market has mobilized this capability, and created a new environment where taxable and tax-exempt entities can transact freely with one another. This new environment can be launched for all other securities and processes are underway to clear the systems and technology attendant to bring into play the integrated environment.

3.1.1.2 Cash Liquidity: The organized market looks forward to the creation/strengthening of market programs that can contribute to greater cash liquidity in the market, so that players are equipped with the necessary tools to support their trading activities. In the coming years, these efforts would include the repurchase agreements markets and, the securities financing markets.

Repurchase Agreements Markets: The organized market has launched a repurchase (Repo) agreement capability to assist dealers in firming up trade commitments in the market. The current Repo market is an Inter-Professional market, participated in by dealers as Repo Sellers, and Qualified Investors and Dealers as Repo Buyers. While a slow and steady growth was witnessed in its early years, the need for a well-defined tax environment is needed to nurture this growth and make the program a relevant market tool for liquidity. Tax regulatory authorities must deeply understand the function of the program in order to align tax policy with the market dynamics.

Securities Financing: A securities financing program is proposed to enable a wider community access to cash facilities to support trading activities.

3.1.1.3 Securities Liquidity: To supplement the cash liquidity tools for the market, the organized market also looks forward to the strengthening of securities liquidity programs, to equip market players with the necessary tools to support their trading activities. In the coming years, these efforts would include the growth of the securities lending program.

Securities Lending: A defined securities lending program has been available to the market. Efforts are underway to create a market impetus for the utilization of the program, so that the same can function as a market tool to boost securities liquidity.

3.1.1.4 Issue Liquidity: A vital contributor to market liquidity is the creation of an environment that would boost liquidity of issues for trading in the organized market. In particular, the Government is interested in launching and institutionalizing programs that would rationalize its bond issuances to ensure optimal tradability of its issues.

Continuous Switch and Swap: The Continuous Switch Program is envisioned to operate as a fails settlement mitigant and as a critical tool in identifying issues that are losing tradability in the market. Under the envisioned program, market makers will be provided an opportunity on any given day to switch securities which they consider to be losing tradability with more liquid issues of government securities. This mechanism will ensure that untradeable issues are swept out of the market and replaced with more tradeable issues. It may also allow dealers to swap illiquid issues with more liquid ones on a scheduled basis.

Securities Stripping: A program to enable the creation of new securities from the coupons of outstanding securities (including packaging of strips) is in the beginning stages of development. Through the program, the issues can gain depth and attractiveness to the market base.

3.1.1.5 Market Maker Programs: The National Government, through the Bureau of the Treasury (BTr) envisions a full-scale program that would identify entities that are committed to merchandize its issue, and provide a suite of support facilities that would assist these specialists in delivering on their commitments and incentives that would reward them for the performance of their obligations. These facilities include support systems from the BTr in the Repo and Securities Lending Programs, as well as the Continuous Switch and Continuous Swap facilities. In return, and utilizing the full suite of support facilities if necessary, Market Makers are envisioned to commit themselves to continually provide price discovery to the issue, with firm bids and offers on the issue across all market segments.

3.1.2 Development of private debt issues market

The bond market has begun corporate securities trading, and had witnessed the entry of various corporate securities into the marketplace, from varied sectors, and with varying features to suit investors' needs. We look forward to building further on this growth to develop the **Qualified Notes Market** (securities issues to a restricted number of investors), the **Securitized Markets** (creation of an organized marketplace for the trading of asset-backed securities) and **ETFs** (making the market venue available for Exchange-Traded Funds). Regulatory discussions have begun to pave the way for these expansions to take place.

3.1.3 Institutionalization of hedge/protection markets

The spot market gains in development, strength and robustness pave the way for the market's readiness for the institutionalization of hedge and protection products and markets in the near future. These markets, including **Interest Rate Swaps**, **Non-Deliverable Forwards**, and **Forward Rate Agreements**, are envisioned to provide exit points out of the market, in ways that would not unduly impact the spot market. Moves to institutionalize the market structure can only go forward under a clearly defined regulatory environment. However, before a regulatory environment can be defined, it is necessary to develop a policy framework. It is envisioned that such policy framework will be founded on the following mutually reinforcing principles for the sustainability of these markets and activity therein: domesticity and centrality.

The principle of domesticity recognizes all of an issuing country's laws, rules and regulations for its financial markets and instruments, including licensing, settlement, leverage, currency and taxation. It ensures that all risk exposures from Philippine financial instruments whether "physical" or "notional" are monitored and overseen for systemic impact by the country's own regulators. The principle of domesticity will be expressed through coordinated policies between the BSP and SEC and with the Bureau of Internal Revenue (BIR) on taxation matters.

The related principle of centrality applies to several areas including price discovery, access to liquidity, settlement location, securities productivity, and protection markets.

Both principles and the implied policies arising are fully consistent with global regulatory trends toward the hedge and protection markets post the 2007-2011 financial crises as expressed through the US Dodd-Frank Act (DFA) and European Market Infrastructure Regulations (EMIR). More importantly, the above principles, will strengthen the Philippine local community by providing equal access and participation to the intermediaries, investors and issuers when we move towards regional integration.

It is a recognized goal to expand the range of traded products by introducing new products such as hedge funds and alternative investments. It was emphasized that investor protection, particularly for non-traditional securities and derivatives, should be put in place.

3.1.4 Strengthening clearing and risk management of securities and currencies

In parallel with all the other planned future initiatives and consistent with international prescriptions of market research, the Philippines also needs to strengthen its clearing and risk management environments both for securities and currencies, to assure market players of equal access to the market and deeper liquidity, clear of counterparty risk friction. The key initiatives included in the Philippine roadmap are the following:

Margins: Use of margins to collateralize counterparty credit risk both in response to the Basel capital requirements for financial institutions as well as to afford equal access to trading markets by trading participants of varying capitalization. A specific example is the proposed Multilateral Trading Program of the PDS Group, which seeks to cover the pre-settlement risk of trading counterparties through the delivery of margin collaterals which are translated to trading limits in the trading system.

Netting: The use of exposure or position netting is also being explored for certain products, whether bilateral or multilateral, as a means to reduce final settlement obligations and promote settlement efficiency. One potential candidate for netting are the foreign exchange (FX) spot market trades, where bilateral netting would achieve a netting efficiency of 70 percent in terms of trade count and 45 percent in terms of value. Efficiencies through multilateral netting are even more dramatic at 98 percent in terms of trade count and 75 percent in terms of value. Similar studies are being conducted for other asset classes, notably fixed income securities and eventually the hedge products.

