



Completion Report

Project Number: 36408
Loan Number: 2003
September 2006

Philippines: Second Nonbank Financial Governance Program

Asian Development Bank

CURRENCY EQUIVALENTS

	Currency Unit	–	peso (₱)	
				At Appraisal 7 August 2003
				At Program Completion 4 November 2004
₱1.00	=			\$0.0183
\$1.00	=			₱54.7500
				\$0.0177
				₱56.3550

ABBREVIATIONS

ADB	–	Asian Development Bank
AML	–	anti-money laundering
AMLC	–	Anti-Money Laundering Council
BOA	–	Board of Accountancy
BSP	–	Bangko Sentral ng Pilipinas (Philippines central bank)
DOF	–	Department of Finance
DST	–	documentary stamp tax
IAS	–	International Accounting Standards
IOSCO	–	International Organization of Securities Commissions
MIB	–	market integrity board
MOU	–	memorandum of understanding
MRD	–	market regulatory department
NBFI	–	nonbank financial institution
PSE	–	Philippine Stock Exchange
RBCA	–	risk-based capital adequacy
RICA	–	Revised Investment Company Act
SEC	–	Securities and Exchange Commission
SNBFGP	–	Second Nonbank Financial Governance Program
SRC	–	Securities Regulation Code
SRO	–	self-regulatory organization
TA	–	technical assistance

NOTES

- (i) The fiscal year (FY) of the Government and its agencies ends on 31 December.
- (ii) In this report, "\$" refers to US dollars.

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CONTENTS

	Page
BASIC DATA	ii
I. PROGRAM DESCRIPTION	1
II. EVALUATION OF DESIGN AND IMPLEMENTATION	1
A. Relevance of Design and Formulation	1
B. Program Outputs	3
C. Program Costs and Disbursements	7
D. Program Schedule	7
E. Implementation Arrangements	7
F. Conditions	7
G. Technical Assistance	7
H. Performance of the Borrower and the Executing Agency	8
I. Performance of the Asian Development Bank	8
III. EVALUATION OF PERFORMANCE	8
A. Relevance	8
B. Effectiveness and Efficiency in Achieving Outcome and Outputs	8
C. Preliminary Assessment of Sustainability	10
D. Impact	11
IV. OVERALL ASSESSMENT AND RECOMMENDATIONS	12
A. Overall Assessment	12
B. Lessons Learned	12
C. Recommendations	12
APPENDIXES	
1. Program Framework	14
2. Policy Matrix	17
3. Selected Nonbank Financial Sector Indicators	31
4. Terms of Reference for Consultants	33

BASIC DATA

A. Loan Identification

1.	Country	Philippines
2.	Loan Number	2003-PHI
3.	Program Title	Second Nonbank Financial Governance Program
4.	Borrower	Republic of the Philippines
5.	Executing Agency	Department of Finance
6.	Amount of Loan	\$150 million
7.	Program Completion Report Number	PCR: PHI-950

B. Loan Data

1.	Appraisal	
	– Date Started	13 January 2003
	– Date Completed	25 April 2003
2.	Loan Negotiations	
	– Date Started	29 July 2003
	– Date Completed	29 July 2003
3.	Date of Board Approval	02 September 2003
4.	Date of Loan Agreement	02 September 2003
5.	Date of Loan Effectiveness	
	– In Loan Agreement	02 December 2003
	– Actual	26 September 2003
	– Number of Extensions	None
6.	Closing Date	
	– In Loan Agreement	31 March 2005
	– Actual	07 December 2004
	– Number of Extensions	None
7.	Terms of Loan	
	– Interest Rate	ADB's LIBOR-based
	– Maturity (number of years)	15 years
	– Grace Period (number of years)	3 years

8. Disbursements

a.	<u>Dates</u>		
	Initial Disbursement	Final Disbursement	Time Interval
	29 September 2003 (first tranche)	7 December 2004 (second tranche)	14 months
	Effective Date	Original Closing Date	Time Interval
	26 September 2003	31 March 2005	18 months
b.	<u>Amount (\$ million)</u>		
	Original Allocation	Amount Disbursed	Undisbursed Amount
	150	150	0
Total	150	150	0

C. Program Data

1. Program Performance Report Ratings

Implementation Period	Ratings	
	Development Objectives	Implementation Progress
From 02 Sep 2003 to 30 Sep 2003	Satisfactory	Satisfactory
From 01 Oct 2003 to 31 Oct 2003	Satisfactory	Satisfactory
From 01 Nov 2003 to 30 Nov 2003	Satisfactory	Satisfactory
From 01 Dec 2003 to 31 Dec 2003	Satisfactory	Satisfactory
From 01 Jan 2004 to 31 Jan 2004	Satisfactory	Satisfactory
From 01 Feb 2004 to 29 Feb 2004	Satisfactory	Satisfactory
From 01 Mar 2004 to 31 Mar 2004	Satisfactory	Satisfactory
From 01 Apr 2004 to 30 Apr 2004	Satisfactory	Satisfactory
From 01 May 2004 to 31 May 2004	Satisfactory	Satisfactory
From 01 Jun 2004 to 30 Jun 2004	Satisfactory	Satisfactory
From 01 Jul 2004 to 31 Jul 2004	Satisfactory	Satisfactory
From 01 Aug 2004 to 31 Aug 2004	Satisfactory	Satisfactory
From 01 Sep 2004 to 09 Sep 2004	Satisfactory	Satisfactory

D. Data on Asian Development Bank Missions

Name of Mission	Date	No. of Persons	No. of Person-Days	Specialization of Members
Loan Reconnaissance	3–5 July 2002	2	6	Principal Financial Economist; Principal Counsel
Fact-Finding	5 Aug–26 Sep 2002	5	intermittent	Principal Financial Economist; Principal Counsel; Financial Economist; staff consultant
Appraisal	13 Jan – 25 April 2003	6	intermittent	Principal Financial Economist; Principal Counsel; Sr. Programs Coordination Specialist; Programs Officer; Economist; Financial Economist
Program Review	3-13 Feb 2004	2	22	Senior securities market legal & regulatory specialist, financial economist
Program Completion Review	13 March 2006 – 13 July 2006	3	10	Senior securities market legal & regulatory specialist, financial economist, anti-money laundering specialist

I. PROGRAM DESCRIPTION

1. On 2 September 2003, the Asian Development Bank (ADB) approved the Second Nonbank Financial Governance Program (SNBFGP)¹ for \$150 million from ADB's ordinary capital resources to the Government of the Philippines. The program was intended to (i) strengthen the regulatory and policy framework for developing viable institutions and properly functioning financial markets; (ii) strengthen supervisory and surveillance capacities of the Philippine Securities and Exchange Commission (SEC); (iii) enhance compliance with financial information and disclosure requirements and prudential standards for nonbank financial institutions (NBFIs); and (iv) reduce reliance on banks to mobilize savings. ADB provided related technical assistance (TA) grants to support implementation of the reforms.² The TAs are ongoing.
2. The SNBFGP builds upon the results and lessons of the first Nonbank Financial Governance Program and the earlier Capital Market Development Program that focused on (i) strengthening governance of the SEC; (ii) modernizing the governance and regulatory structure of the Philippine Stock Exchange (PSE); (iii) strengthening market oversight, compliance, and enforcement by SEC; and (iv) facilitating diversification and innovation in corporate financing.³
3. This program completion report (PCR) provides an overview and an evaluation of initial impacts and benefits under SNBFGP.

II. EVALUATION OF DESIGN AND IMPLEMENTATION

A. Relevance of Design and Formulation

4. The SNBFGP was designed to promote the sustainability of reforms supported under earlier ADB initiatives, encourage greater financial stability, and improve access to capital. ADB has been supporting deepening of the financial sector through development of the nonbank financial sector (NBFS) in the Philippines for more than 10 years. Despite earlier reform initiatives, banks continued to dominate the financial sector as a result of (i) distortions in the legal, regulatory, institutional and tax framework resulting in preferential treatment for bank investment products, and (ii) ongoing investor-protection concerns arising from (a) limited enforcement activities; (b) ongoing control of the PSE by small brokers who appear resistant to much-needed changes to improve efficiency and competitiveness; and (c) concerns about the financial stability of pre-need plan companies.⁴ Based on these distortions and investor-

¹ ADB. 2003. *Report and Recommendation of the President to the Board of Directors on a Proposed Program Loan and Technical Assistance Grant to the Republic of the Philippines for the Second Nonbank Financial Governance Program*. Manila (for \$150 million).

² ADB. 2003. *Technical Assistance to the Republic of the Philippines for Support for the Nonbank Financial Sector*. Manila (TA 4168-PHI, for \$500,000, approved on 2 September); and ADB. 2004. *Technical Assistance to the Republic of the Philippines for Strengthening Governance of Securities Trading Markets*. Manila (TA 4321-PHI, for \$250,000, approved on 18 March).

³ ADB. 2001. *Report and Recommendation of the President to the Board of Directors on a Proposed Program Loan and Technical Assistance Grant to the Republic of the Philippines for the Nonbank Financial Governance Program*. Manila (for \$150 million); ADB 1995. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Republic of the Philippines for the Capital Market Development Program*. Manila (for \$150 million).

⁴ Pre-need companies sell pre-need plans, which are marketed to fund the cost of future services (typically education, pension, death-related service or memorials) for a fixed premium during a person's lifetime. Pre-need plans are defined as a security under the Securities Regulation Code and sold by registered pre-need plan dealers. Pre-need plan assets held on behalf of pre-need planholders are managed by pre-need plan company trustees and are required to comply with SEC imposed actuarial requirements to ensure that sufficient funds are available to pay out agreed upon benefits when the pre-defined needs arises.

protection concerns, the financial sector was not able to effectively intermediate funds for much-needed business investment.

5. In 2002, the Philippine capital market was still recovering from the 1997 Asian financial crisis. From a high of 3,422 in January 1997, the PSE Composite Index (PHISix) dropped to 1,018 by year end of 2002 and slowly recovered over the years. Activity in the Philippine equities market was largely subdued in 2002. Aggregate volume turnover declined by 95 % while value of transactions dropped by 72% from 1997. Market capitalization of domestic and foreign companies listed in the PSE totaled P 2,083.2 billion in 2002, 66% higher than in 1997, which could be attributed inclusion of market capitalization of foreign companies listed in the exchange. Capital raised through initial public offerings at P3.9 billion (US\$77 million) was the lowest in the region (Thailand \$217 million, Malaysia \$1,834.8 million, Singapore \$ 1,207 million and Indonesia \$ 120.6 million) but significantly higher than the P0.2 billion raised in 2001 (1,700%).

Table1: Overview of the Non- bank Financial Sector

	1997	2002	% Change	2002 as % of GDP
Market capitalization (Pbillion)	1,251.3	2,083.2	66	52.6
Trading value (Pbillion)	586.2	159.7	-72	4.0
Trading volume (billion shares))	1,924	99.8	-95	.
Capital raised (Pbillion)	32.1	40.1	25	1.0
Initial public offerings	10.1	3.6	-64	
Additional listings	22	36.5	65.	
Composite Index (PHISix)	1,869.2	1,018	-45.5	.
Mutual funds total assets (Pbillion)	4.7	25.4	440	0.6
Pre-need total assets (Pbillion)	78.8	148.7	88	3.7

Sources: Philippine Stock Exchange, Philippine Securities and Exchange Commission

6. Building on prior reform initiatives supported by ADB, the SNBFGP responded to the Government's need to further develop the NBFS, and reflected lessons learned from earlier ADB initiatives (e.g., excluding enacted legislation as a second tranche condition and focusing more on actions that reflect the executive branch's commitment to key policy reforms). Thus the design of the SNBFGP was highly relevant.

7. However, while the overall design of the program was sound, the delay in finalizing the longer-term capital market reform strategy, developed under the program, and the SEC's lack of clear power to ensure PSE compliance with ownership limitations, undermined the impact of these reforms. Reforms to enhance prudential standards of brokerage firms through introduction of a risk-based capital adequacy (RBCA) framework requires (i) a longer time horizon to change the culture of brokerage firms to improve compliance with bookkeeping and accounting requirements and enhance their back-office systems, and (ii) enhanced capacity of SEC and

PSE to monitor compliance on a daily basis and conduct regular spot checks of related books and records to verify the validity of data submitted.

