

**ASIAN DEVELOPMENT BANK**

**PPA: PHI 21223**

**PROGRAM PERFORMANCE AUDIT REPORT**

**ON THE**

**CAPITAL MARKET DEVELOPMENT PROGRAM  
(Loan 1363-PHI)**

**IN THE**

**PHILIPPINES**

**August 2003**

## CURRENCY EQUIVALENTS

Currency Unit – peso (₱)

		<b>At Appraisal</b> (1 June 1995)	<b>At Program Completion</b> (15 June 2000)	<b>At Operations Evaluation</b> (28 February 2003)
₱1.00	=	\$0.04	\$0.02	\$0.02
\$1.00	=	₱26.00	₱42.40	₱54.45

## ABBREVIATIONS

ADB	–	Asian Development Bank
CMDC	–	Capital Market Development Council
CP	–	commercial paper
DOF	–	Department of Finance
EA	–	Executing Agency
FIBV	–	Fédération Internationale des Bourses de Valeurs
IHAP	–	Investment House Association of the Philippines
IMF	–	International Monetary Fund
OEM	–	Operations Evaluation Mission
PCD	–	Philippine Central Depository
PCR	–	program completion report
PSE	–	Philippine Stock Exchange
PSIDF	–	Private Sector Infrastructure Development Facility
ROSS	–	Registry of Scripless Securities
SEC	–	Securities and Exchange Commission
SRC	–	Securities Regulation Code
SRO	–	self-regulatory organization
TA	–	technical assistance
USAID	–	United States Agency for International Development

## NOTES

- (i) The fiscal year (FY) of the Philippines is the same as the calendar year.
- (ii) In this report, “\$” refers to US dollars.

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**BASIC DATA**  
**Loan 1363-PHI: Capital Market Development Program**

**Program Preparation/Institutional Building**

<b>TA No.</b>	<b>TA Program Name</b>	<b>Type</b>	<b>Person-Months</b>	<b>Amount<sup>1</sup> (\$)</b>	<b>Approval Date</b>
2379	Capital Market Development	ADTA	18.5	600,000	22 Aug 1995

<b>Key Program Data (\$ million)</b>	<b>As per ADB Loan Documents</b>	<b>Actual</b>
Total Program Cost	150.0	75.0
ADB Loan Amount/Utilization	150.0	75.0
ADB Loan Amount/Cancellation		75.0

<b>Key Dates</b>	<b>Expected</b>	<b>Actual</b>
Fact-Finding		7–21 May 1990
Appraisal		1–15 Mar 1995
Loan Negotiations		24–26 Jul 1995
Board Approval		22 Aug 1995
Loan Agreement		2 May 1996
Loan Effectiveness	31 Jul 1996	31 Mar 1997
First Tranche Release	end 1995	Apr and May 1997 <sup>2</sup>
Second Tranche Release	1st quarter 1997	cancelled
Loan Closing	31 Dec 1997	31 Dec 1999
Program Completion	31 Dec 1997	31 Dec 1999
Months (effectiveness to completion)	17	33

**Borrower** Republic of the Philippines

**Executing Agency** Department of Finance

**Mission Data**

<b>Type of Mission</b>	<b>No. of Missions</b>	<b>Person-Days</b>
Fact-Finding	1	45
Appraisal	1	80
Project Administration		
- Review	2	8
- Policy Consultation	8	25
- Project Completion	1	7
Operations Evaluation	1	30

ADB = Asian Development Bank, ADTA = advisory technical assistance, TA = technical assistance.

<sup>1</sup> Represents approved amount of technical assistance.

<sup>2</sup> The first tranche of \$75 million was disbursed in two parts on 21 April 1997 (\$70.4 million) and 28 May 1997 (\$4.6 million).

## EXECUTIVE SUMMARY

In the 1980s, the Philippine economy experienced severe economic crisis, political turmoil, and changes in the administration. The economic downturn continued into the early 1990s with high inflation, infrastructure constraints, and precarious public sector resource balances. In this context, the development of the financial sector including the capital market was an integral element of the Government's overall strategy to utilize the private sector as the engine of economic growth. The capital market at the time was very weak with only a few institutional investors operating in it. In response to the Government's request, the Asian Development Bank (ADB) aimed to help the Government to stimulate the private sector through the Capital Market Development Program (the Program).

The Philippine stock market, established in 1927, has a long history of broker self-interest and resistance to reforms. By implementing a number of related technical assistance (TA) grants since late 1980s and disseminating findings widely among all interested parties, the resistance to reforms was gradually overcome. The formulation of the Program took about 6 years and ADB approved the program loan for \$150 million from ordinary capital resources with two equal tranches. TA 2379-PHI attached to the loan covered the study of institutions needed to augment the reforms. The Department of Finance was the Executing Agency.