Central clearing: Centralized clearing and risk management is also being considered as a natural consequence of the organization of our markets. Whether this centralization will involve the use of a central counterparty is also part of the study fully recognizing that the heterogeneity of our market players is best served by adopting a tiered clearing concept with a select group of qualified clearing members representing non-clearing members.

3.1.5 Regional cooperation

The Philippines is committed to regional discussions that would allow the domestic market to expand its reach. In this regard, it contributes to the dialogue opened by the ASEAN+3 Bond Market Forum and hopes for sustained cooperation on the notion that domestic issuers can access foreign investors, and the trading community can extend their activities in organized markets offshore. A central premise of this endeavor is the ability to go beyond local borders while preserving domesticity of our issues.

Regulatory harmonization: Any endeavor to cooperate on a regional level must institute measures to ensure that appropriate regulation is in place to safeguard the activity. Hence, the thrust to look outward and join the regional discussion may lay serious focus on harmonizing regulatory frameworks to the extent possible. This assures a level playing field among countries that desire a cooperative relationship moving forward and predictability in the way a regional market will operate, which is essential to building a stable and sustainable market.

Tax treaty implementation: While tax treaty implementation has been underway to enforce treaty obligations between bound states, the organized market looks to streamlining the process to be responsive to the needs of a fast-paced and dynamic

marketplace, without compromising the taxing authority's verification requirements for the application of preferential treaty rates.

Institutionalization of market access: As markets unite and link with each other, the notion of organization and order remains at the forefront of our vision. We look to the organized markets within the region to create the links that would give life to a regional trading venue that proceeds on the basis of order and cooperative processes, for trading, clearing and settlement. Assessment is being recommended in the following areas:

- The cost burden of fixed income investors;
- Migration to scripless environment;
- To enhance continuing education, improve educational initiatives based on experiences gained, emphasizing the role of banks;
- To improve governance, strengthen the role of independent directors and compliance officers.

3.2 Sectoral Agenda

There is need for internal adjustments in our regulatory environment to achieve these goals, recognizing the key regulatory steps necessary to prepare our markets for a regional presence, as set out by the Philippine Working Group. Thus, the priority activities included in the domestic agenda for reforms and development in the fixed income market are the following: (a) actions from the *Bangko Sentral ng Pilipinas*; (b) actions from the Securities and Exchange Commission; (c) actions from the Bureau of Internal Revenue; and (d) further defining the BSP-SEC regulatory relationship.

3.2.1 Actions from the BSP

Taxation of bank issues: Currently, bank issues suffer from inconsistent treatment of negotiations of instruments. The market has evolved varying approaches, leaving investors in an environment where similar issues have non-uniform negotiation consequences, particularly on the tax aspect. The BIR has issued Revenue Regulation 14-2012 and its accompanying Revenue Memorandum Circulars on the Proper Tax Treatment of Interest Income Earnings on Financial Instruments and Other Related Transactions. The BSP is the competent authority to align the environment for a uniform application among all bank issues..

Ring-fencing nominee ship, trusteeship, custodianship and agency functions: While there is a very clear delineation of the trust functions and assets held in trust away from the main bank, this is not so for services undertaken under a nominee capacity, such as some of the existing securities custodianship arrangement of some banks. This need would be more highlighted as banks enter into third-party clearing arrangements to service the growing needs of our securities market. Third-party clearing enables market participants to concentrate on trading activities by assigning their clearing and settlement responsibilities to a third party (usually a bank) who takes over the trades and becomes the settlement counterparty on behalf of the non-clearing trading participants. The bank third-party clearer normally holds assets on behalf of these non-clearing entities in nominee capacity. Even those entities which may hold these assets in trustee capacity, the third-party clearing arrangement should also be distinguished from the standard trust services which give rise to trustor-trustee relationship. Thus, it is ideal to clarify the regulatory environment for nominee ship activities particularly in relation to securities

servicing as this has far reaching risk management implications on banks offering this service, on their customers and on the securities market in general.

Trust indenture regulations: There is a need to review and assess existing laws and regulations governing trust indentures to ensure there is adequate investor protection.

3.2.2 Actions from the SEC

Shelf registration: Regulatory discussions have been launched to re-examine the existing registration process. In particular, under the current SRC Rules, remaining registered but unsold securities shall be offered after the completion or termination of an offering subject to the filing of any updated registration statement prior to the said offering or sale. The expansion of this rule is being proposed to permit an issuer to register a fixed income security on a continued or delayed basis. A shelf registration on a continued basis is an arrangement that allows a single registration statement to be filed for the issuance of multiple securities while that on a delayed basis is an arrangement that allows a corporation to file its registration statement up to several years in advance before the actual public offering. The proposed shelf registration shall allow the issuer to gain access to the market in a more timely manner. As the regulatory review has been sought in advance, sales may be made as soon as funds are needed or when market conditions are favorable. The proposal also aims to reduce the amount of work required by and costs of a frequent issuer and its advisers at the time of each issue, with the objective of encouraging more corporations to tap the capital markets for their funding requirements.

Special Purpose Vehicle regulations: These regulations are anticipated by the market, so that asset backed securities can enter the organized market, for price discovery and orderly trading and settlement.

Exchange Traded Funds regulations: These regulations are anticipated by the market, to increase asset classes listed in the organized market and diversify investment opportunities available to investors.

3.2.3 Actions from the BIR

DST on repurchase agreements: While existing law and accompanying regulation warrants an exemption from the Document Stamp Tax (DST) for Repurchase Agreements, further growth in the Repo markets is hampered by an unclear DST environment, undermining its relevance as a support facility to the spot market. It is believed that the DST exemption of Repos in the PDEX market should be supported or that the BIR should clearly frame the requirements for Repos to be covered by the DST exemption.

Active/Passive regime: The current tax regime that uniformly imposes a 20 percent final withholding tax on interest income needs to be implemented in accordance with its true intent – as a passive income tax. Hence, only passive income earners should be subjected to this tax. Active income earners should be defined and accorded an active tax regime, for their activities in the market. We support the move to review and harmonize tax policy for the equities and fixed income markets. It is noted that the equities market has a well-defined environment that differentiates active from passive income earners, and ordinary assets from capital assets, with an environment that takes these definitions into account. There is a need for discussions with the BIR to likewise

define a similar environment for the fixed income market so that market players can undertake their activities in a rationalized tax environment.