8. Policy reforms to facilitate the mobilization of domestic savings were geared toward strengthening investor protection for pre-need planholders and mutual fund investors, rather than increasing the amount of funds invested in investment funds. The program called for the submission of a draft pre-need code and a draft Revised Investment Company Act to Congress. These draft bills provide for better regulation of pre-need companies and investment companies but did not remove impediments to diversifying and offering more investment products.

9. Two related TAs helped the SEC accelerate compliance with second tranche and end-program conditions. However, certain reforms have not been fully implemented and these TAs are ongoing. During the Program Completion Report exercise, use of remaining TA funds to support full implementation of program reforms was discussed and related terms of reference were refined in close coordination with the Government (see Appendix 4).

B. Program Outputs

10. Program outputs under SNBFGP can be grouped into four areas: (i) strengthening the regulatory and policy framework for developing viable institutions and properly functioning financial markets; (ii) strengthening SEC supervisory and surveillance capacity; (iii) improving transparency to protect investors from fraud, insolvency, or misconduct; and (iv) facilitating mobilization of domestic savings to increase supplies of investment funds while ensuring adequate investor protection.

11. The Government fulfilled all 37 first-tranche, 13 second-tranche, and 13 end-program policy conditions within the period covered by the program.

1. Strengthening the Regulatory and Policy Framework for Developing Viable Institutions and Properly Functioning Financial Markets

a. Establish an Effective Anti-Money Laundering (AML) Regime

12. The SNBFGP supported the adoption of a comprehensive legal, regulatory, and institutional framework for anti-money laundering (AML). Amendments to the Anti-Money Laundering Act of 2001 - including the lowering of the threshold amount for covered transactions from \$80,000 to \$10,000 - were enacted to align the Philippine AML Law with international norms.

13. The program also supported capacity building of the AML Council (AMLC) and other key Government institutions, including staffing, training, establishment of a transaction monitoring system, and adoption of a compliance system. The AMLC Secretariat has engaged 56 professional staff. As of 30 March 2006, 33 are permanent staff (they have complied with 5-year service requirement), while 19 staff from the manpower pool of the Office of the Governor of the Philippines central bank (BSP), and one from the BSP Office of Special Investigation are temporarily assigned to the AMLC. In addition, one personnel each from the Philippine National Police, National Bureau of Investigation, and Philippine Drug Enforcement Agency are temporarily assigned to the AMLC Secretariat. Professional staff are required to pass relevant civil service examinations. Staff in functional groupings are required to have relevant training, professional qualifications, and experience.

14. From September 2003 to December 2005, AMLC conducted more than 340 workshops and seminars on various aspects of AML. Participants included employees from a wide range of

Government agencies and private sector financial institutions (covered institutions) charged with compliance under the law. Feedback has been positive in terms of program content and participant involvement.

15. Fifty six commercial courts and the anti-graft court for higher-level Government officials (Sandiganbayan) have been designated to hear AML cases and all judges assigned to these courts have been trained on AML-related issues. As of 31 December 2005, 88 AML-related cases have been filed with the courts, including 34 AML cases, seven petitions to extend a freeze order, 24 civil forfeiture cases, 18 applications for a bank inquiry, and five applications for a freeze order. Of the 34 AML cases, one has been successfully prosecuted, 23 are being tried before the AML courts, and 10 are pending preliminary investigation by the AML Task Force of the Department of Justice. Of the 24 civil forfeiture cases, three have been decided in favor of the Government and 21 are pending trial. With respect to freeze orders, approximately ₱1.2 billion has been frozen and ₱691 million has been returned to investors or victims.

16. AMLC has designed and installed a new transaction monitoring system to allow for the receipt, storage, and analysis of transaction reports by banks and other covered institutions. Approximately 50 million transaction reports had been received by AMLC by the end of 2005. The transaction monitoring system is a key tool in supporting AMLC's work.

b. Strengthen Investor Protection and Confidence in the Stock Exchange

17. The program supported the establishment of a framework for broadening ownership of the PSE and improving its governance structure. The Securities Regulation Code prescribes that no industry or group should own more than 20% of the voting rights of an exchange. However, limited interest on the part of broker participant shareholders to sell, and limited SEC powers to enforce this requirement, continue to delay full implementation of divestment. While the ownership of brokerage firms as a group has been diluted from 100% to approximately 50% of the PSE, this is still more than the maximum ownership allowed. The PSE submitted a proposed action plan to the SEC on 12 January 2006 to address the ownership issue. The proposed action plan contained alternative ways to dilute the equity interest of brokers in the PSE including secondary sales by brokers of their shares, initial public offerings, issuance of preferred shares, private placement of primary shares, and an employee stock option plan.

18. Meanwhile, PSE streamlined its staff and rationalized its organizational structure to improve efficiency, reimposed transaction fees in 2004, and increased clearing fees (through its subsidiary the Securities and Clearing Corporation Philippines) and initial listing fees in 2005 to improve revenue streams and facilitate divestiture. As a result of the fee increases, operating revenues more than doubled to ₱273.8 million (\$4.9 million) in 2005 from ₱111.7 million (\$2.0 million) in 2003. Net income after taxes likewise improved tenfold to ₱119.8 million (\$2.1 million) in 2005 from ₱10.7 million (\$0.2 million) in 2003.

19. Under the program, the PSE introduced a new oversight mechanism in 2004 for regulating its participants through the establishment of a market regulatory department (MRD) that reports to an independent market integrity board. The SNBFGP also supported the appointment of a majority of non-broker directors to selected PSE board committees. The PSE exceeded expectations by dissolving several board-level committees (such as the powerful listing committee that interfered in what would normally be considered routine operational matters), and transferring the functions and powers of the dissolved committees to PSE management.

20. While the SEC has initiated several discussions with the PSE to strengthen its compliance and surveillance group under the program, PSE surveillance capacity remains weak. The MRD presently uses a surveillance system that performs elementary analysis based primarily on spreadsheet comparison of reported prices over specific trading periods. While it is possible to conduct basic surveillance with the present system, the system does not comply with best practice. PSE management is in the process of developing a new surveillance framework that is dependent on procurement of a new trading system scheduled for the later half of 2006. PSE plans to acquire new surveillance technology as part of the upgrade of its trading system.

c. Address Weak and Fragmented Policy and Regulatory Framework to Promote Market Efficiency and Development

21. Under the program, the Government took a number of steps to promote a more cohesive and systemic approach to market development and efficiency. In 2004, Congress passed the Act Rationalizing the Tax Treatment of Financial Instruments. The act reduced the documentary stamp tax (DST) on original issuance of shares by half and eliminated the DST on secondary trading of shares on the exchange. The act also rationalized the DST for secondary trading of other financial instruments, such as fixed income securities, and securities borrowing and lending. The Government also developed a capital market development blueprint that articulates a series of strategic objectives (including relevant steps to achieve them) that are intended to stimulate the growth, efficiency, and competitiveness of the Philippine capital market in the next 5 years. Development of the blueprint was a collaborative effort of the public and private sectors. The blueprint is now being reviewed by the Department of Finance (DOF) prior to finalization and publication.

2. Further Strengthening SEC Supervisory and Surveillance Capacity

22. The program supported the development of training programs, the development and utilization of information technology (IT), and the review and revision of inspection procedures to enhance the supervisory and surveillance capability of the SEC.

23. The SEC is developing an i-Report IT system that will, among other things, make it easier for the SEC to collect and analyze data. System components that will enable the SEC to enhance its supervisory and surveillance capability include: (i) SEC File Manager for tracking of submitted documents; (ii) Reverse Search for making inquiries on affiliations; (iii) SEC i-Mode 1 for monitoring substantive compliance; and (iv) SEC i-Mode 2 for monitoring regulatory parameters such as minimum capitalization and RBCA requirements for brokerage firms.

24. With earlier funding assistance from ADB,⁵ SEC procured the Advanced Warning and Control System (AWACs), a real-time market surveillance engine. The SEC later developed a staff training program and user's manual on AWACs. Key SEC officials who attended foreign training programs on surveillance, enforcement, and compliance also conducted echo seminars to pass on the knowledge gained from these training programs to staff members of relevant operating departments.

⁵ ADB. 2001. *Technical Assistance to the Republic of the Philippines for Strengthening Regulation and Market Governance*. Manila (TA 3773-PHI, for \$1 million, approved on 15 November).

3. Improving Transparency to Protect Investors from Fraud, Insolvency, or Misconduct

a. Improve the Quality of Financial Information Disclosed to the Market

25. To promote greater transparency and enhanced investor protection against fraud, insolvency, or misconduct, key program conditions required SEC to disclose on its website the annual audited financial statements of all registered NBFIs, adopt international accounting standards (IAS) by all companies registered with the SEC, and impose new reporting requirements on auditors of NBFIs and listed issuers.

26. In November 2005, the SEC began providing on its website all documents submitted by SEC registered companies (including NBFIs) from 1996 to 2004. These documents, which include audited financial statements, annual reports, and general information sheets, can be viewed and printed out for a small fee (equivalent to the fee previously charged for paper document requests).

27. The SEC issued regulations for the adoption of IAS by all companies registered with the SEC. In addition, the SEC conducted several public seminars on IAS to ensure smooth transition to the new accounting standards and began accrediting auditors and imposing new reporting requirements on auditors. Thus far, SEC has accredited 299 individuals and 73 accounting firms to audit financial statements of public companies.

b. Strengthen Prudential Standards in the Nonbank Financial Sector

28. SEC-issued RBCA standards for brokerage firms, developed under the program, have been in effect since December 2005. The new RBCA rule requires brokerage firms to compute compliance with these standards on a daily basis and submit monthly RBCA computation reports to PSE. However, full compliance has not been achieved because of difficulties experienced by some brokerage firms in the computation of counterparty risk. These difficulties, in turn, have resulted from a lack of discipline in applying proper accounting standards, inadequate technical skills, and/or inadequate related backroom systems.

29. To promote more effective oversight of brokerage firm participant compliance with the RBCA rule, PSE is working to develop a harmonized and integrated (into the PSE trading system) back-office system that can automatically transmit compliance reports on a daily basis to the PSE. However, development of this system has been deferred until the installation of the PSE's new trading system. In the interim, PSE has conducted an analysis of brokerage firms' back-office systems as a first step in developing a new system. SEC is planning on conducting a review of compliance with the RBCA rule during the second half of 2006 (once an indicative sampling of reports is available) to clarify compliance issues and problems. SEC has delayed the roll out of the RBCA rule to investment houses until outstanding implementation issues for brokerage firms have been resolved.

30. To promote greater accountability and strengthen internal controls, the SEC under the SNBFGP requires every registered brokerage firm, investment house, and financing company to have at least one certified compliance officer. However, a lack of resources has resulted in the SEC thus far conducting certification examinations for compliance officers of brokerage firms only. Certification requires compliance officers to pass five modules. Thus far, 57 out of the 132 active PSE brokerage firm participants have certified compliance officers. Another 13 have officers who have passed four of the five modules and are awaiting the exam results on the last modules while the rest (62) need to retake and pass the exams for the modules that they failed.

Engagement of a certified compliance officer is a pre-condition for the renewal of the brokerage firm's annual registration.

4. Facilitating Mobilization of Domestic Savings to Increase Supplies of Investment Funds While Ensuring Investor Protection

31. To promote this objective, the program sought to strengthen the legal and regulatory framework for pre-need plans and mutual funds based on the assumption that stronger investor protection would help mobilize investment. Regulation of pre-need plans is currently pursuant to a rules-based framework adopted by the SEC, while regulation of mutual funds is pursuant to an outdated Investment Company Act. Under the program, new pre-need rules were adopted and a draft Pre-Need Code and a draft bill to amend the Investment Company Act were submitted to Congress.

C. Program Costs and Disbursements

32. ADB supported the program with \$150 million from its ordinary capital resources. The loan was disbursed in two installments.

