

TECHNICAL ASSISTANCE COMPLETION REPORT

Division: SEGF

TA No., Country and Name TA 4321-PHI: Strengthening Governance of Securities Trading Markets			Amount Approved: US\$250,000	
			Revised Amount: n/a	
Executing Agency: Securities and Exchange Commission	Source of Funding TASF		TA Amount Undisbursed: US\$29,048.58	TA Amount Utilized: US\$220,951.42
Date			Completion Date	
Approval 18 March 2004	Signing 13 Apr 2004	Fielding of Consultants 8 Jun 2004	Original 31 December 2004	Actual 31 March 2007
			Account Closing Date	
			Original: 31 Dec 2004	Actual: 30 Sep 2007
Description ADB had a long standing involvement in strengthening financial market regulation and supervision by improving the governance of the Philippine Stock Exchange (PSE) and enhancing the regulatory capacities of the Securities and Exchange Commission (SEC) to oversee the PSE and other securities trading markets. While an effective regulatory framework is now in place and SEC's supervisory capacity has been considerably strengthened, governance- and capacity-related issues remain to be addressed at the exchange level. The recent listing of PSE shares on the PSE (self-listing) and PSE's planned divestment of shares, along with plans to establish other securities trading markets, present a new set of challenges and will require SEC to develop appropriate capacity to effectively address them. On 12 August 2003, ADB approved Loan 2003-PHI: Second Financial Governance Program, including TA 4168-PHI: Support for Non-bank Financial Governance II, which supported the implementation of the Program together with this TA.				
Expected Impact, Outcome and Outputs The desired impact of the TA was to contribute to the development of the Philippine capital market through the strengthening of corporate governance and improved regulation of PSE and other securities trading markets. The expected outcome was to (i) enhance the ability of PSE to perform its Self-Regulatory Organization (SRO) function by strengthening its governance structure, procedures, and capacity; and (ii) strengthen SEC's capacity to effectively regulate PSE and other securities trading markets. Impact and outcome were to be achieved through the following outputs: <ul style="list-style-type: none"> (i) Governance review of PSE. This assessed the corporate structure and governance practices of PSE, including a review of the roles and responsibilities of the PSE board. (ii) Self-Regulatory Organization (SRO) review. This was to include a review of SRO operations of PSE and identification of appropriate options to address conflicts of interest and enhance independence of PSE's compliance and surveillance functions. A similar review will be conducted for other securities trading markets. (iii) Capacity building component. For PSE and other securities trading markets, this will include strengthening the capacity of compliance and surveillance staff to monitor compliance with laws, rules, and regulations. The component was to include developing SEC's capacity to address new challenges raised by demutualization and self-listing of PSE, and operation of other securities trading markets. (iv) Review of PSE's business operations. This will include a review of PSE's current fee and cost structures, comparison with the fee and cost structures of other exchanges, and development of proposals to strengthen the profitability of PSE's operations and its ability to attract investors. 				
Delivery of Inputs and Conduct of Activities The TA builds upon earlier ADB assistance for the capital markets in the Philippines and complements ongoing work that supports development of a forward-looking strategy to develop the non-bank financial sector. <p>TA 4321-PHI was formulated in close cooperation with the SEC and PSE under the leadership of Chairperson Lilia R. Bautista. The TA budget was adequate to support all field work, and workshops. The SEC, and the PSE, as the implementing agencies for the TA, quickly accepted the supporting role of the TA team in coordinating reform efforts in the SEC and with other financial market agencies. The terms of reference (TOR) for the consultants were clear and four international consultants were deployed for seven person-months. The performance of the consultants has been satisfactory. Two consultants were rated excellent, one as satisfactory, and one was not rated.</p>				
Evaluation of Outputs and Achievement of Outcome The consultants successfully met the terms of reference of the TA and delivered inception, interim, and final reports on time. Key results are summarized below:				

