Philippines: Financial Market Regulation and Intermediation Program - Subprogram 2

Project Name	Financial Market Regulation and Intermediation Program - Subprogram 2
Project Number	38276-023
Country / Economy	Philippines
Project Status	Closed
Project Type / Modality of Assistance	Loan
Source of Funding / Amount	Loan 2715-PHI: Financial Market Regulation and Intermediation Program, Subprogram II Ordinary capital resources US$ 200.00 million
Strategic Agendas	Inclusive economic growth
Drivers of Change	Gender Equity and Mainstreaming Governance and capacity development Private sector development
Sector / Subsector	Finance / Banking systems and nonbank financial institutions - Finance sector development - Insurance and contractual savings - Money and capital markets
Gender	Some gender elements
Description	Output 1: Enhanced Financial Sector Stability. To mitigate the immediate effects of the crisis, the government has enacted a number of measures to strengthen its ability to assure the stability of the financial sector and to reduce systemic risk. The central bank, Bangko Sentral ng Pilipinas (BSP), adopted measures to provide additional liquidity to the banking sector and enhanced its ability to serve as a lender of last resort by doubling the peso rediscounting facility to P60 million, as well as opening a US dollar repurchase facility. BSP also submitted proposed amendments to Congress to strengthen its monetary policy framework, including a mandate to carry out open market operations of BSP bills. In addition, congress doubled the deposit insurance ceiling to P500,000 and granted the Philippine Deposit Insurance Corporation (PDIC) additional powers, including the flexibility to adjust the maximum deposit insurance ceiling in times of systemic stress and to exclude deposits from the deposit insurance coverage scheme in cases of fraud or abuse. PDIC also established a mechanism to build up and maintain an adequate deposit insurance fund (DIF) and has approved a resolution for submission to Congress in support of legislation to establish bridge banking and other resolution methodologies. The Philippines has completed a Financial Sector Assessment Program and, under subprogram 2, the BSP, PDIC, and SEC have begun implementing corrective actions to address financial sector risks as well as regulatory and structural bottlenecks identified in the assessment. The BSP and PDIC have combined their efforts to encourage industry consolidation. The Strengthening Program for Rural Banks was launched with P5 billion in funding to provide incentives for weaker rural banks to merge with stronger rural banks. The PDIC board also approved the investor-investee framework, which is an electronic matching system intended to facilitate mergers, acquisitions, and consolidation among banks. To enhance financial sector stability and reduce systemic risk, the Department of Finance (DOF) has strengthened its capacity for public debt management and has prepared a needs assessment for its newly established Debt and Risk Management Division. The division subsequently prepared a draft public debt management strategy for FY2011 as well as a debt sustainability assessment for fiscal years 2010 and 2011. Output 2: Strengthened Financial Sector Regulatory Oversight. Under subprogram 2, measures were implemented to improve interagency coordination and sharing of information, and to strengthen regulatory oversight functions in the financial sector. The enforcement powers of the PDIC were strengthened and the SEC enhanced its capacity for market surveillance. Subprogram 2 addresses the long-standing governance weaknesses of the SEC and the Insurance Commission by sequencing reforms over the medium to long term, with the primary objective of lifting the capacity of the two agencies toward a par with the other financial sector regulators (i.e., BSP and PDIC). Subprogram 2 also promotes greater integration and coordination between the different regulators, with the goal of establishing a highly coordinated financial sector regulatory and surveillance framework to enhance the conduct of micro and macro prudential supervision. Memorandums of understanding setting out the working relationship of the regulators in the Financial Stability Forum (FSF) have been signed. Standing committees have been established to address standardization of supervision and risk measurement across regulators, as well as for optimizing the regulatory architecture. BSP has just issued its third Financial Sector Stability Report. Subprogram 2 initially anticipates supporting the internal efforts of the FSF to strengthen early warning systems, and promoting better coordination and communication. Subprogram 2 will strengthen coordination between BSP and the PDIC with regard to the examination of problematic banks to lessen the risk to the DIF. Congress amended the PDIC charter to grant the agency the authority to adopt a new or revised organizational structure and to provide enhanced legal protection for its staff. The PDIC may now conduct special examinations in coordination with BSP when there are threats of bank closures, and may examine deposit accounts in cases of unsafe and unsound practices. Congress further granted the PDIC the authority to rescind splitting of deposits within 120 days before bank closure. This authority is expected to enhance stability and to contain losses to the DIF arising out of high rate deposit promotions that have been used to forestall the timely resolution of problem banks. The extension of examination authority to deposit accounts in specified situations is also expected to curtail the use of high rate deposit promotions to fund fraudulent or other improper activities. Subprogram 2 places the SEC under the DOF s administrative authority, which should strengthen the SEC s ability to pursue reforms. The DOF, in consultation with the SEC, produced and endorsed an action plan for restructuring the SEC. This plan identified the core responsibilities of the SEC and recommended arrangements to deal with non-core responsibilities. It also identified organizational structures, staffing complements and skill sets, and pay scales. Finally, the plan will identify a funding mechanism to ensure the eventual administrative and fiscal autonomy of the agency. In the interim, the government (Department of Budget and Management [DBM]) raised the SEC s proposed 2011 general budget appropriation to accommodate the priority recommendations of the action plan, as committed to higher resources in the DBM s forward estimates, until an independent, self-funding mechanism can be established. The DOF, in consultation with the Insurance Commission, will produce an action plan for restructuring the Insurance Commission. This plan will contain recommendations regarding restructuring the agency to address the organizational structure as well as staff size, skills, and remuneration. As with the SEC, recommendations will be provided to establish a funding mechanism to ensure ongoing administrative and fiscal autonomy. Completion and implementation of the action plan will be monitored under the P3F. Output 3: Improved Efficiency and Liquidity in Securities Markets. To develop an efficient and liquid secondary market, the SEC defined the guidelines for the over-the-counter market, which included the requirement for a central trade reporting system. This effectively provides for price discovery of the bilateral transactions that define the over-the-counter market, aligning it with the data capture and reporting standards used in exchange-based markets. Subsequently, the SEC approved listing requirements and trading rules of the designated selfregulatory organization, effectively providing an enabling environment for trading in corporate bonds on the fixed-income exchange. To stimulate secondary trading and accelerate the pace of capital market development, Congress enacted a permanent stamp duty exemption for secondary trading of listed companies. Several enabling laws were passed, including the Personal Equity Retirement Account Act, 2008, which creates a tax-free personal retirement account, and the Law on Real Estate Investment Trusts, 2009, which is expected to act as a stimulus to capital market development by providing a method to increase investor participation in the real estate market. Together, these acts should stimulate demand for both investment products and professional investment management. Implementing regulations for the Personal Equity Retirement Act are expected to include a requirement for formal training and licensing of investment professionals similar to the Series license in the United States. Finally, the Credit Information System Act