D. Program Schedule

33. The program was approved on 2 September 2003 and became effective on 26 September 2003. The first tranche was released on 29 September 2003, while the second tranche was released on 7 December 2004. The loan was closed on 7 December 2004, almost four months ahead of the 31 March 2005 closing date that was originally envisaged in the Loan Agreement.

E. Implementation Arrangements

34. The Department of Finance (DOF) was the Executing Agency and SEC was the implementing agency. As envisioned under the program, SEC established an interagency coordination committee headed by the SEC chairperson and including representatives from AMLC, BSP, DOF, Insurance Commission, National Economic Development Authority, and PSE. The committee met on a regular basis to oversee program implementation. ADB met with the committee regularly to provide updates on the status of implementation, identify any areas of concerns, and facilitate prompt corrective action.

F. Conditions

35. SNBFGP consisted of 63 policy actions, 37 of which were complied with at the time of loan approval and 26 of which were complied by December 2004, four months ahead of schedule - a testament to the Government's strong commitment to the reform agenda. To date none of the reforms adopted under the program has been reversed.

G. Technical Assistance

36. A piggyback TA provided support for implementing the conditions of the loan's second tranche. At the request of the Government, during TA implementation, a new TA to Strengthen Governance of Securities Trading Markets was also approved.⁶ During the PCR mission, ADB and the Government identified reform areas where further assistance under the TA was needed to ensure the sustainability of program reforms and related terms of reference (TOR) were

⁶ Additional support for AML conditions was also provided through TA 3847-PHI: Strengthening the AML Regime.

agreed to (See Appendix 4). As reflected in the TOR, additional assistance will be provided to support the: (i) SEC in evaluating compliance with the RBCA rule for brokerage firms (ii) SEC in evaluating the effectiveness of the PSE's new SRO structure in addressing conflict of interest concerns and its capacity to performance its surveillance and audit functions; (iii) SEC and PSE in developing an enforcement strategy to address perceived gaps in related enforcement activities; and (iv) new Fixed Income Exchange and SEC in developing a public awareness campaign on the role of the new exchange in promoting greater transparency in the pricing of fixed income securities and highlight the importance of centralizing the fixed income market in order to deepen and improve liquidity in the secondary market.

H. Performance of the Borrower and the Executing Agency

37. Overall Government performance is rated as satisfactory. Commitment of the Executing Agency (DOF) and implementing agency (SEC) to the reform agenda supported by the SNBFGP and implementation of related policy conditions was excellent, as reflected in the Government's accelerated compliance with the 13 second tranche conditions. Throughout program implementation, the SEC and other participating Government agencies made available dedicated and highly competent counterpart staff in support of implementation. The SEC has been strengthened in a number of areas as a result of reforms supported by SNBFGP.

38. However, implementation of program conditions related to adoption and implementation of an RBCA framework for NBFIs and protection of pre-need plan investors is not rated as highly. With respect to the RBCA rule, based on delays in implementing the rule for brokerage firms, SEC has not issued a similar rule for investment houses, as originally envisaged. With respect to the protection of pre-need planholders, there does not appear to have been any concerted proactive (vs. reactive) SEC strategy.

I. Performance of the Asian Development Bank

39. Performance of ADB has been satisfactory. Loan approval and disbursement were timely. Based on the strong commitment of SEC staff and active involvement of ADB staff in closely monitoring compliance with second tranche conditions, compliance with these conditions was accelerated. Related TA support, which was timely and effectively implemented, enabled the Government to accelerate compliance with second tranche conditions.

III. EVALUATION OF PERFORMANCE

A. Relevance

40. Overall program design was highly relevant and built upon earlier ADB reform programs. However, reform activities relating to protection of pre-need planholders and promoting intermediation of domestic savings require more substantive interventions and stronger political will.

B. Effectiveness and Efficiency in Achieving Program Outcome and Outputs

41. As reflected in Appendix 3 (Selected Nonbank Financial Sector Indicators) and as discussed in more detail below, the program is rated effective in achieving the stated outcome (improving the regulatory framework for mobilizing domestic savings to increase the supply of investment funds, while ensuring investor protection). However, the program is rated less efficient with respect to reforms related to prudential standards for NBFIs and increased investment in the mutual fund and pre-need sectors. The policy dialogue and excellent

relationship between ADB and SEC supported overall achievement of program outcomes (purposes) and outputs as originally identified.

42. Among other program achievements, an effective AML regime was established and continues to be strengthened and implemented through ongoing ADB and other development partner support.⁷ As a result of the Government's excellent progress in implementing AML reforms, the Financial Action Task Force removed the Philippines from the list of non-cooperative countries and territories in February 2005. In June of the same year, the Philippines was accepted as a member of the Egmont Group (an international group of financial intelligence units focused on facilitating information sharing and promoting best practices). Most recently, the Philippines hosted the Asia Pacific Group on AML.

43. Investor protection and confidence in the PSE was strengthened through considerable strides made by PSE in improving its governance structure. The new structure has resulted in a dramatic increase in the number of sanctions imposed by the PSE on brokers - from only two in 2003 to 39 in 2005. In addition, the PSE has significantly increased the budget allocated to its compliance and surveillance function. As compared with the budget of its predecessor, the Compliance and Surveillance Group, the budget of the MRD has increased from ₱0.58 million (\$10,300) in 2003 to ₱12.1 million (\$215,000) in 2005. Increased investor confidence has resulted in increased trading volumes, trading values, and amount of capital raised through the PSE, and an attendant decrease in investor complaints (See Appendix 3).

44. The SNBGFP helped strengthen the policy and regulatory framework for the capital market to promote greater market efficiency and development. Together with other factors, the elimination of DST on secondary trading of shares on the PSE under the program has resulted in higher trading volume, which increased from 86 billion shares amounting to ₱145.4 billion (\$2.6 billion) in 2003 to 318 billion shares amounting to ₱381.5 billion (\$6.8 billion) in 2005.⁸

45. The program supported improvements in the capacity of accountants to prepare public company financial statements in accordance with the new financial reporting standards. There has been an increase of almost 300% in the number of accredited auditors. To promote higher standards for preparing such statements, when a non-compliant statement is filed SEC will return it without full review and sanction the issuer for late filing. This approach is intended to encourage issuers to file statements that have been properly prepared, while focusing limited SEC resources (for review of financial statements) on statements that appear to have been properly prepared.

46. Although it is too early to demonstrate the impact of the new RBCA rule, the program has strengthened the ability of brokerage firms to comply with the rules. Under the new regulatory framework, 57 new compliance officers of brokerage firms have been certified. These officers provide a focal point for compliance and enforcement-related issues, handle investor complaints, and clarify the responsibility imposed on brokerage firms to undertake stronger internal controls.

⁷ ADB. 2002. *Technical Assistance to the Republic of the Philippines for Strengthening the Anti-Money Laundering Regime (Financed from the Asian Currency Crisis Support Facility)*. Manila (TA 3847-PHI, for \$1 million, approved on 19 March); and ADB. 2005. *Technical Assistance to the Republic of the Philippines for Strengthening the Anti-Money Laundering Regime (Phase II) (Financed by the Cooperation Fund for Regional Trade and Financial Security Initiative)*. Manila (TA 4601-PHI, for \$400,000, approved on 24 June).

⁸ The Capital Market Development Council, a public-private association comprising key stakeholders in the securities industry and government regulators, with the support of the United States Agency for International Development under the EMERGE Project, is currently conducting a comprehensive study on the tax treatment of financial instruments to promote further rationalization.

47. Reforms to facilitate mobilization of domestic savings for pre-need plan companies and mutual funds and strengthen the investor-protection framework did not achieve their intended outcome. With respect to pre-need plans, the reforms did not address the core problems that undermine investor confidence. It appears that comprehensive overhaul of the regulatory framework is needed to address current liquidity problems experienced by several large pre-need plan companies.

48. Under the Securities Regulation Code, pre-need plans are regulated as a security through a rules-based (as opposed to a legislative-based) framework. Thus, the SEC is responsible for defining the investor-protection scheme as well as interpreting this scheme. Under the Securities Regulation Code, SEC officials and staff, when challenged for taking specific actions in their official capacity, are required to demonstrate that they acted with “extraordinary diligence” to avoid liability for enforcing substantive requirements that they might have been responsible for developing. Responsible staff and officials are therefore reluctant to take enforcement actions that may invite a legal challenge. Instead, the SEC appears to use its power to deny renewal of annual registration to dealers selling pre-need plans of pre-need companies experiencing financial difficulties (such as trust fund deficiencies and related impairment of capital). As a result, the number of pre-need plan companies with licenses to sell pre-need plans has declined from 43 in 2003 to 29 in 2006. Moreover, because of ongoing legal challenges resulting from the decision to deny renewal of some pre-need company dealers' licenses, the SEC has been forced to divert its limited staff resources from inspection of pre-need plan companies to preparation of case documentation. Thus, the SEC was not able to conduct any inspections of pre-need companies in 2005. Although the SNBGFP included SEC review of a proposal to establish an investor-protection scheme for pre-need planholders, the Federation of Pre-Need Planholders, which submitted the proposal, did not follow up on concerns raised by SEC.

49. In contrast, the number of mutual funds has increased by more than 50% since 2003. The net asset value of mutual funds has almost doubled along with mutual fund sales and the number of mutual fund accounts. However, the size of this subsector is still small compared with the size of common trust funds (a comparable bank product in the Philippines) and with other regional mutual fund markets.⁹ The future growth of mutual funds will continue to be constrained unless measures are taken to promote greater regulatory and tax parity with bank common trust funds, which directly compete with mutual funds. Thus, more sustainable reforms for both the pre-need and mutual fund sectors are dependent on the enactment of a comprehensive regulatory framework, including legislation. Although relevant bills were submitted by the executive branch to Congress, technical working groups have been organized to discuss the bills, and public hearings on the bills have taken place, it appears that neither adoption of a new pre-need code nor amendment of the Investment Company Act is a Congressional priority.

C. Preliminary Assessment of Sustainability

50. The SNBGFP helped establish a comprehensive legal, regulatory, and institutional framework for AML. However, the effective impact of these reforms will depend on adequate budget support for AMLC and effective and efficient prosecution of AML cases. Ongoing technical assistance support may be required to build much-needed capacity in the investigation and prosecution of AML cases.

⁹ There are 32 mutual funds (and an estimated 60 common trust funds) operating in the Philippines, as compared with 154 investment funds operating in the People's Republic of China, 247 in Indonesia, 281 in Malaysia, and 523 in Thailand.

51. As reflected in Appendix 3 (Selected Nonbank Financial Indicators), investor protection and confidence in the PSE has increased during the program. Less success has been met in broadening PSE ownership, but this is offset by a much-improved governance structure of the PSE and better conditions for effective PSE self-regulation. While the PSE appears to be committed to divestment and enhanced investor protection, it is important to continually track progress in this area and related actions by PSE management and the Board to improve PSE's competitiveness and perceived fairness. The dissolution of several board-level committees should result in further strengthening of investor confidence in the exchange.

52. The sustainability of program reforms to address the weak and fragmented policy and regulatory framework for the nonbank financial sector depends on Congressional action and is less certain. While the SEC has prepared a capital market blueprint, adoption is subject to Department of Finance clearance. Once adopted, close monitoring of the status of key initiatives by the SEC will be needed to ensure effective implementation.

53. The sustainability of program reforms to strengthen SEC supervisory responsibilities and enhance monitoring and surveillance capacity depends on adequate financial and staff resources and capacity. A more proactive approach to regulation depends on adequate protection of SEC staff and officials from unfounded legal challenges.

54. Supervision of entities dually regulated by SEC and BSP has been enhanced under the program and will continue to strengthen based on increased activity of the banking sector in the secondary trading market with the emergence of the new fixed-income exchange. In addition, establishment of the new Financial Sector Forum, comprising the heads of the BSP, SEC, Insurance Commission, and the Philippine Deposit Insurance Corporation, has enhanced information sharing and coordination among these agencies.

