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SEC ORDERS TAKEOVER OF R&L INVESTMENTS TO PROTECT INVESTORS

The Securities and Exchange Commission (SEC) has ordered Capital Markets Integrity Corporation (CMIC) – the independent audit, surveillance and compliance arm of the Philippine Stock Exchange (PSE) – to take over the operations of R&L Investments, Inc. to protect affected customer accounts.

The Commission issued the order on November 14, following the stock brokerage’s collapse allegedly due to unauthorized transfers of proprietary and client shares worth about P700 million into an account with another brokerage.

Section 33.1 (d) of Republic Act No. 8799, or the Securities Regulation Code (SRC), provides that “when the Exchange shall have found that the financial condition of its member firm has so deteriorated that it cannot readily meet the demands of customers for the delivery of securities and/or payment of sales proceeds, the Exchange shall, upon order of the Commission, take over the operation of the insolvent firm and immediately proceed to settle the member firm’s liabilities to its customers.”

Rule 33.1(d).1 of the 2015 SRC Rules further allows the SEC to compel an insolvent or failed trading participant and the exchange or pertinent self-regulatory organization (SRO) – in this case, CMIC – to take the necessary action to protect customer accounts including, but not limited to, the preservation of the failed trading participant’s books and records.

Rule 33.1(d).2 also empowers the SEC, after proper investigation or verification, *motu proprio* or upon verified complaint by any party, to order the exchange or SRO to take over the operation of the failed trading participant for the purpose of preserving and protecting the failed trading participant’s books, records, customer accounts, trade-related assets and settling its liabilities to its customers.

Accordingly, the Commission further directed CMIC to implement the provisions of Rule 33.1(d).3 of the 2015 SRC Rules, whenever appropriate.

The rules provide that an exchange or SRO tasked to take over a failed trading participant shall immediately arrange for another trading participant to take over outstanding contracts relating to securities, notify affected customers of such action and subsequently provide them with the opportunity to transfer their accounts to another trading participant of their choice.

Also, the exchange or SRO shall settle the failed trading participant's liabilities to customers through the sale of the latter's trading rights and other trade-related assets, liquidation of its paid-up capital, and/or supervision of payment of claims against the surety bond.

The exchange or SRO shall inform the failed trading participant's accredited trust fund of the takeover and inform the customers that they may also claim compensation for losses from the trading participant's accredited trust fund, subject to the validation of their claims by the exchange or SRO and the trust fund.

At the PSE, the Securities Investors Protection Fund manages a fund contributed by trading participants for the protection of investors against losses in case of fraud, failure or insolvency of trading participants.

If the trade-related assets fall short, the exchange or SRO shall refer the outstanding liabilities to the trust fund and inform the customers of the further steps necessary for claiming compensation for unsatisfied losses.

The SEC also ordered CMIC to take other necessary actions to protect customer accounts including, but not limited to the preservation of the assets and books and records of R&L investments, and to execute acts or documents necessary or appropriate in carrying out its powers.

In addition, the Commission directed CMIC to determine the various violations of the provisions of the SRC and its implementing rules and regulations possibly committed by R&L Investments, its officers and employees.

CMIC shall submit a report and recommendation to the SEC Markets and Securities Regulation Department within seven days from the conclusion of its audit, but not later than December 20, 2019, for the purpose of instituting administrative or criminal action against responsible persons when warranted.

The findings of CMIC, however, shall not preclude the Commission from continuing its own examination, investigation, or filing of any action against respondent R&L Investments and its responsible officers and employees.

The SEC issued the order, after establishing that the financial condition of R&L Investments has so deteriorated that it cannot readily meet the demands of its clients for the delivery of securities and/or payment of sales proceeds.

In its 2018 audited financial statements, R&L Investments booked client securities worth P738,897,290. However, the Business Partner (BP) Report provided by the Philippine Depository & Trust Corp. (PDTC) showed the brokerage's client portfolio only amounted to P132,255,939.



The audited financial statements also showed that R&L Investments had total net assets of P46,815,973. The number of missing securities, if absorbed by the company, will result in net negative equity of P559,825,378.

Meanwhile, the BP Report submitted by R&L Investments for the regular audit conducted by CMIC reflected P734,405,682 worth of client shares by end-August 2019, far from the P31,544,255 the PDTC reported to the SEC.

A special audit by CMIC also revealed that R&L Investments inflated the number of client shares. It recorded client securities worth P747,819,698 as of October 31, 2019, while PDTC only accounted for P30,395,892 the day before.

R&L Investments nominee Lucy Linda D. Lee first reported the discovery of the discrepancy to the PSE on October 31, 2019, supposedly after the nominee of another brokerage flagged numerous error transactions made by settlement officer Marlon Moron on several trading days.

In a November 4, 2019 letter to PSE Director Alexander Yu, Ms. Lee said Mr. Moron and his wife Edna went to R&L Investments' office on November 1, 2019 and admitted to the unauthorized transfer of shares to Venture Securities, Inc. using the account name Julieto Sulapas.

Mr. Moron also supposedly admitted to forging reports to conceal his actions from the management, as well as from the audits conducted.

On November 8, 2019, CMIC commenced a special audit of the pertinent books and records of the involved parties. It also placed R&L Investments under involuntary suspension.

PDTC, meanwhile, deactivated the sweeping of share balances from R&L Investments' Depository House Accounts to the Securities Clearing Corporation of the Philippines Nostro Account by the end of November 8, 2019.

Sensing the gravity of the inconsistencies, the SEC ordered R&L Investments to preserve its books, records and assets as well as the PSE, CMIC and PDTC to take all the necessary actions through a letter dated November 12, 2019.

The Commission will continue monitoring the investigation conducted by CMIC and will remain prepared to take the necessary actions to unearth the truth behind the 50-year-old brokerage's collapse.

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