The objective of the Program was to promote a diversified, competitive, and vibrant capital market in order to raise investor confidence, domestic and foreign resource mobilization, and allocative efficiency leading to accelerated growth and development of the economy. It supported increased reliance on capital markets as a means of mobilizing long-term funding by tapping domestic and foreign savings, improving prudential regulation of institutions, and adopting internationally accepted standards and practices in the capital markets.

During program formulation, the Capital Market Development Council (CMDC), a public-private forum that had been established in 1992, acted as a champion of reforms. It recognized that other regional stock exchanges were overtaking the Philippines in turnover volume, market capitalization, and quality of standards. In parallel, ADB had also identified a long list of reforms that were conducive to the development of the stock market. The two efforts were merged, indicating sound program ownership and commitment.

The second tranche of the loan was to be released (i) if substantial progress had been achieved in carrying out the Program; and, in particular, (ii) when the seven core conditions, which did not include legislative actions, were taken. It was the lack of substantial progress in carrying out the Program (due to the delay in Securities Regulation Code [SRC] to which 21 out of 49 conditions were attached) that led to the cancellation of the second tranche more than 4 years after loan approval, although the seven core conditions were complied with. While there was an essential need to make necessary changes to the existing Securities Act, the Program became overburdened by conditions linked to passage of legislation.

From an operational perspective, the Program's focus was much more limited than implied by its title. Despite the large number of conditions, the policy action matrix dealt predominantly with the needs of the stock market, particularly its regulatory framework, and did not focus adequately on the debt market, which is also a part of the capital market. Only when this submarket faced considerable difficulties in the last few years, particularly because of the absence of industrywide best practices and the necessary support infrastructure to carry out transparent trading activity, has the call for these reforms in the debt market become pronounced. In addition, since counterpart funding was not readily available for the Program,

there were limited funds to convert the recommended policy actions into outcomes. Therefore, despite its relevance and the apparent commitment, there were some weaknesses in the program design. These weaknesses, changes in administration, as well as external factors such as the Asian financial crisis, prolonged the program implementation.

The policy actions defined by the Program reflected either currently accepted best practice or a response to previously existing malpractices. Although many of them were undertaken providing a basic framework within which to develop the stock market, the current situation is still saddled with outcomes such as low investor confidence, broad-based initiatives to amend the SRC, and some duplicity in the clearing and settlement infrastructure. Therefore, the intended outcomes of a diversified, competitive, and vibrant capital market have not been fully achieved. Instead, investor confidence is currently low and this is reflected in a very inactive equities market today. Initial public offerings have substantially dried up, a reverse of their prominence in the mid-1990s. One predominant negative external factor was the regional financial crisis of 1997. However, while some of the other regional markets have rebounded, the Philippine stock market activity appears to be still shrinking. Opposition to the reforms has also surfaced over basic structures such as the SRC legislation itself. Based on (i) the rationale of the Program, despite some weaknesses in its design evident in hindsight; (ii) its focus on actions, which were complied with at the time although they did not necessarily achieve the anticipated outcomes; (iii) its prolonged and less efficient implementation; (iv) moderate institutional capacity building; and (v) likely sustainability due to subsequent work undertaken, the Program is rated as partly successful.

This program performance audit report highlights several lessons. A comprehensive agenda that included both stock and debt markets would have allowed more flexibility and helped to better monitor deteriorating conditions in the submarkets. Development of a new market structure and associated institutions is time consuming, and the program loan modality, though used for this purpose, should not have had a quick-disbursing nature when applied to an overall sector development agenda. Instead, a multi-tranche loan spread over a longer time horizon and associated with key components of the Program would have been preferable. In addition, if the passage of an important law was fundamental to the success of the Program, it is now possible to consider a cluster program approach where key legislative changes are considered as conditions for board consideration within a specific program.

The overall capital market agenda works best if it is designed through the collective voice of stakeholders where issues are decided in a transparent manner. In the Philippines, this was attempted through CMDC, which helped in crafting a reform agenda agreed by consensus between the regulators and the regulated, speaking in a collective voice while trying to dissipate both political sensitivities and potentially conflicting interests among stakeholders. Based on the positive impetus created by CMDC, a lesson could be learned about establishing and finding a means to sustain such forums during the development of capital markets in any country. While the establishment of such markets could initially be funded by grants for demonstrative effect, it may be possible to generate a long-term fund through a levy imposed on the members of CMDC when the importance and the usefulness of the forum become evident.

Given that institutional development is a continuing process that needs continuing monitoring, the short-term TA modality that only allows international consultants to provide recommendations may not be the most suitable; a longer-term TA or cofinancing arrangements may be more appropriate for such capacity-building programs. These TAs should be geared to clearly identifying capacity-building needs and should include sufficient funds and duration, not only to derive recommendations but also to implement them.