55. The sustainability of reforms related to improved quality of financial information appears strong. The SEC has taken strong leadership in this area and has adopted a comprehensive regulatory and supervisory framework. The sustainability of reforms related to the adoption of a new RBCA-based approach to capital adequacy by NBFIs appears strong - this framework mirrors the framework adopted by the BSP for the banking sector, reflects international best practice standards, and promotes regulatory parity. Long-term success in this area depends on behavioral changes and implementation of new systems to effectively monitor compliance, which will take time. By requiring NBFIs to have certified compliance officers, it will be easier for the SEC to focus on related capacity-building initiatives and ensure greater accountability.

56. While the proposed legislative reforms in the pre-need and mutual fund sectors should strengthen investor protection for pre-need planholders and mutual fund investors, they alone will not facilitate the mobilization of savings as originally envisaged. The policy actions under the program focused more on investor protection and less on addressing direct impediments to the ability of funds to diversify and offer more investment products. Moreover, the recent failure of several large pre-need companies has significantly dampened the growth of pre-need plan sales. Stronger growth in the mutual funds subsector also depends on greater tax parity with similar bank products and on facilitating the organization and registration of mutual funds.

D. Impact

57. The stated goal (impact) of the SNBFGP is enhanced compliance with the objectives and principles of the International Organization of Securities Commissions, which was achieved through adoption of the new RBCA rule for brokerage firms and a stronger framework for self-regulation by the PSE.

IV. OVERALL ASSESSMENT AND RECOMMENDATIONS

A. Overall Assessment

58. The SNBFGP was implemented as conceived and was highly relevant to the Government's development strategy, ADB's lending strategy for the Philippines, and ADB's strategic objectives at the time of approval. The program was effective in meeting the stated outcome at the time of approval. However, the program was less efficient in achieving results in two key areas: (i) prudential standards for NBFIs, and (ii) in facilitating mobilization of domestic savings for pre-need plan companies and mutual funds and protecting mutual fund investors and pre-need planholders, which require legislative action. Based on the Government's strong ownership of program reforms and ongoing support for implementation, sustainability of reforms that are under the control of the executive branch is likely. The program is thus rated successful.

B. Lessons Learned

59. While the program focused on key reform initiatives that were under the control of the executive branch, objectives focused on facilitating mobilization of domestic savings require legislative action. Thus further reforms to enhance sustainable growth of mutual fund and pre-need plans depend on enactment of legislative reforms.

60. While it is acknowledged that funding for Government agencies remains limited, key reform initiatives require adequate resources to strengthen regulatory capacity, especially in the area of surveillance and enforcement. Likewise, until SEC staff are sufficiently protected from frivolous and intimidating lawsuits, it may be unrealistic to expect strong enforcement actions.

61. In addition to focusing on legislative measures, it may be more effective to help the SEC review other regulatory tools to achieve greater compliance. For example, greater use of information and communication technology (ICT) to monitor compliance with regulatory requirements by both the SEC and PSE could free up much-needed staff resources and provide timely review of compliance, although initial costs may be substantial. For example, the Government has demonstrated strong ownership of financial reporting reforms, where compliance can also be monitored by market professionals through the SEC's new i-Report system.

62. Ongoing domination of the financial sector by banks will continue in the absence of a concerted Government policy to promote regulatory and tax parity among bank and nonbank investment products. Moreover, simply changing a law or regulation will not change behavior in the absence of strong enforcement and sustained (long term) commitment to the reform agenda. In the future, program designs should focus on areas where there is strong commitment and adequate resources available to successfully implement reforms.

63. The SNBFGP was developed prior to adoption of the Results-Based Framework by ADB, which shifts the orientation of country programming from resource transfers to development outcomes. Future projects thus need to focus on more concrete outcomes linked to tangible medium- and longer-term results.

C. Recommendations

1. Program-Related

64. **Future Monitoring.** Appendix 3 includes a proposed indicator's framework to track the progress of SNBFGP reforms. In addition to the proposed indicators, the following key results

areas should also be closely monitored through regular consultations with the DOF and SEC (biannually to clarify the impact of reform activities): (i) ownership of PSE shares by trading participants; (ii) PSE profitability; (iii) budget for PSE's compliance function; (iv) installation of PSE's surveillance, trading, and integrated back-office system for participants; (v) status of reform initiatives under the SEC's capital market blueprint; (vi) rollout of SEC's i-Report system; (vii) implementation of RBCA framework; and (viii) status of pre-need plan code and legislative reforms for mutual funds.

65. **Further Action or Follow-Up.** Follow-up support under the two ongoing TAs will be provided to ensure the sustainability of RBCA and governance reforms.

66. **Additional Assistance.** TA may be needed to support implementation of the capital market blueprint, once adopted and issued. TA may also be needed to promote more effective prosecution of AML cases.

67. **Timing of Project Performance Audit Report.** To further assess the impact of reforms on the nonbank financial sector and the economy, it is proposed that a program performance audit report be conducted in 3 years.

PROGRAM FRAMEWORK

Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
<p>Goal Enabling capital markets to mobilize savings for productive investments while protecting investors and ensuring the solvency of nonbank financial institutions (NBFIs); mitigation of the systematic risk in the financial system</p>	<p>Moving closer to full compliance with International Organization of Securities Commission's (IOSCO) 30 Objectives and Principles of Securities Regulation^a</p>	<p>Asian Development Bank (ADB) review mission</p>	<p>Assumptions:</p> <p>Political stability exists</p> <p>Political commitment to anti-money laundering efforts</p> <p>Resistance from vested interest groups could be overcome</p> <p>Risks:</p> <p>Slower growth (resulting from other factors, including external sector) could weaken the activities in the capital markets</p>
<p>Purpose Improved regulatory and policy framework for the development of viable institutions and properly functioning financial markets</p> <p>Improvement of the Securities and Exchange Commission's (SEC) enforcement capabilities, supervisory skills, and practices</p>	<p>Effective anti-money laundering regime</p> <p>Removal of documentary stamp tax to increase liquidity in the secondary markets</p> <p>Improved governance structure of the Philippine Stock Exchange (PSE)</p> <p>PSE self-regulation</p> <p>More capable SEC to effectively supervise and enforce Securities Regulation Code rules and regulations</p>	<p>(refer to policy actions)</p>	<p>Assumptions:</p> <p>Strong SEC and Anti-Money Laundering Council (AMLC) staff skills to implement the Program</p> <p>Strong political will to resist vested interest groups and to implement the Program</p> <p>Adequate resources for training and adopting International Accounting Standards</p> <p>Strong political will to resist interest groups and to implement the Program</p>

Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
<p>Greater transparency and financial disclosure to protect investors from fraud, insolvency, or misconduct</p> <p>Improved regulatory framework for mobilizing domestic savings to increase supply of funds while ensuring investor protection</p>	<p>Phased-in International Accounting Standards</p> <p>Harmonize prudential regulations of NBFIs</p> <p>Submission of pre-need code and Revised Investment Company Act to Congress</p>		
<p>Outputs</p> <p>Improved regulatory and policy framework for developing viable institutions and properly functioning financial markets</p> <ul style="list-style-type: none"> A. Robust legal framework in line with international norms established B. AMLC and other key Government institutional capacities enhanced C. Improved investor protection and confidence in the stock market D. Address weak and fragmented policy and regulatory framework to promote market efficiency and development <p>SEC supervisory and surveillance capacity further strengthened and clearly defined</p> <p>Improved transparency and financial disclosure to protect investors from fraud, insolvency, or misconduct</p> <ul style="list-style-type: none"> A. Adoption of international accounting standards B. Financial disclosure and audit 	<p>(refer to policy matrix)</p>		

Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
<p>requirements strengthened</p> <p>Prudential standard in nonbank financial sector strengthened</p> <ul style="list-style-type: none"> A. Risk-based capital standards harmonized B. Fit and proper standards C. Compliance officer-director certified <p>Improved regulatory framework for mobilizing domestic savings and increasing supplies of investment funds while ensuring investor protection</p>			
<p>Inputs</p> <p>Reform program loan to the Government (SNFG)</p> <p>Technical Assistance (TA) to assist with implementing reforms</p> <p>TA 3487-PHI: Strengthening the Anti-Money Laundering Regime</p> <p>TA 3245-PHI: Nonbank Financial Sector Development</p>	<p>A loan of \$150 million</p> <p>TA of \$500,000 providing 13 person months of international consulting services and 10 person months of domestic consulting services</p> <p>TA of \$1,000,000 providing 19 person months of international consulting services and 25 person months of domestic consulting services for advising and training AMLC staff members</p> <p>TA of \$2,000,000 providing 36 person-months of international consulting services and 60 person months domestic consulting services for advising the SEC and training SEC staff and others</p>	<p>Regular progress reports, statistics, and ADB review missions.</p>	

^a Compliance of 2003 (as indicated in para. 30 of the RRP) would be used as a benchmark.

POLICY MATRIX

Focus of Reform	Policy Actions to be Taken Before First Tranche (FT), Second Tranche (ST) and End of Program (EOP)	Progress of Implementation as of 15 May 2006
<p>A. Strengthen the regulatory and policy framework for developing viable institutions and properly functioning financial markets</p> <p>1. Establish an effective anti-money laundering (AML) regime</p> <p style="padding-left: 20px;">a. Establish a robust legal framework in line with international norms</p>	<p>The Government to promulgate implementing rules and regulations for the AML Act of 2001 approved by Congressional Oversight Committee [FT]</p> <p>The Government to establish the Anti-Money Laundering Council (AMLC) as the financial intelligence unit [FT]</p> <p>The Government to enact amendments to the AML law in line with international norms [FT]</p> <p>The Government to promulgate implementing rules and regulations for the AML Act as amended in 2003 [ST]</p> <p>AMLC to sign memorandum of agreement with the Department of Justice formalizing inter-institutional coordination among AMLC, National Bureau of Investigation, and Bureau of Immigration to provide for exchange of intelligence material, stored data (e.g., immigration movement), and financial transaction reports [FT]</p> <p>SEC, Insurance Commission, and the Philippines central bank (BSP) to issue AML operating manual for financial institutions under their supervision [FT]</p>	<p>Complied with. Implementing rules and regulations for the AML Act of 2001 took effect on 2 April 2002</p> <p>Complied with. AMLC established in 2001 following the enactment R.A. 9160 or the Anti-Money Laundering Act of 2001</p> <p>Complied with. On 7 March 2003 R.A. No. 9194 (An act amending R.A. No. 9160) was signed into law and took effect on 23 March 2003.</p> <p>Complied with. Implementing rules and regulations for the amended AML Act were promulgated on 6 August 2004 by the Congressional Oversight Committee assigned to oversee implementation of the AML Act</p> <p>Complied with.</p> <p>Complied with. The BSP, SEC, and Insurance Commission prepared model AML operating manuals and advised institutions under their supervision to develop an internal manual using the models for guidance. According to the AMLC, a vast majority of the covered institutions</p>

Focus of Reform	Policy Actions to be Taken Before First Tranche (FT), Second Tranche (ST) and End of Program (EOP)	Progress of Implementation as of 15 May 2006
	<p>Certain courts to be designated to hear and adjudicate money laundering cases [ST]</p> <p>The Government to complete the formulation of AML implementation plan mutually satisfactory to Asian Development Bank (ADB) and the Government [ST]</p> <p>Redesign reporting forms for suspicious transaction reports, covered transaction reports, and other reporting requirements in consultation with financial institutions and to reflect amendments to AML Act [EOP]</p>	<p>have complied with this requirement.</p> <p>Complied with. On 1 June 2004, the Supreme Court issued a resolution designating the country's commercial courts as AML courts for cases involving persons other than public officers or private persons conspiring with a public officer to commit graft or corruption.</p> <p>All judges of Regional Trial Courts and Sandiganbayan divisions that were designated to hear money laundering cases have been trained. In addition, Anti-Graft Court justices and Court of Appeals justices nationwide have also received AML-related training.</p> <p>Complied with. Based on ADB comments, in April 2004, AMLC amended the implementation plan submitted to the Financial Action Task Force in January 2004 to include forward-looking, measurable milestones.</p> <p>Complied with. AMLC Resolution 292, adopted on 24 October 2003, establishes rules on the submission of suspicious transaction reports and covered transaction reports by covered institutions. AMLC Resolution 317, adopted on 30 December 2003, approves the new suspicious transaction reports and covered transaction report reporting forms designed in consultation with financial institutions and in accordance with the amended AML Act. The form for covered reports lowers the threshold reporting amount from approximately \$80,000 to \$10,000.</p>
b. Build capacities of AMLC and other key Government institutions	<p>The Government to transfer staff identified in BSP, SEC, and Insurance Commission to AMLC secretariat [FT]</p> <p>Key Government agencies (AMLC, judiciary, law enforcement agencies, SEC, Insurance Commission, and BSP) to complete the assessment of staff training needs and conduct training programs to implement an effective AML regime [EOP]</p>	<p>Complied with. AMLC has subsequently hired professional staff to run the AMLC Secretariat</p> <p>Complied with. Training needs assessment (jointly supported by ADB and Asia and Europe Meeting has been conducted, and related training programs are being implemented on an ongoing basis</p> <p>From September 2003 through December 2005, AMLC conducted over 340 workshops and seminars on various aspects of AML. Training participants included employees of a wide range of Government agencies and private</p>