Project Rationale and Linkage to Country/Regional Strategy	The Philippine capital markets do not produce a level of intermediation sufficient to support growth and alleviate poverty. Capital market development has been constrained by the predominance of family-owned mixed use conglomerates, connected lending, a perception of heightened market instability, low investor confidence, and the lack of an enabling environment. Inadequate intermediation between savers and investors has slowed Philippine economic growth and development. The government recognizes these issues, including the linkage between financial sector development and poverty reduction, and has prioritized financial sector development within its development plan. The program cluster is anchored in the Medium-Term Philippines Development Plan, 2004 to 2010. To increase the contribution of the financial sector to growth and poverty reduction, this plan seeks to mobilize savings to achieve a savings to GDP rate of 25% to 30% and an investment to GDP rate of 28%. The program will contribute to economic growth and development by providing an enabling environment, increasing investment alternatives, enhancing disclosures, and improving market efficiency. In turn, financial sector development will help reduce poverty through higher economic growth, financial sector inclusiveness, and financial sector stability. The impact and lessons of the global financial crisis have highlighted weaknesses in the Philippine financial sector that were not addressed by the original subprogram 2. The crisis demonstrated the importance of maintaining financial stability, including the capacity to provide liquidity in sufficient quantity and at reasonable price to ensure smooth functioning of the financial and payment systems. The crisis also increased recognition of the need to strengthen regulatory oversight to reduce financial sector vulnerabilities, and in particular the need to enhance coordination and cooperation between micro and macro-prudential supervision. Should the efforts of the regulator fail, the financial system must be backstopped by an effective resolution methodology. The crisis underscored the need to maintain an adequately funded deposit insurance mechanism to minimize the risk of depositor flight and contagion. It also highlighted the need to establish and maintain efficient and liquid markets, as countries with well-functioning and liquid local bond markets were better able to cope with shocks to the global credit markets. In response, subprogram 2 has been reformulated to address three key considerations. First, there has been a sharpened and renewed focus with regard to government policy priorities for the financial sector. Subprogram 2 now includes a number of measures designed to enhance financial sector stability in direct response to heightened instability arising out of the global financial crisis. Second, subprogram 2 recognizes the government s efforts to coordinate micro and macro prudential supervision; and to close the gaps in supervision caused by the use of separate functional regulators to supervise complex, mixed use conglomerates. Third, the reformulated subprogram 2 supports the government s efforts to address significant weaknesses in the governance and operational effectiveness of both the SEC and the Insurance Commission that had led to slippage under the original subprogram 2. The SEC and the Insurance Commission operated with a lack of fiscal autonomy and inadequate budgets. In turn, suppressed salaries and high employee turnover limited the ability of the SEC to perform effective market surveillance and on-site examinations of the financial entities under its mandate. By strengthening the coordination between regulators, as well as the operational and fiscal autonomy of the SEC and the Insurance Commission, sequenced capacity development can be initiated, which will allow the government to focus more effectively on the issues that have constrained development of the capital markets.
Impact	The impact of FMRIP-02 will be improved access to finance and increased contribution of the financial sector to economic growth.