The key issues discussed in this report are the need for adequate funds to operationalize the reform agenda, continued capacity building of SEC, and sustaining the reforms in the Philippine Stock Exchange. In addition, there is a need to undertake reforms in the debt market. Follow-up actions recommended include the continuation of the demutualization of the Philippine Stock Exchange; approval of the legislation on the Revised Investment Company Act, which was not complied with under the Program; continuation of efforts for more unified supervision of nonbank financial institutions; and ensuring that the necessary resources are made available to achieve effective compliance of existing regulations.

## I. BACKGROUND

### A. Rationale

1. In the 1980s, the Philippine economy experienced severe economic crisis, political turmoil, and changes in the administration. The economic downturn continued into the early 1990s with high inflation, infrastructure constraints, and precarious public sector resource balances. The Asian Development Bank (ADB) had begun to prepare a program loan for the financial sector in 1989, but it was shelved, as there was no window of opportunity at the time. Subsequently, the Government's 1993–1998 Medium-Term Philippine Development Plan gave priority to reviving economic growth, developing infrastructure, and reducing poverty. ADB's 1993 country operational strategy reflected similar priorities, emphasizing sustained economic growth and poverty reduction.

2. The development of the financial sector, including the capital market, was an integral element of the Government's overall strategy to utilize the private sector as the engine of economic growth. Private sector investments had been stifled by the low savings rate in the country<sup>1</sup> and by its unstable political situation. To stimulate savings and channel it toward productive investments, financial sector reforms were urgently needed. Some basic reforms had already been initiated by the 1980s.<sup>2</sup> The capital market, however, was very weak with only a few institutional investors operating in it. In response to the Government's request, ADB attempted to help the Government to stimulate this private sector-led growth through the Capital Market Development Program (the Program) and the associated policy reforms.

### B. Formulation

3. The formulation of the Program took about 6 years. It was based on the recommendations of the studies undertaken under ADB technical assistance (TA). The Philippine stock market, established in 1927, has a long history of broker self-interest and resistance to reforms. Since the late 1980s, ADB had provided wide-ranging TA to the Philippine financial sector. By implementing a number of related TAs and disseminating findings widely among all interested parties, the resistance to reforms was gradually overcome. In 1989, the Government and ADB began formulating the Program. The Fact-Finding Mission took place in May 1990, and the first management review meeting within ADB was held in August 1990. However, the management considered further loan processing at the time, to be premature and suggested the implementation of TA ahead of the loan. It also wished to confirm the Government's commitment through the initiation of actions.

4. TA 1640-PHI and TA 1641-PHI, approved in 1992,<sup>3</sup> helped to review the nature of the existing capital market and identify impediments and potential reform areas, and recommended policy actions that formed the basis for the subsequent policy matrix (paras. 33–36). Some of the recommended policy actions were undertaken as preconditions for the loan. The unification of the Manila and Makati stock exchanges in 1993 was an important first step in capital market development and indicated the willingness of the parties to reform. Subsequently, the trading system in the stock exchange was partly computerized. However, the Securities and Exchange

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<sup>1</sup> In 1993, the domestic savings rate in the Philippines was 14%, compared to 32% in Indonesia, 39% in Malaysia, 45% in Singapore, and 35% in Thailand.

<sup>2</sup> Interest rates were liberalized, directed credit was being phased out, and restructuring the public sector banks had begun in 1980s. The Central Bank was restructured and the banking sector was opened to foreign competition in the early 1990s.

<sup>3</sup> These were TA 1640-PHI: *Stockmarket Development*, for \$585,000, and TA 1641-PHI: *Institutional Strengthening of the Securities and Exchange Commission*, for \$589,000, both approved on 2 January 1992.



Commission (SEC) was still saddled with outmoded regulatory practices and implementation of various nonregulatory functions, distracting it from its primary task.

5. The next formal stage of loan processing came in when a second management review meeting was held in March 1994. The management was concerned about the large number of conditions for the second tranche release, and the project staff was asked to review and prioritize the conditionalities. The management was also concerned with the modality of reforms—whether the passing of legislation, or the presentation of a related bill to Congress, should be a condition for the second tranche release. The staff was asked to obtain the Legislator's feedback on the passage of legislation. There is no record of whether such feedback was obtained during formulation. In mid-1994, the policy reform agenda was finalized in consultation with the Government and the endorsement of the Capital Market Development Council (CMDC), a public-private forum that had been established in 1992.<sup>4</sup> The appraisal of the proposed program took place in March 1995. Due to its length, the policy matrix comprising 49 conditions did not include the actions already undertaken prior to loan approval. In August 1995, more than 5 years after the Fact-Finding Mission, ADB approved the program loan for \$150 million from ordinary capital resources with two equal tranches. While the seven core tranche conditions to be implemented by March 1997 did not include legislative action, a majority of the conditions (21 out of 49) to be implemented by December 1997 were linked to passage of legislation. The loan amount was not determined by cost of adjustment, but there were indicative guidelines in the report and recommendation of the President regarding the use of counterpart funding. It mentioned that the Government would use the counterpart funds for general economic and financial development after meeting the cost of modernizing SEC's operations up to a limit of \$15 million.