Focus of Reform	Policy Actions to be Taken Before First Tranche (FT), Second Tranche (ST) and End of Program (EOP)	Progress of Implementation as of 15 May 2006
	<p>AMLC to establish a time-bound action plan with milestones for establishing an effective AML regime [FT]</p> <p>Develop project specifications for transactions monitoring system [FT]</p> <p>AMLC to establish a transaction monitoring system [ST]</p> <p>AMLC to be staffed to operational level [FT]</p> <p>The Government to file AML cases [FT]</p> <p>AMLC to develop and adopt an AML compliance system satisfactory to ADB [ST]</p>	<p>sector financial institutions (covered institutions) charged with compliance under the law. Feedback has been positive in terms of program content and participant involvement.</p> <p>Complied with. Significant milestones in the action plan included membership in the Egmont Group of financial intelligence units by June 2005, establishment of phase I of the transaction monitoring system by December 2004, and AML training for the judiciary by September 2004. These milestones were substantially achieved within the envisioned time frame.</p> <p>Complied with. AMLC has established a transaction monitoring system and is in the process of upgrading its capacity as part of a well-planned and systematic multiphase development effort.</p> <p>As of 28 February 2006, the transaction monitoring and analysis system has received about 52 million covered transaction reports and 2,324 suspicious transaction reports involving 9,688 suspect transactions.</p> <p>Complied with. AMLC has engaged 56 professional staff. As of 30 March 2006, 33 are permanent (have complied with 5-year service requirement), while 19 staff from the manpower pool of the BSP Office of the Governor, and one from the BSP Office of Special Investigation are temporarily assigned to the AMLC Secretariat. In addition, one personnel each from the Philippine National Police (PNP), National Bureau of Investigation (NBI), and Philippine Drug Enforcement Agency (PDEA) are temporarily assigned to the AMLC Secretariat. Professional staff are required to pass relevant civil service examinations. Staff in functional groupings are required to have relevant training, professional qualifications, and experience.</p> <p>Complied with. As of 28 February 2006, 91 AML related cases have been filed and are in various stages of trial.</p> <p>Complied with. On 5 April 2004, AMLC approved a</p>

Focus of Reform	Policy Actions to be Taken Before First Tranche (FT), Second Tranche (ST) and End of Program (EOP)	Progress of Implementation as of 15 May 2006
	Develop and adopt program for issuing AMLC guidelines and information bulletins to financial institutions and other agencies [EOP]	<p>compliance system designed with the help of an ADB expert. This system should provide a consistent and transparent framework of procedures across financial sector regulators for addressing noncompliance by regulated entities.</p> <p>Complied with. AMLC established a website to ensure that guidelines and information bulletins issued are publicly available. AMLC issues information bulletins upon request to supervisory authorities who disseminate them to regulated (covered) institutions. With respect to guidelines, AMLC issues resolutions directing supervisory authorities to issue guidelines or circulars to covered institutions under their supervision. Prior to issuing such guidelines, supervisory authorities invite key stakeholders to comment on the proposal. Comments are provided to AMLC for consideration.</p>
<p>2. Strengthen investor protection and confidence in the stock exchange</p> <p>a. Establish a framework for broadening ownership of the Philippine Stock Exchange (PSE) and improve its governance structure to strengthen investor confidence</p>	SEC to require PSE to establish a plan to broaden ownership of the exchange as mandated under the Securities Regulation Code by (i) developing a medium-term business strategy to improve its revenue to facilitate divestiture; and (ii) appointing majority nonmember directors to the PSE's selected board committees [FT]	<p>Complied with. The SEC issued several directives to the PSE to broaden ownership of the exchange as provided under the Securities Regulation Code (SRC). Although brokerage firms continue to control approximately 50% of the voting stock of the PSE, the PSE has submitted an action plan to address the ownership issue. Options presented include (i) the secondary sale of 4.9 million common shares held by brokers; (ii) the primary issue of 24.4 million common shares; and (iii) the issuance of 25 million voting, non-convertible, redeemable preferred shares.</p> <p>To improve its revenue in order to facilitate divestiture, PSE increased transaction fees and initial listing fees. As a result, operating revenues doubled to ₱273.8 million in 2005 from ₱137.6 million in 2004. Net income after tax likewise improved from ₱22 million to ₱120 million during the same period.</p> <p>Following the PSE's 2006 annual stockholders' meeting, the PSE announced that it has dissolved a number of</p>

Focus of Reform	Policy Actions to be Taken Before First Tranche (FT), Second Tranche (ST) and End of Program (EOP)	Progress of Implementation as of 15 May 2006
		board-level committees and transferred their powers and functions to the exchange's management. This is in line with PSE's efforts to further professionalize the exchange. The remaining committees are the Audit Committee, the Compensation and Remuneration Committee, and the Nominations and Elections Committee. The Floor Trading and Arbitration Committee was allowed to stay for another 6 months to ensure a smooth turnover of its specialized procedures to management.
b. Establish conditions for effective PSE self-regulation	<p>SEC to require PSE to develop a business plan for self-regulation in a demutualized (for profit corporate status in contrast to earlier not-for-profit membership owned status) environment which would include (i) identification of functions to be performed by PSE; (ii) clearly defined Government (SEC) and self-regulatory organizations (SRO) oversight role in each program area (i.e., market surveillance, on-site inspection, and off-site monitoring); and (iii) budget estimates of the cost of regulatory compliance [FT]</p> <p>SEC to sign a memorandum of agreement with PSE regarding implementation of business plan for PSE's self-regulation [ST]</p> <p>SEC to audit implementation of the PSE's SRO surveillance and compliance systems and procedures.</p>	<p>Complied with. While a business plan was prepared during the demutualization process, this plan was superseded by a new regulatory structure adopted in 2004 in connection with related second tranche conditions.</p> <p>Complied with. On 12 November 2004, PSE and SEC signed a Memorandum of Agreement regarding implementation of PSE's new framework and plan for self-regulation of broker trading participants.</p> <p>In August 2004, PSE's board approved a new structure for self-regulation under which the PSE's compliance and surveillance group would be restructured into the new market regulatory office (MRO). That office would report to a newly established independent market integrity board, chaired by a retired Supreme Court justice and consisting of a former SEC commissioner, an independent member of PSE's board of directors, and two broker trading participants. PSE's president would participate as a nonvoting member of the market integrity board.</p> <p>The new structure has resulted in an increase in the number of sanctions (with monetary penalties) imposed by the PSE on brokers from only two in 2003 to 39 in 2005.</p> <p>Complied with. The SEC conducts desk audits of the activities being performed by the PSE as an SRO based</p>

Focus of Reform	Policy Actions to be Taken Before First Tranche (FT), Second Tranche (ST) and End of Program (EOP)	Progress of Implementation as of 15 May 2006
	<p>[FT]</p> <p>SEC to require PSE to (i) strengthen its compliance and surveillance group by upgrading the information technology system for surveillance and audit; and (ii) examine trading participants, without notice, for compliance with regulatory requirements [FT]</p> <p>SEC to develop a policy statement setting out its oversight objectives and how it will relate to cooperation in market regulation with PSE in a demutualized environment [FT]</p> <p>SEC to require PSE to update the trading and compliance rules and rationalize penalties for a trading participant's violation of the rules [EOP]</p>	<p>on reports submitted by the PSE under SRC Rule 39.1-1. However, the SEC has not conducted a comprehensive audit of PSE's SRO surveillance and compliance systems and procedures. SEC plans to conduct such an audit in May 2006 in conjunction with its review of the effectiveness of PSE's new regulatory structure.</p> <p>Complied with. The SEC initiated several discussions with the PSE on strengthening the exchange's compliance and surveillance group. In 2005, the PSE board approved ₱2.5 million to purchase IT to develop surveillance software. However, the purchase of such software is tied to the purchase of a new trading system, which the PSE hopes to procure in 2006.</p> <p>Complied with. A draft memorandum of understanding (MOU) between SEC and PSE was prepared.</p> <p>Complied with. PSE and SEC have completed discussions on draft PSE trading and compliance rules that increase penalties. The proposed rules clarify major and minor violations and increase the minimum fines from ₱1,000 to ₱10,000. The rules also provide for suspending and blacklisting trading participants for major violations, and require beneficial ownership to be captured by the trading system to provide an audit trail and facilitate investigation.</p>
<p>3. Address weak and fragmented policy and regulatory framework to promote market efficiency and development</p> <p>a. Rationalize the tax treatment of financial instruments</p>	<p>The Government to submit a draft bill to rationalize the documentary stamp tax (DST) on all debt and equity instruments traded in the secondary markets, and in stock lending and borrowing transactions [FT]</p> <p>The Government to review the initial public offering (IPO) tax on listed securities (i.e., corporate stocks and closed-</p>	<p>Complied with. On 12 February 2004, Congress passed the Act Rationalizing the Tax Treatment of Financial Instruments, which reduces the DST on original issuance of shares and eliminates DST on secondary trading of shares on the stock exchange.</p> <p>Complied with. The Capital Market Development Council, which is composed of government regulatory agencies</p>

Focus of Reform	Policy Actions to be Taken Before First Tranche (FT), Second Tranche (ST) and End of Program (EOP)	Progress of Implementation as of 15 May 2006
	end investment companies) [EOP]	and industry associations, continues to discuss ways to further develop the capital market. This includes reviewing taxes on financial instruments and transactions such as the IPO tax.
b. Promote the development of efficient capital markets	<p>The Government through SEC to develop a medium- and long-term strategy for the development of capital markets to advise top-level policy makers on the existing constraints (i.e., tax, regulatory, and legal impediments) to capital market development, taking into account the need to achieve greater market efficiency, attract external investment in a highly competitive global capital market, and achieve investor protection in a cost-effective manner in line with international best practice and the mandate of the laws administered by SEC [EOP]</p> <p>The Government through SEC to draft an agenda for legal and regulatory reforms necessary to reduce or eliminate impediments to capital markets development as an integral part of capital markets development strategy [EOP]</p>	<p>Complied with. The Government, through SEC, has developed a blueprint containing a medium- and long-term strategy for capital market development with key stakeholders, along with milestones that need to be met to achieve these objectives and a related legal and regulatory reform agenda.</p> <p>The latest draft of the blueprint (September 2004) incorporates the comments of key stakeholders (Government, market institutions, market participants). The public was invited to comment on the draft blueprint, which was posted on the SEC website. In August 2004, roundtable workshops on the draft blueprint were held with more than 100 key stakeholders to discuss outstanding issues.</p> <p>The revised draft has been incorporated into the Government's national economic strategy and medium-term development framework. The Government plans to finalize the blueprint within the year. Additional time is needed to follow up on a number of key issues, including clarification of mechanisms to effectively monitor implementation.</p> <p>Complied with. The Government developed an agenda for legal and regulatory reform in connection with the blueprint.</p>
B. Further strengthen SEC supervisory responsibilities and enhance monitoring and surveillance capacity	<p>SEC to develop training programs relating to regulation and compliance for the staff and associated persons such as brokers and dealers [FT]</p> <p>SEC to install information technology to enable the agency to gather and analyze large databases for monitoring and surveillance purposes [FT]</p>	<p>Complied with. SEC developed a training program for associated persons (compliance officers) of brokerage firms in preparation for their certification exam.</p> <p>Complied with. SEC installed the Advanced Warning and Control System, market surveillance software provided by ADB to monitor trading at the stock exchange. SEC is also developing the SEC i-Report IT system, which will, among</p>