Tax treaties: Investors from countries with mutual tax treaty agreements with the Philippines look forward to enjoying the preferential tax rates on the income from their securities investments in the Philippines as one incentive for investing. The single biggest bottleneck that prevents this from being realized is the requirement to obtain a BIR tax clearance for each and every withholding event (e.g. for every cash dividend or coupon payment). This could be simplified by adopting a one-time registration process, through accredited intermediaries (such as nominees or trustees) to establish the tax regime applicable to a particular investor which would hold true until changed or revoked.

3.2.4 Further clarifying the BSP-SEC regulatory relationship

Segregation: There is a need to provide a clear delineation of regulatory functions that undertake multifarious activities in the financial markets. The current environment that bundles underwriting, investing, and brokering activities hampers a market's ability to determine order. Hence, the moves to initiate a segregation process are strongly supported. It is hoped that the segregation will cause the following delineations: (1) the securities business from the regular banking business; (2) within the securities business – delineation of the dealing business from the brokering business; and (3) within the brokering business, assets of the broker are kept separate from those of clients. This segregation will enable regulators to clearly discern the underlying intent in trading activities, and enable market players to perform their functions with a clear understanding of their roles and duties. Records of banks will likewise be capable of appropriate scrutiny where warranted and the proper regulatory and tax monitoring can be operationalized.

Centralized clearing/risk management and third-party clearing: On the securities servicing, clearing and settlement and payment, BSP and SEC should define the regulatory environment on this. In the aftermath of the financial turmoil, one recommended best practice that has gained global acceptance is the implementation of centralized clearing and risk management whether trades are executed in exchanges or over-the-counter. Markets and their regulators are being challenged to seriously consider implementing centralized clearing and risk management, in whatever arrangement best suits the market needs, to achieve greater transparency, apply uniform risk standards and protocols, lower systemic risk, and better control leverage and potential shocks to the market. Centralization could also bring about economies of scale and when coupled with netting, could result to better liquidity.

In addition, the regulatory relationship between the banking regulator and the securities regulator calls for the need to clearly define the environment for activities in the securities industry where potential ambiguity exists. In particular, the development of a well-defined regulatory environment for derivatives must be in place to squarely position the appropriate oversight structure so that all requirements can be met.

As the clearing and settlement infrastructure undergoes its assessment process to define and operationalize norms of central clearing, we look forward to the regulatory coordination between the BSP and the SEC to define the framework under which these new paradigms could be operationalized – prescribing together the layers of protection that must be installed for the system to function appropriately and the roles and responsibilities of parties engaged in the clearing process (trustees, nominees, and

custodians). The BSP, with its perspective on the preservation of values in the clearing cycle and its impact to monetary stability, must assess appropriate risk valuation models and set capital standards.

These discussions are envisioned to prepare our market to face the challenges of a regional effort that will take our bond market beyond our borders. There is much to be determined from the regulatory plane, so that any regional endeavor can bear fruit. In particular, these could include the following:

3.2.4.1 Regulations on cross bordering of securities

Trading of securities across national boundaries pose a special challenge both to the SEC and the BSP as this opens up our markets to players that are not subject to the direct supervision of either BSP or SEC. This calls for a regional collaboration among regulators to set-up a regulatory framework that would be acceptable and enforceable in multiple jurisdictions notwithstanding the differences in laws, regulations and conventions of markets, bearing in mind that our bid to be regionally attractive should also not compromise our domestic investors. On the other hand, when cross-border activities are subjected to a uniform standard or protocol, our regulators would have a better handle on trading activities in foreign markets of supervised entities.

3.2.4.2 Maintaining productivity and domesticity of instruments

As discussions ensue on the clearing and settlement process, we believe that the proposition of centrality must be supported not only on the basis of market efficiency. Regional activity is greatly enhanced by the presence of a central securities depository that brings order to the settlement process and contains the attendant risks. The depository architecture should support multiple asset classes so that investors can benefit from the productivity of their assets, which can be converted from one asset type to another and used in various market programs, with minimal process friction.

While regionalization is a key objective of the Blueprint, we must lay down the precepts under which we allow ourselves to be part of a regional activity. We believe that regionalization will bring increased liquidity to the market and expand and deepen our investor base. But we likewise believe that this growth and opportunity must be tempered with a resolve to maintain the domesticity of our instruments and markets and control the environment of regionalization. Cross-market activity should be undertaken under a framework where the linkages are based on an institutional market-to-market approach, as such an institutional market approach would better assure domestic markets' capability to maintain the order and integrity of their own markets and manage the upward surge or stoppage of capital flows.

3.2.4.3 FX regulations on settlements

The existing procedure for FX investment registration and repatriation has served its purpose for the last decade. Given the developments in real-time payments, centralized settlement and electronic messaging, it is high time that the existing process be reviewed and enhanced to streamline the process or automatically embed in originating transactions such as a trade, a settlement or a payment.

3.2.4.4 Dispute Resolution

As we become more involved in jurisdictions outside of our borders, the management of possible disputes should likewise be defined under a framework that would afford predictability for investors and the market. Otherwise, the applicability of several and potentially varied legal systems would make the market unattractive to investors and players, who would not have a clear framework for redress and remedy of their disputes.

3.2.4.5 SROs and Enforcement

Part and parcel of a dispute resolution framework is an enforcement environment that should likewise be clear and predictable. Market players in a regional marketplace should be bound by rules of conduct that are more or less aligned with each other, and SRO powers and jurisdiction must be clear. Otherwise, market players could be faced with multiple SROs having jurisdiction over a single act of misconduct.

4. Alternative Products

Healthy and vibrant capital markets require both a diverse base of investors, as well as a broad range of investment products broad enough to meet the diverse needs of investors. Unfortunately, the Philippines has often fallen short on both these factors. The Philippine market for alternative products remains relatively thin. This is due to the collective effect of a multitude of factors including a relatively small set of foreign and domestic institutional investors offering limited market depth and liquidity in a narrow range of basic investment products, and compounded by regulatory issues in the framework and other political and economic constraints.

However, the recent strong performance of the Philippine economy- even in the face of severe economic problems in the Americas and Europe – and a renewed focus on fiscal discipline, transparency and good governance has thrust the Philippines into the position of being one of the best performing markets in the world. With the added near-term prospect of a possible upgrade to investment grade, the Philippines has the attention of global investors and is in an excellent position to jump-start the growth of its capital markets and remain competitive with its ASEAN neighbors by broadening its selection of investment products with alternative products such as REITs, ETFs, derivatives and other Structured Products.