### **C. Program Objectives**

6. The Program was classified as an economic growth program. The proposal included a detailed policy matrix with target dates and the development policy letter. It stated that the objective of the reform program was to promote a diversified, competitive, and vibrant capital market in order to raise investor confidence, domestic and foreign resource mobilization, and allocative efficiency leading to accelerated growth and development of the economy. It supported increased reliance on capital markets as a means of mobilizing long-term funding by tapping domestic and foreign savings, improving prudential regulation of institutions, and adopting internationally accepted standards and practices in the capital markets.

7. The specific goals of the Program included (i) enhancing investor confidence by introducing internationally accepted standards, (ii) more focused attention of government agencies to capital market development issues by establishing a capital market coordination committee, (iii) strengthening the regulatory and enforcement capability of SEC by bringing about legislative and organizational enhancements, and (iv) improving stock exchange operations and introducing rules that help promote capital market savings. The full policy reform agenda included 49 conditions with seven core conditions. The second tranche release was contingent on achieving sufficient progress in carrying out the Program and the fulfillment of these seven core conditions.

### **D. Financing Arrangements and External Agency Coordination**

8. The program loan had a maturity of 15 years, including a 3-year grace period, and the interest rate was determined by pool-based variable lending rate system for US dollar loans and

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<sup>4</sup> It received funding from the United States Agency for International Development from 1994 to 2000.

included a commitment charge of 0.75% per annum. The loan was disbursed in two tranches of \$75 million each. The Department of Finance (DOF) was the Executing Agency (EA) and the proceeds of the loan were available for financing eligible imports procured under ADB guidelines, determined by a negative list. The program period was 1992–1998,<sup>5</sup> and the second tranche was to be released in the first quarter of 1997, 19 months after loan approval. TA 2379-PHI attached to the loan covered the study of institutions that were needed to augment the reforms proposed under the Program (para. 36).<sup>6</sup>

9. There was substantial coordination between external agencies (ADB, United States Agency for International Development [USAID], International Monetary Fund [IMF], and the World Bank) regarding the overall reform agenda where each contributed in a complementary fashion. In 1992, IMF had approved an extended fund facility and a stabilization program to address the macroeconomic crisis facing the country. Postponement of loan processing by ADB at the time enabled IMF to keep the stabilization program on track. During aid coordination consultations, it was agreed that the World Bank would help continue the reforms in the banking sector and contractual savings institutions, while ADB would take the lead on promoting the capital market development. The World Bank Financial Sector Program loan was approved in 1993 to address banking sector reforms. Meanwhile, the USAID Capital Market Development Project for \$27 million was approved in 1993 to modernize the stock exchange and support the private sector activities related to the capital market. The USAID project extensively used recommendations that had resulted from previous ADB-related TAs. Of these funds, \$2 million was allocated to CMDC.

## **E. Program Completion Report**

10. The program completion report (PCR) circulated in August 2000 was well prepared and provided a comprehensive picture of the reform package and assessment of the program implementation relative to the program targets. It indicated that the Program was well timed and coincided with the macroeconomic stabilization program and the broad-ranging structural reforms in the economy. The PCR noted that the implementation of the Program was less than satisfactory, primarily due to delays in passing the Securities Regulation Code (SRC). It attributed the delay to a few critical factors such as the number of reforms attached to one piece of legislation, distractions related to congressional elections of May 1998, and resistance from vested interests. It explains that despite extensive dialogue throughout 1997–1999 with the Government, DOF, SEC, and Philippine Stock Exchange (PSE), the Program was not fully implemented by the end of 1999 (even after two extensions), although all seven of the core conditions had been complied with by that time (Appendix 1). As a result, ADB and the Government agreed to cancel the second tranche in December 1999 and close the loan.

11. Based on the noncompliance with a policy action and the significant delays in the enactment of the SRC, the PCR rated the Program as partly successful.<sup>7</sup> While the delays in legislature created uncertainty among investors, their confidence was further eroded by the major stock market scandal reported in March 2000. The tranche cancellation notwithstanding, the SRC was enacted in June 2000. Discussing the lessons learned, the PCR claims that while the reforms identified in the Program were correct, its excessive reliance on achieving these reforms through one key legislative act may have been a weakness in the design. Instead, it

<sup>5</sup> The program period was defined as 1992–1998 as some of the reforms were initiated in 1992 on the basis of the TAs (footnote 3). For brevity, actions already undertaken prior to loan approval were not shown in the policy matrix.