Focus of Reform	Policy Actions to be Taken Before First Tranche (FT), Second Tranche (ST) and End of Program (EOP)	Progress of Implementation as of 15 May 2006
		other things, allow the SEC to gather and analyze large databases to monitor regulated entities' compliance with regulatory requirements.
	<p>SEC to develop and execute training programs for its own staff in market surveillance and monitoring, enforcement, and compliance in conformity with SEC's regulatory mandate [FT]</p> <p>SEC to review and update its existing inspection procedures and allow for SEC-PSE joint on-site examination of PSE member brokers and dealers on a sample basis, or in respect to cause or thematic examinations [FT]</p> <p>SEC and BSP to amend the memorandum of understanding between the two agencies to (i) provide an action plan and procedures for joint on-site inspection of dually regulated entities, where necessary, to minimize cost of supervision while ensuring that regulatory gaps do not occur; and (ii) standardize the regulatory and operational reports filed with BSP and SEC [ST]</p>	<p>Complied with. With assistance from other development partners (USAID), SEC developed a training program for its staff on the use of the Advanced Warning and Control System. Key SEC officials who attended foreign training programs on enforcement and surveillance between 2003 to 2005 also passed on the knowledge gained from these training programs to staff of operating departments through echo seminars.</p> <p>Complied with. In 2003 the SEC and PSE conducted joint thematic inspections (regular inspections) of all brokerage firms to review compliance with customer protection rules. In 2004 and 2005, SEC participated in a few special audits (when fraud or misconduct is suspected or a complaint has been filed - for cause) with PSE. Since 2004, SEC has not participated in thematic inspections—this has been delegated to PSE. Participation in special audits is determined on a case-by-case basis.</p> <p>Complied with. SEC and the Philippines central bank entered into an MOU on 12 May 2004 to provide for better SEC-central bank coordination of oversight of dually regulated entities, including joint inspections, to avoid potential gaps and enhance regulatory efficiency. Under the MOU, the central bank will take the lead in coordination, and invite the SEC to participate. The central bank and SEC agree to notify each other of their findings during an inspection. SEC also agreed to standardize the regulatory and operational reports for dually regulated entities by the end of the year. This MOU builds on an earlier MOU signed in July 2003 that outlines cooperative arrangements for more efficient sharing of supervisory responsibilities and information about dually regulated entities.</p> <p>In addition, to further enhance interagency coordination, SEC, central bank, Insurance Commission, and the Philippine Deposit Insurance Corporation established a multilateral interagency forum on 5 July 2004. The forum</p>

Focus of Reform	Policy Actions to be Taken Before First Tranche (FT), Second Tranche (ST) and End of Program (EOP)	Progress of Implementation as of 15 May 2006
		is intended to facilitate consultations and exchange of information among members on matters that relate to the supervision and regulation of financial institutions.
<p>C. Improve transparency to protect investors from fraud, insolvency, or misconduct</p> <p>1. Improve the quality of financial information disclosed to the market</p> <p>a. Phase in the adoption of international accounting standards</p>	<p>SEC to commence the public disclosure, on its website, of annual audited financial statements and information so as to eventually cover all registered nonbank financial institutions [ST]</p> <p>SEC to issue a regulation requiring external auditors for First Board-listed companies¹⁰ to be chosen by an audit committee comprising at least two independent directors of the board of directors [EOP]</p>	<p>Complied with. In November 2005, SEC launched the SEC i-View, a new system for hosting the audited financial statements (and other reports filed with the SEC) of all companies registered with the SEC, including listed companies and NBFIs. The public may view and/or print these documents from the SEC website for a fee.</p> <p>Complied with. On 1 April 2004, SEC issued Memorandum Circular No. 6 Series of 2004, to require all companies listed on the First Board of PSE to have an audit committee consisting of at least two independent directors, one of whom shall be its head or chairperson. The audit committee is responsible for choosing the external auditor of the company. The new requirement became effective on 22 April 2004.</p>
<p>b. Strengthen disclosure and audit requirements</p>	<p>SEC to issue a circular requiring all companies registered with SEC to adopt auditing by 2004 and accounting standards by 2005 (based on international accounting and auditing standards) [FT]</p> <p>SEC to require the auditors of all public companies to report serious breaches of accounting standards to the regulator in the event companies fail to publicly disclose such information [FT]</p>	<p>Complied with. SEC issued several circulars requiring all companies registered with the commission to adopt auditing and accounting standards.</p> <p>Complied with. SEC Circular No. 13, Series of 2003, requires all auditors of public companies and NBFIs to be accredited. Accredited auditors are required to report serious breaches of accounting regulations to their respective regulator.</p>

¹⁰ Companies listed on the First Board of the PSE need to meet the following criteria: (i) track record of profitable operations for the last three full fiscal years; and (ii) market capitalization of ₱500million, providing it has a five year operating history; or (iii) net tangible assets of ₱500m, provided that is has a five year operating history.

	<p>SEC to require the auditors of all nonbank financial institutions registered with BSP, SEC, or the Insurance Commission to report serious breaches of accounting standards to the relevant regulator if companies fail to publicly disclose such information [ST]</p> <p>SEC to implement training programs on IAS with support of the Board of Accountancy (BOA) [FT]</p> <p>The Professional Regulatory Commission will, in coordination with BOA, adopt the code of ethics in harmony with international best practice, such as that of the International Federation of Accountants [ST]</p> <p>SEC to require listed companies to rotate auditing firms or signing partners every 5 years to improve the quality of audits [FT]</p> <p>SEC to issue rules providing standards for accrediting auditors of public companies [FT]</p> <p>SEC to require chief executive officer and chief financial officer of listed companies, or persons performing similar functions, to disclose to the listed company's auditors and to the audit committee of the board of directors (i) all significant deficiencies in the design or operation of internal controls that could adversely affect its ability to</p>	<p>Complied with. In cooperation with several professional groups (such as BOA, Philippine Institute for Certified Public Accountants, and Philippine Regulatory Commission), the SEC conducted several seminars and workshops on IAS in 2004 and 2005. The seminars/workshops were conducted by the SEC in Metro Manila and other key cities. A total of 685 participants from listed companies, banks, mutual funds, investment houses, transfer agents, pre-need companies, and other institutions reporting to the SEC attended the seminars.</p> <p>Complied with. A new code of ethics that incorporates international best practice standards was approved in December 2003 and became effective in January 2004.</p> <p>Complied with. The Code of Corporate Governance requires the rotation of auditing firms or signing partners every 5 years. Compliance with this requirement is monitored through a review of submitted information statements that disclose the names of auditing firms and signing partners.</p> <p>Complied with. Section 5 of SEC Circular No. 5, Series of 2002, provided the qualification requirements for accrediting auditors (individuals and auditing firms) of public companies. As of 28 February 2006, 299 individuals and 73 accounting firms have been accredited. There were also 260 pending applications and 166 denied applications for accreditation. Many applications were denied because the applicant lacked minimum audit experience or familiarity with new standards.</p> <p>Complied with. SEC Rule 68.1 requires that the board meet and submit a resolution with recommendations on how to address such disclosures when they occur.</p>
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	<p>record, process, and report financial data that have been identified for the listed company's auditors, and material weakness in internal controls; and (ii) any fraud that involves management or other employees who have a significant role in internal controls [FT]</p> <p>SEC to issue a circular that it will take effective disciplinary actions against issuers (and other NBFIs) or auditors for significant violations of established accounting standards and rules, including revoking the accreditation of noncompliant auditors [FT]</p> <p>SEC to establish a system for monitoring and enforcing compliance with accounting requirements for all listed companies (and other NBFIs) or auditors, including an arrangement for conducting investigations or special examinations to substantiate information provided by issuers and/or listed companies or auditors [ST]</p> <p>SEC to require the chief executive officer and chief financial officer, or persons performing similar functions, to certify under oath the material accuracy and completeness of financial and other information contained in annual reports of listed companies [FT]</p> <p>SEC to review the feasibility of requiring the chief executive officer, or persons performing similar functions, to certify under oath the material accuracy and completeness of financial and other information contained in quarterly reports of listed companies. [EOP]</p> <p>SEC to prohibit officers and directors of a listed company (and other issuers of securities to the public) and persons acting under the direction of an officer or director from taking any action to fraudulently influence, coerce, manipulate, or mislead the auditor of the issuer's financial statement for the purpose of rendering the financial statement materially misleading [FT]</p>	<p>Complied with. SEC Circular No. 5, Series of 2002, provides for sanctions and disciplinary actions against external auditors for violation of accounting standards and rules, including revocation of their accreditation.</p> <p>Complied with. On 29 April 2004, SEC institutionalized its current practices for enforcing accounting requirements by adopting a system that includes a comprehensive checklist, procedures for verifying information, and coordination with SEC's compliance and enforcement department when the Office of the General Accountant believes that an investigation and/or sanctions are warranted.</p> <p>Complied with. SRC Rule 17.1 requires annual reports to be signed under oath by the chief executive officer and chief financial officer. SRC Rule 68, as amended in February 2004, requires a statement of management responsibility.</p> <p>Complied with. SRC Rule 68 paragraph 6 (iv) covers this requirement.</p>
<p>2. Strengthen prudential standards in nonbank financial sector</p> <p>a. Risk-based capital</p>	<p>SEC, in coordination with BSP where appropriate, to develop risk-based capital standards for registered</p>	<p>Substantially complied with. With the assistance of an ADB-funded expert on risk-based capital adequacy</p>

<p>standards</p>	<p>brokers, dealers, and investment houses with minimum entry requirements and ongoing risk-based capital standards for securities brokers, dealers, and investment houses [FT]</p> <p>SEC, in coordination with BSP where appropriate, to issue risk-based capital standards for registered brokers, dealers, and investment houses with minimum entry requirements and ongoing risk-based capital standards for securities brokers, dealers, and investment houses. The minimum capital requirement and the ongoing capital requirement will be based on the risk of conducting the business of broker, dealer, underwriter, and related business activities, as appropriate. [ST]</p>	<p>(RBCA) requirements, SEC adopted RBCA standards to address market, credit, and operational risks. These standards were incorporated into a new RBCA rule for securities brokers and dealers. The rule was adopted by the SEC on 12 November 2004 but went into effect only in January 2006 to allow transition from the old net capital rule.</p> <p>There has not been any progress on the investment houses rule. SEC wanted to ensure that the RBCA rule for brokerage firms could be implemented before extending to investment houses. SEC also needs to develop criteria for underwriting risk.</p>
<p>b. Fit and proper standards</p>	<p>SEC to submit through the Capital Market Development Council an amendment of the SRC to Congress that would enable SEC to establish “fit and proper” standards for the officers and directors of regulated entities (i.e., broker dealers, listed companies, investment companies, investment advisors) comparable with the Banking Act whereby SEC will be able to prescribe, pass upon, and review the qualifications of individuals elected or appointed directors or officers of such regulated entities and disqualifying those found unfit [FT]</p>	<p>Complied with. SEC submitted a letter to the Capital Market Development Council on proposed amendments to the Securities Regulation Code. One of the proposed amendments was the establishment of fit and proper standards for certain SEC-regulated entities.</p>
<p>c. Certification of compliance officer-director</p>	<p>SEC, together with BSP where appropriate, to require that each investment house, finance company, securities broker, and dealer have at least one officer, director, or associated person certified by examination as compliance officer to ensure compliance with the risk-based capital standards and other regulatory safeguards imposed on such entity under the laws administered by SEC and BSP [EOP]</p> <p>SEC, together with BSP where appropriate, to administer one or more examinations for certification of compliance officers of securities brokers and dealers, investment houses, investment companies, and others [EOP]</p>	<p>Complied with. Section 28 of the Securities Regulation Code and implementing regulations set forth the requirement for securities brokers and dealers to have a certified compliance officer. SEC Memorandum Circular No. 8 Series of 2004, issued on 15 May 2004, imposes this requirement on financing companies, investment houses, fund managers, mutual fund distributors, mutual funds, and pre-need companies.</p> <p>Complied with. SEC began administering examinations for compliance officers of broker dealers (based on a five-module approach) in 2004. The SEC conducted exams for modules 1 to 4 in 2004 and 2005. However, the examination for the fifth module (RBCA Requirements) was conducted only on 9 December 2005. So far, 57 compliance officers of broker dealers have passed all five modules, of which 54 are associated persons of PSE member brokers. Another 13 have passed Modules 1, 2, 3</p>