Achieving this will require that both public and private sectors work together in a timely fashion to produce a coherent - and competitive- legal and tax framework for alternative investment products. A single regulatory framework under the proposed Collective Investment Scheme Law (CISL) would be invaluable toward fast-tracking the development and marketing of various alternative products. In addition, the implementing guidelines and regulations for both existing investment laws (e.g. the PERA and REIT laws, etc.) and the proposed CISL need to be harmonized so as to balance both the interests of investors and the requirements of fiscal policy, while at the same time remaining competitive vis-à-vis other ASEAN capital markets.

During the plan period, the development challenge is how to generate a more vibrant capital market through a responsive competitive policy framework that would harmonize existing rules and regulations towards the promotion of derivatives and structured products in the market. An enabling policy environment will hopefully facilitate the introduction of derivative and other structured products with attractive investor returns at minimal investment risk depending on the type of structured product.

On **derivatives and structured products**, the challenge is to harmonize the provisions governing derivatives in the SEC-IRR and BSP Circular 594. Among the key issues to be resolved are the following: (a) definition of derivative products; (b) definition of end-user participants (i.e. sophisticated vs. general public); and, (c) institutions allowed to engage in financial derivatives business.

On **collective investment scheme products**, the challenge is to harmonize the existing laws on various types of CIS products to create a level playing field, provide greater protection to the investing public and provide greater investment opportunities for middle to low-income investors.

On **PERA products**, the challenge is how to encourage retirement savings and long-term investment through tax-exempt investment products. At present, there is need to firm up the operational details covering the following PERA products: (a) Unit Investment Trust Funds (UITFs); (b) shares in mutual funds; (c) annuities; (d) insurance pension; (e) pre-need pension plan; (f) other securities listed and traded in the stock exchange; (g) Exchange traded bonds; and (h) government securities; among others.

On **REITs**, the challenge is how to encourage small investors to participate in the real estate industry through a listed investment vehicle which holds income-producing real estate or real estate-related assets.

On **ETFs**, the strategic objective is to encourage the introduction of this alternative product which promotes work, savings and investment. Of immediate need is the finalization of governing rules and regulations on ETFs.

5. Tax Matters

The main challenge confronting the aspect of taxation in the Philippine capital market is to resolve within the near-term, important tax issues that if resolved will contribute progressively to the growth and competitiveness of the Philippine capital market given the forthcoming ASEAN economic integration.

5.1 Taxes on Financial Products

Various concerns have been raised by the private sector as to the imbalance of tax rates of financial products. Based on the results of a 2007 study, the present final withholding tax (FWT) system is biased against savings and imposes different taxes on income arising from the same or equivalent acts of saving depending on the currency, denomination, maturity, and issuer of the financial instrument of asset in which the savings are invested.

The same study revealed that one of the causes of perceived financial distortion was the income tax exemption given to interest arising from long-term instruments, trust

accounts and other issuances by banks. If the goal is to encourage savings, there is no real justification for exempting long-term deposits in banks from the FWT. If savings are to be encouraged, all savings should be taxed similarly regardless of the issuer of the financial instrument. The report also indicated that the 20 percent final tax on nominal interest income is a very high tax on real interest income if inflation is large relative to nominal interest. This is the reason for recommending the Financial Sector Tax Neutrality Bill (“Fintax Bill”), a uniform tax rate of 10 percent instead of 20 percent.

With respect to interest income earned by banks and financial intermediaries with quasi-banking (QB) functions from deposit substitutes and securities, such interest is a substantial part of both the revenue and costs of firms in the financial sector and the gap between interest income and interest expense is small so that a FWT on gross interest income can be a large percentage of net interest income. Thus, one way to reduce the tax bias against the financial sector is to treat interest income of banks as normal revenue from which interest expense and other operating costs can be deducted for tax purposes.

In addition, the FinTax Bill also proposes to address other major concerns on the taxation of financial transaction. Since 2007, only the following issues have been addressed: (1) Documentary stamp tax (DST) on listed shares transaction with the passage of Republic Act No. 9648 on 30 June 2009; (2) DST and premium tax on life insurance with the enactment of laws amending the rates of premium tax and DST on life insurance; and, (3) Tax issues pertaining to pre-need companies with the enactment of the Pre-need Code.

The following recommendations have been floated to address the tax issues:

Figure 5 - Recommendations to Address Tax Issues

Tax Rates under the NIRC	Policy Recommendations	Fin Tax Bill
Imposition of final withholding tax (FWT) of zero or 20% on interest income depends on issuer, currency or maturity	Shift to a uniform FWT on all interest income regardless of issuer, currency or maturity	Recommendation included in the Bill
Interest income earned by banks and financial intermediaries with quasi-banking (QB) functions from deposit substitutes and securities, is subject to FWT of 20%	Exempt from FWT the interest income earned by banks and financial intermediaries with QB functions from deposit substitutes and securities; subject to corporate income tax	Recommendation included in the Bill
Net Repo trading gains included in the gross receipts tax (GRT)	Removal of net Repo trading gains from GRT; subject to corporate income tax	Recommendation included in the Bill
Reverse repurchase agreements between BSP and authorized agent banks included in the definition of “deposit substitutes”	Removal of reverse repurchase agreements between BSP and authorized agent banks from the definition of “deposit substitutes”	Recommendation included in the Bill
Income derived by finance companies from leases, whether or not exercising quasi-banking functions, is included in GRT	Removal from GRT and incorporate into VAT income derived by finance companies from leases, whether or not exercising quasi-banking functions	Recommendation included in the Bill
A tax is imposed on initial public offering (IPO)	Suspension or abolition of IPO taxes	Abolition of IPO tax adopted in the Bill
½ of 1% on the gross selling price or gross value in money on the shares sold through the exchange		¼ of 1% on the gross selling price or gross value in money of the shares sold through the exchange

5.2 ASEAN Economic Integration

With the forthcoming integration of the ASEAN economies, the Philippines must enhance its system of taxation and exchange of information in order to be efficient and competitive. There are targets under the scorecards of ASEAN Forum on Taxation that the Philippines must accomplish by year 2015, particularly the adoption of best practices on exchange of information and execution of bilateral tax treaties to address double taxation and other issues.

Priority improvement for the integration is the streamlining of procedures in availing preferential tax rates for investors from countries with mutual tax treaty agreements with the Philippines.

The next step being looked into by the ASEAN Forum on Taxation is the harmonization of the tax rates in the region. However, this may be considered as a long-term target because of the legislative actions needed to implement the same.