<sup>6</sup> TA 2379-PHI: *Capital Market Development*, for \$600,000, approved on 22 August 1995, was to study the central depository, strengthening of regulatory capabilities, and identification of reforms needed in the mutual fund and pre-need sector, which was not studied earlier.

<sup>7</sup> Based on a three-category scale adopted before 2001.

recommends that future operations focus on the enforcement of existing regulations. It also identifies other practical lessons for increasing the effectiveness of SEC enforcement capacity, maintaining good corporate governance, and broadening consultation at program formulation.

## **F. Operations Evaluation**

12. An Operations Evaluation Mission (OEM)<sup>8</sup> was undertaken in Manila from 17 February to 10 March 2003. The OEM met with DOF and key stakeholders—SEC, PSE, CMDC, Central Bank, Investment House Association of the Philippines (IHAP), Financial Executives Institute of the Philippines, Bankers Association of the Philippines, and other private market players. The primary purpose of the evaluation is to identify the strengths and the weakness of the Program to learn lessons for future operations of ADB within the Philippines, as well as in similar sectors of other countries. The Program was assessed on the basis of (i) need for the program and the effectiveness of its design (relevance), (ii) achievement of program purpose and production of outputs (efficacy), (iii) efficiency, (iv) sustainability, and (v) contribution to institutional strengthening and other impacts. The draft program performance audit report was circulated interdepartmentally in ADB and to the Government and other stakeholders. Comments received were considered in finalizing the PPAR.

## **II. PLANNING AND IMPLEMENTATION PERFORMANCE**

### **A. Effectiveness of Design**

#### **1. Rationale**

13. The program goal was to promote private sector investment-led growth to recover from the significant difficulties the country had experienced for much of the 1980s. To achieve this, there was a heightened emphasis on mobilizing long-term funds. The macroeconomic premise for the program reform was the mobilization of savings, in part because the saving rate had fallen to such a low level compared to other countries in the region (footnote 1). The program rationale was to raise investor confidence and instill vibrancy and competitiveness in the capital market. This was indicated in the development policy letter, which clearly and correctly covered both the stock and bond markets. It indicated that the development of the stock market was desirable because, first, it was part of the strategy of the Government to rely on the private sector as an engine of growth. Second, it was one avenue through which state-owned enterprises could gradually be privatized, and third, it was necessary to attract foreign portfolio capital. Referring to the bond market, the development policy letter described the Government's desire to broaden the range of instruments for risk capital and showed that it was important for financing requirements of large infrastructure investments. As such, the rationale of the Program appears to have been sound.

#### **2. Adequacy of Coverage**

14. From an operational perspective, the Program's focus was much more limited than implied by its title or the coverage of the development policy letter. Despite the large number of conditions given, the policy action matrix dealt predominantly with the needs of the stock market, particularly its regulatory framework, and did not focus adequately on the debt market. The program documents have no evidence that a holistic and sequenced reform agenda, which included the stock market and the debt market, was formally agreed upon. In hindsight, these

<sup>8</sup> The Mission comprised M. Hettige (Senior Evaluation Specialist/Mission Leader), R. Azanza (Capital Market Development Specialist), and J. Ravallo (Financial Sector Development Specialist).

reforms should have been planned and sequenced to minimize possible disruptions in funds flow and/or dislocations of opportunities in these submarkets. The lack of focus on the debt market may be partly explained by the pronounced growth of commercial papers (CPs) prevailing at that time, and the need for reforms in this area may not have been clear due to the high activity level in the debt market. It is evident from Table 1 that short-term CPs enjoyed increased turnover while long-term CPs were experiencing a notable expansion up to the time of the loan approval in the mid-1990s.<sup>9</sup> Ironically, it may have been this “good fortune” that left the reforms undone with respect to CPs. Only when this submarket faced considerable difficulties in the last few years, particularly because of the absence of industrywide best practices and the necessary support infrastructure to carry out transparent trading activity, has the call for these reforms in the debt market become pronounced.<sup>10</sup> A comprehensive agenda that included both stock and debt market would have helped to monitor deteriorating conditions in the submarkets, both individually and collectively. Due to the narrower focus, today the CP market has not been able to emerge as a viable alternative source of risk capital. In fairness, the narrower focus on the stock market may also have been dictated by prudence. With the needs of the reforms in the stock market creating a rather long policy matrix, the possibility of taking on additional reforms in a complementary market would have made the Program unwieldy and, therefore, this focus on the stock market appears to have been a deliberate choice made in the design of the Program. Multiple tranching related to different segments of the capital market may have been considered in this context. Alternatively, a cluster of program loans identifying long-term reform agenda would have been useful.