		<p>and 5 but are awaiting results of the Module 4 exam. The rest (62) need to retake and pass the exams for the modules that they failed before they can be certified.</p> <p>SEC plans to hold examinations for compliance officers of investment houses and fund managers during the latter part of 2006.</p>
<p>D. Facilitate the mobilization of domestic savings to increase supplies of investment funds while ensuring investor protection</p> <p>1. Pre-need plans</p>	<p>SEC to issue a rule to pre-need plan companies failing to comply with SEC regulations—particularly regarding trust fund deficits—to cease or desist from selling new plans. [FT]</p> <p>A draft pre-need code to be submitted to Congress [FT]</p> <p>SEC to coordinate joint inspection with BSP of trustees administering pre-need plans through bank trust departments or investment houses licensed to provide trust services [FT]</p> <p>SEC to conduct thorough, on-site, unscheduled inspections of pre-need plan companies at least once every 3 years [FT]</p>	<p>Complied with. In 2003 and 2004 all licensed pre-need companies were inspected. However, in 2005, the SEC lacked staff and was unable to inspect all pre-need firms. There are only five staff members for auditing and registration (all CPAs). Staff resources have been diverted to working on documentation for trial cases involving pre-need companies that have been sued in the courts.</p>
	<p>The pre-need regulatory agency to:</p> <p>a. coordinate with Department of Trade and Industry in issuing comprehensive guidelines on pre-need advertisement</p> <p>b. require that pre-need companies have an officer designated and certified as compliance officer</p>	<p>Complied with. On 29 April 2004, SEC approved comprehensive guidelines for pre-need advertisements. Developed in coordination with the Department of Trade and Industry and the Advertising Board of the Philippines (ABP) (Memorandum Circular No. 7 Series of 2004), the guidelines are self-executing and clarify that SEC has not reviewed the accuracy of the advertisements and that a disclaimer to this effect (currently required under pre-need rule 14) be included. The guidelines also clarify (i) the role of the Advertising Board, (ii) the practices prohibited, and (iii) the SEC's powers to impose sanctions following violations.</p> <p>Complied with. Pre-Need Rules require pre-need companies to designate a compliance officer. SEC</p>

	<p>c. review a proposal to establish an investor-protection scheme to compensate pre-need policy holders in the event of insolvency or demise of a pre-need company [EOP]</p>	<p>Circular No. 8, dated 13 May 2004, requires certification of pre-need company compliance officers and gives them 1 year to pass the examination. SEC conducted examinations for candidates for certification as pre-need company compliance officers in 2004 and 2005. Of 29 pre-need companies with dealer's licenses in 2006, 24 have certified compliance officers.</p> <p>Complied with. SEC has reviewed a proposal by the Federation of Pre-Need Plan Companies to introduce a guarantee bond and liquidity pool to help ensure compliance with SEC requirements on maintenance of trust fund balances. The trust fund covers payment of benefit obligations of individual firms. The proposal addresses trust fund liquidity concerns. On 29 April 2004, SEC formally commented on this proposal and suggested that the Federation consider establishing a broader investor-protection scheme for pre-need plan holders.</p>
<p>2. Investment companies/ mutual funds</p>	<p>SEC to require investment companies to adopt a corporate governance code [FT]</p> <p>SEC to submit Revised Investment Company Act (RICA) the to Congress [FT]</p> <p>SEC to develop certification program for independent directors of investment companies. [EOP]</p>	<p>Complied with. All active investment companies have submitted corporate governance manuals and self-rating forms to the SEC. Investment companies are likewise required to submit annual certifications attesting to, among other things, the attendance of directors (including independent directors) at Board meetings and the companies' compliance with their own manuals.</p> <p>Complied with. Draft RICA bills were filed in the House of Representatives and the Senate at the start of the 13th Congress in July 2004. The first Senate Technical Working Group meeting on RICA was held on 23 March 2006. There are no significant developments on RICA in the House of Representatives.</p> <p>Substantially complied with. As of May 2003, SEC accredited 14 institutional training providers to offer training programs for independent directors of nonbank financial institutions and public companies, including investment companies. However, these are not certification programs.</p>

ADB – Asian Development Bank; AML – Anti-money laundering; AMLC – Anti-money laundering council; BOA – Board of Accountancy BSP – Philippine central bank; CPA – Certified public accountant; DST – Documentary Stamp Tax; IPO – Initial Public Offering; MOU – Memorandum of Understanding; MRO – Market Regulation Office of the PSE; NBI – National Bureau of Investigation; PDEA- Philippine Drug Enforcement Agency; PNP- Philippine National Police; PSE – Philippine Stock Exchange; RBCA – Risk Based Capital Adequacy; SEC – Philippine Securities and Exchange Commission; Securities Regulation Code (SRC); SRO- Self Regulatory Organization;

SELECTED NONBANK FINANCIAL SECTOR INDICATORS

Indicator	2003	2004	2005
A. Reduced risks to financial institutions resulting from establishment of an effective anti-money laundering regime			
1. Enhanced detection and reporting of suspicious transactions			
a. Number of Suspicious Transaction Reports	215	555	1,048
b. Number of suspicious transactions	—	2,679	2,951
B. Deepening of financial sector			
1. Bank assets as a % of GDP	—	68.4	61.3
2. Equity market capitalization as a % of GDP	—	34.4	39.3
3. Bonds outstanding as a % of GDP ¹¹	—	29.7	39.3
4. Assets of institutional investors as a % of GDP	—	14.0	n.a.
Pension (primarily government)	—	9.2	n.a.
Life Insurance	—	3.1	n.a.
Mutual funds	—	1.6	n.a.
Pre-need plan companies	—	156.7	n.a.
C. Increased confidence in the stock exchange			
1. PSE trading volume (number of shares in millions)	86,000	284,300	317,600
2. PSE trading value (R millions)	145,400	206,600	381,500
3. Transactions by foreign investors (R millions)	175,000	222,800	392,700
4. Transactions by foreign investors (as percentage of total brokers' turnover)	60%	54%	51%
5. Transactions by domestic investors (as percentage of total brokers' turnover)	40%	46%	49%
6. Number of listed companies	236	235	237
7. Number of initial public offerings	5	1	2
8. Capital raised through primary offerings & additional listings (R millions)	1,700	2,120	36,814
9. Number of investor complaints received by PSE	61	15	5
10. Number of thematic inspections/audits by PSE	131	132	132
11. Number of "for cause" inspections by PSE	7	9	20
12. Number of sanctions (with monetary penalties) imposed on brokers by PSE	2	7	39
D. Increased efficiency and development of the equity market			
1. PSE Operating Revenue (R millions)	112	138	274
2. PSE Net Income (R millions)	11	22	120
3. Number of active brokers	134	132	132
4. Number of inactive brokers ^a	50	52	52

¹¹ Primarily government bonds.

Indicator	2003	2004	2005
E. Strengthening of SEC supervisory and surveillance capacity with respect to broker dealers			
1. Number of broker dealers with certified compliance officers ^b	—	—	54
2. Number of thematic inspections/regular audits conducted by SEC	14	24	0
3. Number of “for cause” inspections of broker dealers by SEC	0	2	2
4. Number of show cause letters issued by SEC	64	8	11
5. Number of sanctions imposed by SEC against broker dealers	10	17	17
F. Improved quality of financial information on public companies disclosed to the market			
1. Number of accredited accountants	121	191	356
2. Number of financial statements reviewed for compliance with accounting standards	110	90	135
3. Number of investor complaints received by SEC/PSE	0	0	0
4. Number of sanctions imposed on public companies for non-compliant financial statements	109 ¹²	68	29
5. Amount of sanctions imposed on public companies for non-compliant FS (₱ '000)	4,450	5,087	5,974
G. Increased investment opportunities			
1. Pre-need plans			
a. Number of pre-need companies with dealer’s licenses (issued at start of year)	43	41	33
b. Number of pre-need plans sold	533,548	507,846	362,596
c. Amount of pre-need plans sold (Gross Contract Price in ₱ millions)	33,166	36,916	20,547
d. Total assets of pre-need companies (₱ millions)	152,000	156,700	—
e. Trust fund sizes of pre-need companies (as at 30 June in ₱ millions)	60,621	66,370	68,600
2. Mutual funds			
a. Number of active mutual funds	21	24	32
b. Net Asset Values of mutual funds (₱ millions)	43,991	53,512	76,915
c. Mutual fund sales (₱ millions)	25,087	23,603	44,129
d. Mutual fund net sales (sales less redemptions, ₱ millions)	12,052	6,632	20,341
e. Number of mutual fund accounts	51,440	67,911	93,679

^a Includes 27 voluntary suspensions, 5 involuntary suspensions, 7 never operated, 6 trading right holder only and 7 ceased operations.

^b Modules 1 to 4 of Associated Person Exams (for compliance officers of broker dealers) were offered in 2004 and 2005 but module 5 was only offered in December 2005. The list of associated persons who have passed all five modules was actually released only in April 2006.

PSE – Philippine Stock Exchange; SEC- Securities and Exchange Commission

Sources: ADB Bonds Online, 2006; AMLC Annual Report; Bank for International Settlements; East Asian Robust Markets, Conference Edition ; PSE Annual Reports; PSE, Market Regulation Office; SEC, Brokers/Dealers Division; Market Regulation Department; SEC, Securities Registration Division, Corporation Finance Department; SEC, Non Traditional Securities and Instruments Department; Investment Company Association of the Philippines; World Bank.

¹² First year that international accounting standards were imposed. Subsequently SEC decided not to accept financial statements that appeared non-compliant. Issuers submitting such statements were deemed not to file and were sanctioned for late filing.

TERMS OF REFERENCE FOR CONSULTANTS

A. Risk Based Capital Market Expert (International)

1. Background

1. Following a one-year transition period, broker dealers are required to fully comply with the new risk based capital adequacy (RBCA) rule starting 1 December 2005. However, based on initial monthly RBCA reports submitted to the Philippine Stock Exchange (PSE), it appears that some broker dealers may not have a good appreciation of the RBCA rules and that they are encountering difficulties in accomplishing the RBCA template, particularly in the computation of the counterparty risk. In fact, PSE has had to redo more than half of the submissions before forwarding them to the SEC.

2. Objective/Purpose of Assignment

2. The expert will assist the PSE and SEC assess compliance of broker dealers with RBCA requirements and develop a strategy and related actions to promote greater compliance.

3. Scope of Work

3. The expert should have substantial experience in risk based capital standards and be familiar with the RBCA rule. The expert will participate in a two day workshop with the PSE and SEC to develop a strategy and related actions to enhanced compliance with the rule by broker dealers.

4. SEC will provide the expert with an update on the status of the implementation of the RBCA rule and the concerns/issues encountered during implementation. The expert will discuss with SEC officials and staff the rule's fundamental requirements, which can not be waived or modified. The expert will also participate in a two day workshop with SEC and PSE to (1) clarify the types of difficulties experienced by broker dealers in complying with the rule, (2) identify non-fundamental areas of the rule that could be simplified to assist brokers in addressing difficulties in compliance, (3) review the current framework for monitoring compliance with the rule and identify gaps therein and strategies to address, and (4) assist SEC and PSE develop an enforcement strategy (appropriate sanctions) for non-compliance.

4. Output/Reporting Requirements

5. The expert will work closely with the SEC and PSE and shall report to the Senior Securities Market Legal and Regulatory Specialist of the Southeast Asia Department, Governance, Finance and Trade Division (SEGF). He/she shall submit a report summarizing the results of the workshop, including key recommendations made and agreements reached on moving forward.