5.3 Recently-Enacted Laws on Capital Market

It is said that there are laws providing incentives that are not being availed of because of tax rulings or regulations that tend to negate the advantages given under the laws. One particular area of concern is on the implementation of the Real Estate Investment Trust (REIT) Act. The following requirements under the REIT Act and its Implementing Rules and Regulations (IRR) reportedly have discouraged interested companies from engaging in the transactions subject of the Act: (a) imposition of Value Added Tax (VAT) on the real property to be transferred by developer-proponent to a REIT corporation; (b) placement under an escrow the monetary incentives obtained from REIT operation; and, (c) MPO of 67 %.

5.4 Venue for Discussion of Issues on Taxes

There are tax rulings and regulations that have a direct or indirect impact on capital market transactions. The impact may be positive or adverse depending on the resulting tax consequence of on the capital market transaction. There may also be procedures under the system that create an imbalance of tax impositions within the capital market. These tax issues or procedures may be best threshed out through a formal group comprising of members from the respective sectors who can identify the possible direct or indirect impact of a tax ruling or regulation to the capital market and who can propose to the tax authority reasonable and practical measures to avoid or to mitigate any adverse effect to the capital market.

C. CMDP 2011-2016 RESULTS FRAMEWORK

At the national level, the broad development challenges and opportunities confronting the Philippine capital markets cascade from the challenges and opportunities faced by the Philippine financial sector. As indicated in the Philippine Development Plan 2011-2016, key actors in the Philippine capital markets commit to pursue a number of key national reform objectives.

First, is the promotion of a regionally responsive and inclusive financial system through institutionalized savings generation and resource mobilization. Second, is the development of an enabling environment for long-term investments. Third, is the strengthening of the governance framework of the financial system in line with best practices and standards. Fourth, is the establishment of a strong legal framework for financial sector development. Recognition of these key national reform objectives and alignment thereto of the sectoral reform objectives will facilitate consistency and deepening of the reform initiatives for the capital markets.

At the level of the capital markets sector, the goals of the CMDP Blueprint 2013-2017 are directed towards the realization of a strong, reliable and competitive Philippine capital markets. The CMDP Plan expects that each of the critical subsectors contribute towards this sectoral goal.

Building on the gains of the predecessor plan, the CMDP for 2013-2017 shall pursue development activities that will progressively result in the attainment of the following specific sub-sectoral goals and objectives:

- First, a strong, reliable and competitive fixed income market;
- Second, a strong, reliable and competitive equities market;
- Third, a strong, reliable and competitive market for alternative investment products;
- Fourth, a neutral taxation system and rational tax consequences; and,
- Finally, an institutionally strong and capacitated corporate regulator.

The above-stated broad development challenges, opportunities and sectoral goals and objectives are reflected in the results framework depicted in Figure 6. The CMDP Blueprint 2013-2017 sectoral goal of a strong, reliable and competitive Philippine capital markets will be realized through the collective and positive results of the above-stated five development objectives. A total of 26 strategies will support the attainment of the CMDP Blueprint 2013-2017 sectoral goals that will hopefully contribute progressively towards a resilient and inclusive financial sector as indicated in the Philippine Development Plan 2011-2016.

D. DEVELOPMENT OBJECTIVES, STRATEGIES AND EXPECTED RESULTS

1. Development Objective 1, Strategies and Expected Results: Towards a strong, reliable and competitive fixed income market

The attainment of this development objective of a strong, reliable and competitive fixed income market will be the result of the positive effects of seven corollary strategies.

First, **bond market liquidity will be enhanced** through: (a) enhancing market liquidity; (b) encouraging cash liquidity through repurchase agreements markets; (c) encouraging securities financing and; and (d) ensuring issue liquidity.

Market liquidity may be pursued through (i) tax unification wherein a tax-exempt entity will be able to buy from or sell to a taxable entity without restrictions; (ii) through market maker programs which are expected to result to the accreditation of more market makers; and, (iii) through the use of the Securities Stabilization Fund to address settlement failures.

Cash liquidity will be significantly enhanced through the organized inter-professional repurchase market with the implementation of repurchase agreements.

Securities financing and lending will be encouraged. Issue liquidity will be enhanced with the use of the continuous switch, swap and securities stripping facility for market makers.

Second, the **private debt issue market will be developed** by (a) streamlining the registration process through shelf-registration; (b) allowing trading of qualified notes in the organized market to provide price discovery and transparency; (c) through a securitized market; (d) by the issuance of regulations for the ETFs; and, (e) through a perpetual bonds regulatory framework after the core regulatory framework has been well-defined.

Third, the **governance and regulatory framework will be strengthened and enhanced** through the (a) implementation of the 3-step segregation of securities to strengthen the ability of banks to perform its role as a securities intermediary, either as a securities dealer and/or broker; (b) clarification of the tax environment of fixed income securities; (c) clarification on the functions of nomineehip, trusteeship, custodianship and agency; (d) review and assessment of existing laws and regulations governing trust indentures; and, (e) strengthening the role of independent directors and compliance officers.

Fourth, the **clearing and risk management of securities and currencies will be strengthened** through the use of margins, netting and central clearing. The use of margins is intended to allow equal access for all trades in an organized market under a multilateral framework.