**Table 1: Commercial Paper Market Activity**

Year	New Issuance		Year-End Outstanding	
	Short-Term (₱ million)	Long-Term (₱ million)	Short-Term (₱ million)	Long-Term (₱ million)
1985	5,857.10	1,000.00	1,508.30	1,000.00
1986	4,799.80	410.00	1,487.70	1,410.00
1987	6,141.20	—	1,219.60	1,410.00
1988	4,129.40	—	322.80	1,410.00
1989	7,293.70	800.00	1,427.40	2,300.00
1990	14,953.90	925.00	3,107.00	3,675.00
1991	23,970.70	2,925.00	2,974.00	7,615.00
1992	13,328.40	8,402.50	2,543.30	6,828.40
1993	12,092.30	900.00	2,774.10	9,717.40
1994	18,005.90	6,200.00	3,907.20	22,165.20
1995	11,080.20	12,064.75	3,918.77	24,977.29
1996	15,134.60	20,250.35	5,929.60	45,555.83
1997	13,184.50	11,400.00	4,740.42	50,238.85
1998	7,307.00	750.00	3,395.00	44,299.55
1999	2,016.00	6,700.00	2,004.00	45,479.78
2000	1,170.50	0.00	1,651.50	42,971.58

— = not available.

Source: Investment House Association of the Philippines.

<sup>9</sup> Long-term CPs are really corporate bonds. This form of “repacking” is meant to obtain a more favorable tax structure for the instrument.

<sup>10</sup> The trading activity for debt instruments was essentially governed by bilateral arrangements between buyer and seller. Since the terms of the transaction were not being made public, this prevented other players from knowing the “true” market price of any issue and it had also not prevented the illicit activity of multiple sales.

### 3. Operational Focus

15. In addition to lack of coverage, several factors indicate that focusing on the stock market alone was not ideal to achieve the stated objective of mobilization of resources and their efficient allocation.<sup>11</sup> First, as Table 2 shows, the stock market had traditionally been the most limited venue for raising term funds, suggesting that it is not an ideal vehicle for mobilizing aggregate saving. This is not reflective merely of the comparative size of these submarkets but actually also indicates the respective retail side of these markets. Savers, for example, are able to access the bank deposit market with relative ease but some amount of sophistication would be incumbent on those investing in either CPs or shares. Thus, the stock market may not have been the ideal target for the generation of term funding and heightened saving mobilization. Second, shares become a venue for saving only when new issues are listed but, on its own, the trading of shares in the secondary market has no real impact on saving mobilization.<sup>12</sup> Therefore, the stock market is more supply driven, with the available saving responding to what is available as public offerings. Third, saving is intrinsically finite and can be reallocated across the alternative submarkets that offer stocks, debt instruments, saving options denominated in foreign exchange, and banking products. Thus, reforms in any one submarket (i.e., stocks) will invariably have an impact of altering the balance between all the submarkets and, therefore, an overall agenda addressing the major deficiencies of the entire capital market would have been preferable.

**Table 2: Alternative Use of Funds**  
(in million)

Year	Loans Granted (₱)	Change in Loans Outstanding (₱)	Issuance of CPs (₱)	Value of Public Offering (₱)	Change in Private Foreign Debt (\$)
1985	270,201.4	(28,528.0)	6,857.1	—	171.0
1986	328,169.8	(3,501.0)	5,209.8	0.0	(462.0)
1987	368,821.7	12,786.0	6,141.2	156.5	(564.0)
1988	421,922.1	25,503.0	4,129.4	802.3	(602.0)
1989	385,906.7	39,243.0	8,093.7	3,702.2	62.0
1990	512,419.9	82,326.0	15,878.9	4,134.3	334.0
1991	844,043.8	(7,929.9)	26,895.7	5,658.3	252.0
1992	1,097,087.9	23,820.2	21,730.9	8,205.5	937.0
1993	3,459,555.6	63,355.2	12,992.3	8,713.9	321.0
1994	—	105,399.9	24,255.9	37,333.6	1,563.0
1995	—	109,966.6	30,880.9	33,266.3	392.0
1996	—	194,464.6	35,384.9	27,049.5	1,861.0
1997	—	383,003.9	24,584.5	12,706.7	3,385.0
1998	—	296,520.5	8,057.0	1,392.2	(401.0)
1999	—	(68,594.0)	8,716.0	756.5	1,155.0
2000	—	6,037.2	1,170.5	560.7	874.0

— = not available, CP = commercial paper.

Notes: (i) Data are flow variables for activity in the submarkets of loans, CP, equity, and foreign debt; (ii) loan data is for commercial banks only; (iii) 2000 data for CPs is for the period January to May; and (iv) private foreign debt refers to the total external debt incurred by the private sector with or without Government guarantee.

Sources: Central Bank's Special Philippine Economic Indicators and Investment House Association of the Philippines.

<sup>11</sup> The OEM recognizes that there was absolutely no question that the stock market needed fundamental improvements.