B. Self-Regulatory Organization (SRO) Expert (International)

1. Background

11. The PSE was recognized as a self-regulatory organization (SRO) by the SEC in June 1998 while it was still a mutual association. In 2001, as provided in the Securities Regulation Code 2000 (SRC), the PSE demutualized, raising concerns about perceived conflicts of interest arising from PSE's dual status as an SRO and a for-profit corporate entity.

12. In accordance with international best practice standards, the SRC and its implementing rules provided that a demutualized exchange with 'SRO' status is required to establish an "independent" audit, compliance and surveillance office, whether within the corporate structure of the exchange or within a separate entity. To establish independence, this office must not be subordinated or otherwise controlled in its function by the Exchange's Board.

13. In August 2004, in compliance with regulatory requirements, PSE's board approved a new structure for self-regulation under which the PSE's compliance and surveillance group was restructured into the new Market Regulatory Division (MRD). MRD reports to a newly established independent Market Integrity Board (MIB). PSE and the Securities and Exchange Commission signed a Memorandum of Agreement (MOU) in November 2004 defining the steps and timetable to implement the creation of the MRD/MIB including a provision that the PSE and SEC shall evaluate the MIB and MRD structure within one year from signing of the MOU, and on a yearly basis, thereafter. The new offices were established in November 2004.

2. Objective/Purpose of the Assignment

14. The international expert will assist the SEC evaluate the effectiveness of the new MRD/MIB. He/she will conduct training sessions to enhance skills of the staff and officers of the Market Regulation Department of SEC in supervising MRD, conduct off-site and on-site visits and to prepare an evaluation report to the Commission.

3. Scope of Work

15. The expert shall:

- In consultation with SEC and PSE, assist in developing the parameters for evaluating the effectiveness and efficiency of the MRD in performing its audit, market surveillance and compliance monitoring functions.
- Conduct training to strengthen skills of SEC officials and staff to evaluate effectiveness and efficiency of MRO and MIB.
- Assist SEC conduct its first annual evaluation of the MRD/MIB structure. In addition to assessing the impact of the structure on more credible enforcement and investor confidence, the evaluation should review whether this new structure fully implements related International Organization of Securities Commissions (IOSCO) Objectives and Principles. The review should identify perceived gaps and help SEC officials and staff develop a strategy to enhance this structure and address such gaps.

4. Detailed Tasks

16. The expert will help SEC develop indicators to assess the effectiveness of MRD taking into consideration PSE's demutualized structure and SRO status. The indicators may include but not be limited to the following areas:

- Autonomy of both MRD and MIB in performing their regulatory functions (audit, market surveillance and compliance monitoring) over trading participants including the timeframe for disciplining from the time a violation is detected;
- Capacity of MRD to perform its functions (state of technology, technical skills of MRD staff, resources available);
- Composition of MIB, independence of MIB members, regularity of MIB meetings; role of PSE Board in reviewing MIB decisions;

- Quality and quantity of sanctions for offenses, capability of MRD/MIB to enforce these sanctions, referrals to SEC/DOJ for further action;

17. The expert will assist the SEC conduct its first annual evaluation of the MRD/MIB structure.

18. The expert will also conduct training sessions for the SEC staff on how to improve the indicators, how to conduct off-site and on-site evaluation and prepare report to the Commission. A briefing session with the PSE MRD and MIB will also be conducted to familiarize them with the proposed indicators and initial results of the first evaluation.

19. The expert will also review the delineation of responsibilities between PSE and SEC with respect to supervision of compliance with disclosure requirements, identify gaps therein, and make recommendations to address such gaps.

20. Additionally, the expert will assist the SEC assess compliance of brokers/dealers with capital adequacy requirements. Details for this task to be agreed upon during the initial visit.

5. Output/Reporting Requirements:

21. The expert will work closely with the SEC and PSE. He/she will report to the Securities Market Legal and Regulatory Specialist, SEGF. He/she will submit:

- an inception report within two weeks from mobilization including a work schedule;
- a draft final report two weeks before end of contract; and
- a final report in both hard (3) and soft copies (2)

C. Securities Regulatory Enforcement Expert (International)

1. Background

22. In February 2005 ADB approved a technical assistance (TA) project for the Philippines aimed at promoting the development of the Philippine capital market through the strengthening of corporate governance and improved regulation of secondary trading markets in securities. Under the TA, an international expert prepared a report on how to better align corporate governance structure and procedures of the PSE with international best practice, including recommendations to strengthen PSE's compliance and surveillance procedures and a general strategy and plan to strengthen the governance-related capacity of the PSE and other exchanges and SEC.

23. The recommendations highlight the need to enhance the skills of SEC and PSE officials and senior staff in performing their enforcement functions. An initial assessment indicated that complaints filed by SEC to the Department of Justice often do not meet the evidentiary or investigative standards required for successful prosecution under criminal or administrative law.

2. Objective/Purpose of the Assignment

24. An international expert, with extensive securities enforcement experience, will be engaged to enhance the skills of the SEC and PSE enforcement officials and staff. The expert will work closely with the officials of SEC and PSE, particularly the SEC Director of Compliance and Enforcement Department, the SEC Director of Market Regulation Department and the PSE Counsel. The expert will assess review the current enforcement framework, including (i) applicable record-keeping requirements; (2) surveillance and oversight framework, including the use of information and communication technology to detect violations; (3) types of investigations, related powers and

responsible agencies; (4) processes and procedures for investigation (workflow and case management); (5) rules of evidence, including ability to determine beneficial ownership by non-regulated entities; and (5) inter-agency cooperation and information sharing. The expert will identify gaps therein and make recommendations to address these gaps for discussion and review. Based on the gaps identified, he or she shall provided related training to increase capacity in several key areas.

3. Scope of Work:

25. The expert, working closely with SEC and PSE, will:

- Review recent securities enforcement activities and classify by types of cases investigated, how violation was detected, status of investigation and sanction imposed
- Summarize the current enforcement framework, including applicable laws and regulations (including those governing disclosure of beneficial ownership and ability to obtain information from non-regulated persons), processes and procedures, respective roles of SEC, PSE and Department of Justice, and identify gaps therein, including those related to surveillance, investigation, and prosecution
- Assist SEC and PSE prepare a draft enforcement strategy, clarifying key enforcement priorities and a related action plan on how to address currently constraints to successful prosecution of related cases..
- Prepare a case management process map/manual to serve as a guide in future investigations/enforcement actions to be taken by PSE and SEC.
- Provide several workshops to enhance capacity in areas where gaps in prosecuting securities cases have been identified (e.g. evidence gathering)

4. Output/Reporting Requirements:

26. The expert will work closely with the domestic regulatory expert and with the PSE and SEC. He/she will report to the Securities Market Legal and Regulatory Specialist, SEGF. He/she will submit:

- an inception report within two weeks from mobilization including a work schedule;
- a draft final report two weeks before end of contract; and
- a final report in both hard (3)and soft copies (2)
- workshop materials.

D. Developing the Fixed Income Market: Public Awareness Campaign Expert

1. Background

27. Through the years that the Philippine fixed income market has evolved and expanded, several weaknesses have been identified such as the fragmentation of the market, lack of public price discovery and transparency and lack of liquidity.

28. The government and the private sector have taken steps to address these weaknesses and promote development of the fixed income market. On the part of the government, the SEC worked for the passage of the Securities Regulation Code (SRC) in July 2000. The Bangko Sentral ng Pilipinas (BSP) improved securities settlement through the delivery versus payment mechanism and issued circulars on to encourage development of new fixed income securities products such as the negotiable certificates of deposit and the unsecured subordinated debt.

29. The private sector, led by the Bankers Association of the Philippines, spearheaded the establishment of a fixed income exchange infrastructure with objectives of promoting greater transparency and public price discovery in the fixed income market and deepening and improving

liquidity in the secondary market. One of the operating subsidiaries of the Fixed Income Exchange Infrastructure is the Philippine Dealing and Exchange Corp. (PDEX) which was established in June 2003. PDEX was granted an Exchange license by the SEC in April 2004. It became operational in March 2005 starting with the inter-dealer platform for government securities with 28 Trading Participants composed of 27 banks and 1 investment house, all of whom are registered government securities dealers.

30. PDEX operates a negotiated trading platform, a quote driven system and order-driven trading platform, which provide for anonymous order-driven electronic matching system. Trading volume at the PDEX negotiated trading platform for the period January to June 2006 amounted to P 200 billion with an average daily volume of P1.5 billion.

31. The inter-dealer order-driven trading platform is a precursor of the public order driven trading platform which will enable retail and institutional investors to place buy and/or sell orders of fixed income securities through a broker. Orders will be electronically matched, allowing the public to have the best accessible bid and offer. Currently, retail and institutional investors purchase fixed income securities through financial intermediaries, most of whom are banks and investment houses that act as dealers directly dealing with the investors. Inherent in this set-up is the potential conflict of interest as the dealer's primary interest is to sell high and to buy low without looking into the interest of the investing public. This set-up raises investor protection concerns. PDEX will incorporate the role of the broker in the public market to address the concern on investor protection, as the broker's primary interest is to get the best price for the investor for a commission.

32. Development of the secondary fixed income market is key to capital market development in the Philippines. To promote investment in fixed income securities, there needs to be greater public awareness of fixed income products, how the price of fixed income securities is determined, and the important role that will be played by the new exchange in providing price discovery and promoting transparency and enhanced liquidity.

33. It is critical that the intermediaries also comprehend and appreciate the need to centralize the fixed income market and to segregate the roles of the dealer and the broker.

34. The education campaign will be directed at the investing public, financial intermediaries, issuers and the media and academe.

2. Objectives

35. To promote investment in fixed income securities in the Philippines by widely disseminating information on these products, the benefits and advantages of the centralizing trading of these securities in the new fixed income exchange, and attendant regulatory requirements to enhance investor protection, to the investing public, financial intermediaries, and issuers. A fixed income securities expert will be engaged to develop the information materials for the campaign and provide the technical knowledge for the campaign and an information campaign expert will be engaged to design and help implement a market education campaign strategy.

3. Scope of Work

36. The experts, working closely with the PDEX and SEC will:

- a) Identify the target audience for the information campaign and identify the information needs of each target group classified into:

Understanding – defined as having a basic knowledge of the features of fixed income securities and an overview of its processes sufficient to make an investment decision

Conversant – defined as having a more detailed knowledge of the features and processes of fixed income securities

Expert – defined as having a extensive or thorough knowledge of fixed income securities from its origination to the final disposition of the securities

37. The information needs survey will quantify the current awareness of the target group prior to the public campaign and follow up with a survey after the campaign to gauge the impact of the campaign (effectiveness)

- b) Based on the information needs survey, the experts will develop a public awareness campaign strategy to clarify the unique features of fixed income securities (distinguished from equity products), the benefits of centralizing trading of fixed income securities, including need for related price discovery, and regulatory requirements to address investor protection concerns. The experts will identify the most appropriate media to use for particular groups or information needs.
- c) The experts will develop the information campaign materials and organize media events most suited for the target audience that may include:
 - i) **Print** –articles on Fixed Income Exchange in widely circulated newspaper
 - ii) **Electronic (TV/Radio/Internet)** – interviews in talk shows & get a segment on investing in FIS and the FIE in business channels of ABS-CBN, other public service shows (representatives from BSP/SEC/BAP/IHAP to talk about FIS and FIE)
 - iii) **Investors' Forum/Seminars**
 - Seminars for Journalist on investing in FIS
 - Seminars for Investors Professional Organizations and Civic Organizations
 - Seminars for Financial Intermediaries/Issuers on Fixed Income Securities

4. Output/Reporting Requirements:

38. The experts will work closely with PDEX and SEC. He/she will report to the Securities Market Legal and Regulatory Specialist, SEGF. He/she will submit:

- an inception report within two weeks from mobilization including a work schedule;
- results of the information needs survey;
- a draft campaign strategy one month from fielding and a final campaign strategy after one month;
- information campaign materials including videos of interviews in talk shows and TV segments; and a final report in both hard (3) and soft copies (2), including pre and post campaign.