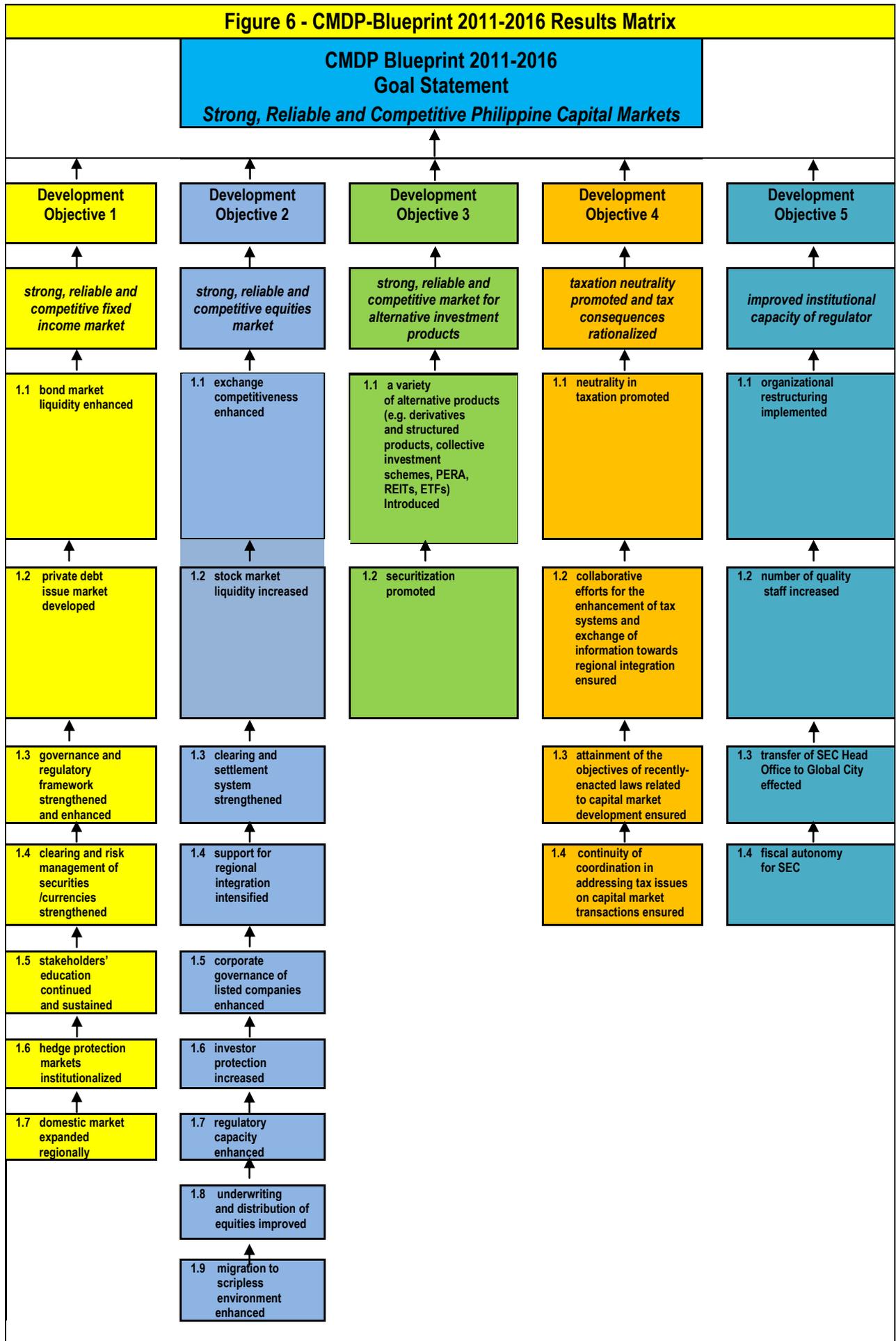
On the other hand, netting of positions is expected to result to a higher trading activity as funding liquidity constraint is alleviated and settlement risk is reduced.

Fifth, **stakeholders education will be continued and sustained** through the conduct of continuing market-based educational programs for market development.

Sixth, **hedge/protection markets will be institutionalized** through the (a) development of a policy framework; (b) the clear definition of the regulatory environment; and (c) formation and operation of a registered OIS/interest rate swaps markets, registered non-deliverable forward market, and registered forward rate agreement market.

Finally, the domestic **market will be expanded regionally** through regulatory harmonization/mutual recognition, tax-treaty implementation and by the institutionalization of market access.

Figure 6 - CMDP-Blueprint 2011-2016 Results Matrix



2. Development Objective 2, Strategies and Expected Results: Towards a strong, reliable and competitive equities market

The attainment of this development objective of a strong, reliable and competitive equities market will be the result of the positive effects of nine corollary strategies.

First, **Exchange competitiveness will be enhanced** by: (a) expanding the range of traded products; (b) rationalizing non-tax friction costs to encourage trading activity; (c) providing an on-line service bureau for trading participants; and (d) implementing an active disaster recovery site that will reduce system downtime.

Second, **liquidity in the stock market will be increased** by: (a) implementation of the MPO; (b) encouraging Board of Investments (BOI)-registered companies to list in the stock exchange and conduct a public offering; (c) encouraging retail investment in stocks by broadening stock market interest and awareness; (d) introducing market making program and by issuing rules/guidelines on market making; (e) refining regulations for short selling and securities borrowing and lending; (f) allowing direct market access; and, (g) allowing algorithmic or high frequency trading.

Third, the **clearing and settlement system will be strengthened** by: (a) requiring posting of margin collateral to cover risk of clearing members' unsettled positions; and, (b) by allowing third party clearing.

Fourth, **support for regional integration will be intensified** by: (a) pursuing the ASEAN collaboration through system linkages of trading, clearing and settlement, and depository; and by participating in the creation of an ASEAN asset class, and, by (b) creating an enabling environment for regional integration by entering into mutual recognition agreements with securities regulators in the ASEAN; and by working towards harmonization of the tax regime and related regulations and streamlining of treaty rate implementation.

Fifth, the **corporate governance of listed companies will be enhanced** by: (a) reviewing the coverage of corporate governance and proposing more mandatory provisions in the Revised Code of Corporate Governance; (b) launching the Maharlika Board for companies complying with the highest standards of governance; (c) actively promoting the Maharlika Board to issuers and investors in order to expand listings; (d) giving Bell Awards for Corporate Governance for the top 5 listed companies and top 3 trading participants per category of large and small that are fully compliant with the rules and corporate governance best practices; (e) and by implementing the use of the name on central depository (NoCD) account structure to enable listed companies to identify their beneficial stockholders.

Sixth, **investor protection will be increased** by: (a) implementing the use of sub-accounts or NoCD account structure for the equities market; (b) by implementing a system by which the investor can access information on own account holdings and movement; (c) imposing stricter requirements on Stock Transfer Agents of listed issuers; (d) allowing the submission of a single Tax Treaty Relief Application per investor regardless of the number of dividend payments per issue; (e) conducting a regular investors forum and training on regulatory surveillance and monitoring; and, (f) by implementing a more advanced surveillance and monitoring system adapted to the Philippine capital market.

Seventh, **regulatory capacity will be enhanced by** participating in periodic training on the latest product offerings and international best practices in the capital market.

Eighth, **reforms in the underwriting and distribution of equities will be introduced and improved** by reviewing and rationalizing the present underwriting practice where foreign underwriters have significantly larger share of initial public offerings (IPO) and for the SEC and PSE to identify and implement better alternatives thereto.

Finally, the **migration to scripless environment will be enhanced** by: (a) making mandatory the issuance of scripless securities; and, (b) by educating creditors and other interested stakeholders on the rules on scripless securities.

2. Development Objective 3, Strategies and Expected Results: Towards a strong, reliable and competitive market for alternative investment products

During the plan period, efforts will focus on generating a more vibrant capital market through a responsive and competitive policy framework that would harmonize existing rules and regulations towards the promotion of a strong, reliable and competitive market for alternative investment products. The attainment of this development objective will be the result of the positive effects of four corollary strategies.

First, a **variety of alternative products will be introduced**. These alternative products will include derivatives and structured products, collective investment schemes, PERA products, REITs, and ETFs, among others.