<sup>12</sup> Secondary trading does not increase saving but reallocates the use of saving from seller to buyer. Many of the policy actions of the Program were geared toward the secondary market.

#### **4. Consultation with Stakeholders**

16. It appears that there was extensive consultation between ADB, Government, market players, and other external assistance agencies, but there is no evidence of interaction between the Government and the legislative branch during program formulation. During implementation, extensive interaction between a champion of reforms and the legislative branch would have pushed the reform agenda faster. This type of interaction is crucial not so much for the purpose of securing outright support for the Program itself but more so to actively explain the basic issues that underpin the reform agenda. Given the highly technical nature of some of the envisaged reforms and the eventual need to pass new legislation to authorize the reforms, such interaction may have helped substantially.

#### **5. Commitment**

17. At the time of program formulation, CMDC had recognized the wisdom in adopting the Group of Thirty<sup>13</sup> and Fédération Internationale des Bourses de Valeurs (FIBV) standards, as well as the growing problems in clearing and settlement risk. It realized that the other regional stock exchanges were overtaking the Philippines in turnover volume, market capitalization, and quality of standards. In parallel through TA implementation, ADB had identified 79 reforms that were conducive to the development of the stock market. Consequently, the two efforts were merged and CMDC assistance was sought to prioritize and endorse a shorter list of 49 conditions. As such, program ownership was apparent with the confirmation of what the market already wanted and in fact had modestly begun.

#### **6. Dependence on Legislation**

18. Despite its relevance and the apparent commitment to the Program, a weakness in the design was that it relied substantially on legislation to achieve its intended policy actions. While there was an essential need to make necessary changes to the 59-year-old revised securities act existing at loan approval, the Program became overburdened by conditions linked to passage of legislation.<sup>14</sup> The SRC presented to the Congress in 1995 was tied to 21 of the 49 conditions of the Program. Its approval was delayed for 4 years and led to the cancellation of the second tranche of the loan despite the fact that specific core tranche conditions had been fulfilled. The executive branch, which participated in the design of the Program, does not have any functional control over the actions of the legislative branch, which is structurally and behaviorally independent. This shows how programs laden with conditions linked to legislation can become inherently more risky in the Philippine context. It is better to require such important reforms to be conditions of board consideration.

#### **7. Availability of Operational Funding**

19. Operationally, the program loan funds become part of the general pool of the government budget and cannot be directly earmarked unless the approved subsequent budget specifically makes such a provision. While the TA consultants provided recommendations on the restructuring of related institutions, additional funds are needed to convert these recommendations into practice. Another weakness in the program design was that a mechanism for this much-needed funding was not clearly indicated within the Program. TA

<sup>13</sup> A private, nonprofit, international body established in 1978, composed of very senior representatives of the private and public sectors and academia.

<sup>14</sup> According to Philippine officials, the difficulties with the legislative burden were recognized and, therefore, it was agreed that seven core second tranche conditions would not include legislative actions.

loans or cofinancing arrangements could have been provided to ensure that there are funds to translate policy actions into outcomes.

20. Therefore, despite the sound rationale, substantial consultations with participants in the government and the private sector, and apparent commitment of the executive branch, the program implementation was tedious and prolonged. While external factors such as the Asian financial crisis and changes in administration influenced its prolonged implementation, there were also apparent weaknesses in the program design, namely partial coverage of the capital market, high dependence on legislative action, and lack of funding mechanisms to implement recommendations and policy actions into realistic outcomes.

## **B. Policy Reform Measures**

### **1. Allocation of Regulatory Responsibilities**

21. The conditions in the policy matrix could be separated into five categories of reforms. The first category involved the preparation of a strategy paper by DOF that would allocate and streamline regulatory responsibilities among appropriate government agencies taking account of the recommendations of TA 1641-PHI. Initial steps were made to clarify SEC's authority and jurisdiction. However, the strategy paper was not finalized, and as new market players emerged over the years, overlapping responsibilities between SEC, Central Bank, and Insurance Commission contributed to confusion about the regulatory oversight of some operators in the market. This confusion arises due to the predominance of universal banking in Philippines where the regulatory framework is based on the US model (where universal banking does not exist). To avoid this confusion, various memoranda of agreement have been developed (in multiple versions) by the technical working groups of the regulatory staff. However, the disentangling of the confusions is an ongoing process and the regulatory institutions continue to address these issues through administrative measures. The most recent weaknesses of this oversight overlap were major banking and investment house scandals in 2000–2001 and the recent pyramid/ponzi scheme problems.<sup>15</sup> Although the oversight responsibility is allocated to one institution (i.e., such as the pyramid schemes currently placed under the regulations of the Insurance Commission), it does not necessarily mean that the particular institution has the capacity to enforce its responsibilities.