(i) Governance review of PSE. As the Philippine securities market is not yet up to global standards, further progress must be made, with a focus on: a) completing the privatization of the PSE and the accompanying changes to the composition of its Board; b) Appointing a new (separate) Chairman of the Market Integrity Board (MIB) to eliminate the conflict inherent in an individual serving both as Chairman of the MIB and Chairman of the Exchange, and updating the independence standards for the MIB to avoid similar situations with respect to the Chairman, Vice Chairman or Independent Director; c) Ensuring the Exchange upgrades its surveillance system in order to conduct basic SRO surveillance responsibilities; d) upon the Exchange acquiring a satisfactory surveillance system and reaching an adequate level of staff training, shifting greater SRO responsibility to the Exchange; e) The SEC should closely monitor the attendance, composition, minutes and decisions of the MIB, particularly with respect to disciplinary hearings and Market Regulation Division (MRD) budget/resource decisions, to determine the level of independence and credibility it is in fact exhibiting. If it is determined that the MIB is not effective, the SEC should exercise its powers to make the necessary changes (raising the level of independent representation in particular); and f) The development of alternative capital-raising sources should be encouraged, including the further development of the Philippine Dealing & Exchange Corporation (PDEX) and Alternative Trading Systems.

(ii) SRO review. The overall self regulatory process is rated “marginally acceptable”. There is much room for improvement of PSE as a self regulatory organization. Some activities such as the annual audit process are very well run by the MRD. However, there are many gaps in trading surveillance and many issues relating to proper support through the MIB and PSE management and Board. For a start, the Chairman of MIB should be truly independent and PSE directors sitting on the MIB should not have been subject to serious or numerous MRD sanctions arising from Market Operations and Surveillance Department (MOSD) or MRD audit processes. And finally, the SEC and MRD should develop a closer working relationship as to matters for investigation and which institution will have prime follow up responsibility. There are scarce resources and the Hong Kong model of joint surveillance cooperation is recommended to be studied, and if acceptable, implemented.

(iii) Capacity building component. The consultants developed a capacity enhancement concept, but did not implement any of its components: a) Strengthening the capacity of the Exchange's MRO through a focused and comprehensive training program, as well as a concerted effort within the Exchange's management to raise the level of staff retention in the MRD; and b) more broadly, a comprehensive training program should be instituted to cover regulatory staff from the PSE and PDEX as well as the SEC and prosecutors. This training should be coordinated and cross-attendance should be permitted and encouraged. Secondments between these bodies, as well as with their counterparts outside of the Philippines, should also be encouraged. The implementation of the capacity building plan was done under TA 4168-PHI, which was implemented simultaneously with this TA for the same objective.

(iv) Review of PSE's business operations. The consultants submitted their report in September 2004, which concluded that the PSE was making losses at the operational level and had to rely on interest income. Based on the finding, the consultants came up with the following recommendations, which included : a) the PSE should rebalance its fee structure to increase its reliance on stable annual income and decrease its reliance on income dependent on market activity; b) the PSE should also introduce a new scale of initial listing fees, with lower rates at the top end, a new scale of annual maintenance fees, and a new scale of trade fees; c) the PSE should revalue its properties at Ayala and Tektite in its next reported accounts; d) the PSE should consider appointing an external, professional fund manager to manage its cash and investments, within overall investments guidelines set by the PSE Treasury Department; and e) after increasing funding for the Clearing and Trade Guarantee Fund, the PSE should consider returning around PhP 250 million surplus to its shareholders.

Overall Assessment and Rating

Overall the TA was successful as it contributed to the development of a more strategic approach to financial market reform. The majority of the consultant's recommendations were accepted by SEC and PSE, and provided valuable input for the Blueprint for Growth and Expanded Contributions to the Philippine Economy. The formulation of the TA scope and design was coordinated closely with the implementing agency. As a result, there is now a better understanding and widest consent amongst the stakeholders about the financial sector reform and framework. The TA needed to be extended until March 2007, against an originally expected closing in December 2004. The causes were delays in the implementation of TA 4168 due to extensive stakeholder consultations, which lasted longer than originally anticipated, which necessitated later fielding of consultants under this TA.

Major Lessons Learned: The key to success of the program supported by this TA was the longstanding involvement of ADB with capital market reform in the Philippines. That allowed tailoring the TA exactly to the needs of the capital market institutions involved. The intensive involvement of all stakeholders in the reform process, both public and private sector, ensured sustainability of the reforms, beyond changes in management in the institutions, as well as in Government and the public administration.

Recommendations and Follow-Up Actions: ADB maintains a dialogue with the SEC on regional capital market integration and harmonization.

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