Project Outcome	
Description of Outcome	The outcome of FMRIP02 is a deeper, more diversified and resilient financial sector
Progress Toward Outcome	
Implementation Progress	
Description of Project Outputs	Enhance financial sector stability Strengthen Financial Sector Regulatory Oversight Improve Efficiency and Liquidity of Securities Markets
Status of Implementation Progress (Outputs, Activities, and Issues)	
Geographical Location	

Summary of Environmental and Social Aspects	
Environmental Aspects	
Involuntary Resettlement	
Indigenous Peoples	
Stakeholder Communication, Participation, and Consultation	
During Project Design	
During Project Implementation	

Business Opportunities	
Consulting Services	Not Applicable
Procurement	The loan proceeds will be used to finance the full foreign exchange cost (excluding local duties and taxes) of items produced and procured in ADB member countries, excluding ineligible items and imports fianced by other bilateral and multilateral sources.

Responsible ADB Officer	Schuster, Stephen R.
Responsible ADB Department	Southeast Asia Department
Responsible ADB Division	Public Management, Financial Sector and Trade Division, SERD
Executing Agencies	Department of Finance DOF Building Bangko Sentral ng Pilipinas Complex Roxas Blvd., Manila, Philippines

Timetable	
Concept Clearance	17 Jun 2005
Fact Finding	22 Jul 2010 to 22 Jul 2010
MRM	31 Aug 2010
Approval	07 Dec 2010
Last Review Mission	-
PDS Creation Date	22 Oct 2009
Last PDS Update	25 May 2011

Loan 2715-PHI

Milestones					
Approval	Signing Date	Effectivity Date	Closing		
			Original	Revised	Actual
07 Dec 2010	22 Feb 2011	27 Jun 2011	15 Apr 2012	-	15 Apr 2012

Financing Plan		Loan Utilization			
	Total (Amount in US$ million)	Date	ADB	Others	Net Percentage
Project Cost	200.00	Cumulative Contract Awards			
ADB	200.00	17 Jun 2022	200.00	0.00	100%
Counterpart	0.00	Cumulative Disbursements			
Cofinancing	0.00	17 Jun 2022	200.00	0.00	100%

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Date Generated	06 June 2023