Second, **securitization will be promoted** by providing the legal and regulatory framework for securitization and creating a favorable market environment for a range of asset-backed securities.

On **derivatives and structured products**, the development strategy is to complete discussions between the SEC and Bankers' Association of the Philippines (BAP) to harmonize the provisions governing derivatives in the SEC-IRR and BSP Circular 594. Among the key issues to be resolved are the following: (a) definition of derivative products; (b) definition of end-user participants (i.e. whether sophisticated and general public); and, (c) institutions allowed to engage in the financial derivatives business.

On **collective investment scheme products**, the development strategy is to harmonize the existing laws on various types of CIS products in order to provide greater investment opportunities for middle to low-income investors. Also needed is a comprehensive framework for investment companies (i.e. mutual funds, hedge funds) and unit investment trust funds to remove regulatory differences and tax arbitrage among the different forms of CIS products.

On **PERA products**, the strategy is to formulate and implement measures to encourage long-term investment through tax-exempt investment products. On **REITs**, the immediate need is a review and amendment of the current IRR being urged by industry players. Finally, on **ETFs**, the priority strategy is the finalization of governing rules and regulations on ETFs

3. Development Objective 4, Strategies and Expected Results: Towards promoting taxation neutrality and rationalizing tax consequences

The attainment of the development objective of promoting taxation neutrality and rationalized tax consequences will be the result of the combined effects of three corollary strategies namely: (a) promoting neutrality in taxation in the capital markets; (b) promoting collaborative efforts for the enhancement of the tax system and exchange of information towards regional integration; (c) ensuring attainment of the objectives of recently-enacted laws related to capital market development; and, (d) ensuring continuity of coordination in addressing tax issues on capital market transactions.

First, **neutrality in taxation in the capital market will be promoted** to provide a better level playing field for all market participants and to encourage more investment in financial products. For purposes of this strategy, neutrality means “similarly taxing similar financial activities, encouraging savings and discouraging transaction taxes, including those that are so named to have the same effect”¹⁷.

The strategic objective of promoting taxation neutrality will be pursued through the following initiatives: (a) fast-track the filing of the FinTax Bill; and (b) monitor the progress and facilitate the enactment of the bill into law during the period 2013 to 2016.

The second proposed strategic objective is the promotion of collaborative efforts for the enhancement of the tax system and exchange of information towards regional integration. A formal link between the private sector and concerned government agencies will be established through the Department of Finance to ensure coordinated and consistent actions and deliverables with the activities of ASEAN Forum of Taxation.

The priority area of collaborative action is the compliance with the scorecard for integration which involves the execution of bilateral tax treaties to address double taxation and issues on exchange of information. Also to prioritize is the coordination between the proponents for the streamlining of procedures in availing tax incentives under bilateral treaties.

The third proposed strategic object is to ensure attainment of the objectives of recently-enacted laws related to capital market development. The immediate need is to review specific laws which may not attain their objectives due to certain implementation issues particularly on taxation and related matters.

One of these laws is the REIT Act of 2009 which was enacted to promote the development of the capital market, democratize wealth by broadening the participation of Filipinos in the ownership of real estate in the Philippines, use the capital market as an instrument to help finance and develop infrastructure projects, and protect the investing public. After the review is completed, the next step is to propose measures to mitigate the negative effects of such laws.

¹⁷ Reference: EMERGE Report by Dr. Felipe Medalla, Monetary Board member.

To address concerns on the tax issue on REIT Act, two proposals have been submitted. One of the recommendations is for the DOF to issue an administrative ruling allowing for the following graduated MPO with seven levels:

Market capitalization [Php]	Minimum Public Ownership
300 Million - 1 Billion	67 %
Above 1 Billion - 2 Billion	62%
Above 2 Billion - 5 Billion	57%
Above 5 Billion -10 Billion	52%
Above 10 Billion - 15 Billion	47%
Above 15 Billion - 20 Billion	40%
Above 20 Billion	33%

Another proposal is to submit to the Congress specific amendments to the REIT Law that will remove the tax arbitrage and retain the original MPO requirement. It is proposed that the removal of the tax arbitrage will be by way of imposing tax on the dividend income received by corporations from REITs, and removing the income tax, VAT and DST over the transfer of properties from the developer to the REIT.

The last strategy under this development objective is to **ensure continuity of coordination in addressing tax issues on capital market transactions** through the creation of a **Capital Market Development (CMD) Tax Group** through which tax issues on laws/regulations or pending bills related to capital market development may be identified and deliberated upon and from which proposals could be made. The membership in the CMD Tax Group is as follows: capital market participants, i.e., Bankers' Association of the Philippines (BAP), Financial Executives Institute of the Philippines (FINEX), Philippine Association of Securities, Brokers and Dealers (PASBD), Philippine Life Insurance Association, Inc. (PLIA), Philippine Stock Exchange (PSE), the SEC, BSP, IC, BIR and DOF. A Memorandum of Agreement between and among concerned agencies included in the CMD Tax Group will be executed to define their roles, responsibilities and commitments. The **CMD Tax Group** is also intended to serve as the venue for information sharing on tax related matters through the holding of regular fora to gather inputs from all stakeholders including the public.

4. Development Objective 5, Strategies and Expected Results: Towards an institutionally strong and capacitated corporate regulator.

The attainment of this development objective of an institutionally strong and capacitated corporate regulator will be the result of the facilitating effects of four [4] corollary strategies.

First, is the **pursuit of the SEC organizational review and formulation of an overall re-organizational plan for the agency**. The plan will be used in part, to formulate a revised organization structure of the SEC appropriate to its existing core and emerging functions as the corporate regulator. Additionally, the re-organization plan is intended to set budget allocations with the Department of Budget and Management [DBM] beginning 2014. While this is work-in-progress as the SEC organizational structure has been modified, staff salaries increased, and vacant positions filled, a holistic approach to re-organizing the SEC is needed at this time to address among others, the need to balance between automation and staff count, identify doable and reasonable criteria for setting up SEC Extension Offices, and propose an appropriate organizational structure based on a functional review.

Second, as a result of the functional and structure review and proposed re-organization of the agency, the **SEC will pursue activities and strategies to increase its manpower complement and enhance their capacity to perform and deliver on their duties and responsibilities.** Relatedly, for the year 2012, the SEC has formulated an action plan to implement staff capacity building measures.

Third, the **transfer of the SEC Head Office building from its present site in the Ortigas complex in Mandaluyong City to the Bonifacio Global City,** to enable the agency to accommodate a bigger clientele and provide adequate space for its expanding workforce.

Fourth is **securing Congressional grant of fiscal autonomy to the SEC** to insulate the corporate regulator from bureaucratic rigidities in connection with fiscal concerns which have hampered its capacity to perform its corporate regulatory functions and duties.

E. BLUEPRINT MATRIX OF OBJECTIVES AND INITIATIVES

The CMDP Blueprint 2013-2017 includes an accompanying **Matrix of Objectives and Initiatives** that summarizes the development objectives, strategies, the initiatives in terms of programs and activities, the indicative target date of completion, performance indicators, implementation issues and the responsible lead or support entity. This Matrix will serve as an important guide for Blueprint implementation and monitoring.

F. CMDP PLAN IMPLEMENTATION AND MONITORING

F.1 CMDP Blueprint Action Plan Implementation

In the implementation of the CMDP Blueprint 2013-2017 Action Plan, appropriate government and private sector entities shall be designated as lead and support agencies to ensure that approved programs and activities are undertaken and pursued in accordance with the timetable.

F.2 CMDP Blueprint Action Plan Monitoring

The CMDP Blueprint 2013-2017 Matrix of Objectives and Initiatives shall be used in the periodic monitoring the accomplishments of the CMDP Blueprint Action Plan.

The designated lead and support agencies in the implementation of specific CMDP programs and activities shall be required to submit to the SEC as Plan Secretariat, **monthly reports** on the status of implementation.

Thereafter, the SEC shall consolidate monthly reports into **semestral performance** reports based on the identified performance indicators and submit the same to the DOF Secretary and Chairman, Capital Markets Development Council.

The SEC shall conduct a **mid-term review** of the CMDP Blueprint 2013-2017 Action Plan to be participated in by concerned stakeholders. A **mid-term review report** including a **scorecard of accomplishments** for the period shall be submitted to the Department of Finance.

G. CMDP Blueprint Action Plan Financing

The designated lead and support entities in the CMDP Blueprint Action Plan are encouraged to finance the pursuit and implementation of the programs and activities indicated therein.

Where appropriate, the designated lead and support entities may negotiate and secure donor funding to leverage their limited resources.

For the years 2015 to 2017, designated government entities identified in the CMDP Blueprint Action Plan as lead or support agencies are encouraged to include in their proposed budgets, covering funds to implement the identified programs and activities in the Action Plan.

H. Priority Legislative Agenda

1. Proposed Amendments to the Corporation Code (Batas Pambansa Blg. 68)

The proposed amendments to the Corporation Code include a **new chapter on One Person Corporations** consisting of the following sections:

- a. Applicability of provisions to one person corporations;
- b. One person corporation;
- c. Single stockholder;
- d. Minimum amount of capital stock to be paid for purposes of incorporation;
- e. Articles of incorporation; by-laws not required prohibition against multiple one person corporations;
- f. Prohibition against multiple one person corporations;
- g. Display of corporate name;
- h. Single stockholder as director, president and treasurer;
- i. Corporate secretary and other officers;
- j. Special functions of the corporate secretary;
- k. Nominee and alternate nominee;
- l. Term of nominee and alternate nominee;
- m. Change of nominee or alternate nominee;
- n. Records in lieu of meetings;
- o. Minutes-book;
- p. Co-mingling of property;
- q. Reportorial submissions;
- r. Change of status from a regular stock corporation to a one person corporation; and,
- s. Change in status of a one person corporation.

A **new title regarding Investigations, Offenses and Penalties** is also proposed with the following sections:

- a. Investigation and prosecution of offenses;
- b. Administration of oaths, and subpoena of witnesses and documents;
- c. Cease and desist orders;
- d. Contempt;
- e. Administrative sanctions;
- f. Continued and unjustified use of former corporate name; penalties;
- g. Concealment of disqualification; penalties;
- h. Violation of duty to keep or maintain records and/or allow their knowing or willful certification of incomplete, inaccurate, false or misleading statements or reports; penalties;
- i. Knowing or willful certification of incomplete, inaccurate, false or misleading statements or reports; penalties;
- j. Independent auditor collusion; penalties;
- k. Procuring the organization of a corporation through fraud; penalties;
- l. Fraudulent or unlawful conduct of business; penalties;
- m. Theft of identity; penalties;
- n. Acting as intermediaries for graft and corrupt practices; penalties;
- o. Engaging intermediaries for graft and corrupt practices; penalties;
- p. Tolerating graft and corrupt practices; penalties;
- q. Retaliation against whistleblowers;
- r. Other violations of the Code; separate liability;
- s. Liability of directors, trustees, officers or other employees; and,
- t. Liability of aiders and abettors and other secondary liability.

2. Proposed Amendments to the Securities Regulation Code (RA 8799)

The proposal includes amendments to the following provisions of the Securities Regulation Code:

- a. Section 3.1 on the definition of “securities”;
- b. Section 3.2 on the definition of “broker”;
- c. Section 3.5 on the definition of “associated person of a broker or dealer”;
- d. Section 3.8 on the definition of “insider”;
- e. Section 3.9 and 3.10 on the deletion of the definition of “pre-need plans” and “promoter”;
- f. New Section 3.14 on the definition of “futures contract”;
- g. Section 4.5 on the quorum for Commission meetings;
- h. Section 5 on providing greater enforcement powers for the Commission;
- i. Section 6.2 on the indemnification and responsibilities of Commissioners;
- j. Section 10.3 on the filing of an application for exemption;
- k. Sections 12.3 and 12.4 on the procedure for registration of securities;
- l. Section 16 on the deletion of the provision on pre-need plans;
- m. Section 17 on the posting of reports on a corporation’s website;
- n. Section 17 on reportorial requirements;
- o. Section 19 on the minimum limit for tender offers;
- p. Sections 28.4 (b), 30.1 and 33.2 (f);
- q. Sections 34 and 35;

- r. Section 38 on a fit and proper rule and SEC's resolution of issues on qualifications;
 - s. Section 43 on uncertificated/scripless securities;
 - t. Section 53.2 on greater search and seizure powers for the Commission;
 - u. Section 54.1 on correcting the typographical error and adding disgorgement and restitution as administrative sanctions;
 - v. New Section on whistleblower protection;
 - w. New Section on penalties for destruction, alteration or falsification of records; and,
 - x. Section 75 on retention of fees.
3. Push for the filing of the Financial Sector Tax Neutrality Bill
 4. Propose amendments to the Investment Company Act for consistency with the tax neutrality principles
 5. Propose amendments to the Real Estate Investment Trust Law on certain tax provisions