### **2. Strengthening Regulatory Framework**

22. Under the second category of policy actions, the Program also supported strengthening of the regulatory framework and developing investor confidence by (i) introducing a disclosure-based regulatory system, (ii) strengthening antifraud provisions of the securities laws, (iii) amending the Corporation Code, (iv) amending the 1982 revised securities act, and (v) amending the rules governing the activities of the investment houses. Generally, these policy actions were complied with. In October 1996, SEC adopted comprehensive full disclosure rules and also approved a revised approach to the initial public offering pricing in consultation with ADB. The Corporation Code was amended to ensure that the same offer was made to both majority and minority shareholders. A majority of other conditions in the policy matrix were also incorporated into the amendments to the SRC and SEC business conduct rules. However, there is still no linkage between the stockholder of record and the actual buyer, and 80% of the

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<sup>15</sup> Investment houses, for example, are effectively governed by the regulations of both SEC and the Central Bank. Pyramid/ponzi schemes, on the other hand, are treated as securities violations since there is no law that directly criminalizes such illicit endeavor; however, the regulators have determined that for practical purposes they should be under the oversight of the Insurance Commission.

certificates are still in scrip form. In addition, tender offer provisions under the SRC have undergone major and constant criticism and are now in the process of amendment.

23. In addition, the policy matrix required under the Corporate Code that a minimum number of outside nonexecutive directors for publicly listed companies and the SRC complying with it translated this into requiring at least two independent directors or a sufficient number to represent at least 20% of the members of the board of directors. Further strengthening this requirement, SEC is currently proposing amendments requiring more independent directors (at least 30%) and mandatory appointment of same by SEC itself. This is a contentious issue with some market participants and is not yet resolved. SEC was also required under the Program to provide a risk-based net capital requirement for brokers and dealers, with specific capital items to be defined explicitly in the rules. The implementation of the net capital rule was met with major opposition resulting in numerous delays and changes in the level and/or reporting frequency of such.<sup>16</sup> The policy matrix also required that all transactions by brokers in unlisted securities be traded in a centralized market under the supervision of a registered self-regulatory organization (SRO). Although the PCR indicates that compliance with this policy action was pending enactment of legislation, there is still no formalized “centralized market” present for unlisted securities. With respect to the policy actions related to investment houses that required the brokers to have the required net capital to act as underwriters, this condition had been opposed by both IHAP and SEC. Compliance regarding increasing financial and other penalties specified under the Investment Houses Law is still pending enactment of the Revised Investment Company Act that was submitted to the Congress in 1996.

### **3. Stock Market Development**

24. The third category of reforms introduced modern regulation practices for PSE with the objective of improving transparency and accountability, and the development of market trading infrastructure, particularly through an efficient clearance and settlement system. PSE was accorded SRO status in 1998, following the accreditation by FIBV in December 1996. This empowered PSE to regulate its members, and to formulate and implement rules and regulations subject to oversight authority of SEC. In March 2000, there was a price manipulation scandal that had extensive ramifications for investor confidence.<sup>17</sup> Following this scandal, SEC began to directly supervise PSE until its SRO status was reinstated in 2001. Another important policy action was for PSE to ensure that investor concerns are addressed through the appointment of at least three members from the nonbroker community to the PSE board of governors. Of the 15-person board, seven are now nonbroker directors, plus the president, who is also not a broker. This requirement, though fulfilled on paper, has not completely achieved its underlying objective, as it is still contentious as to how these nonbroker directors are nominated or elected.

25. As recommended in the policy matrix, the Philippine Central Depository (PCD) was established and operationalized in 1996 following the standards of Group of Thirty. Its creation was handled internally without legislative recourse. However, the Securities Clearing Corporation of the Philippines was also set up by PSE in 1996, and the Bureau of Treasury initiated the Registry of Scripless Securities (ROSS), also in 1996. Due to diverse origins, changes in technology, and reduced cost of establishment, these three institutions coexist and fulfill the same functions (para. 44).

<sup>16</sup> This will be exacerbated with the shift from a net to a risk-based capital rule, which is considerably more difficult both to implement and achieve for the typical PSE broker.

<sup>17</sup> Despite the gravity of the scandal, no broker has been prosecuted for the price manipulation and instead the issue now seems to have been reduced to the imposition and collection of monetary fines.



#### **4. Reforming Collective Investment Schemes**

26. The fourth component of reforms focused on collective instruments such as common trust funds, mutual funds, and pre-need plans. The studies undertaken by DOF, with the assistance of ADB and USAID, made recommendations regarding high taxation, lack of clarity of investment guidelines, legal impediments to competitive distribution networks, and limitations on fund management. Based on these recommendations, the Government eliminated double taxation through the passage of the Tax Reform Law in 1998. The Revised Investment Company Act legislation still pending since 1996 incorporated some other recommendations intended to raise investor confidence: prudential guidelines on portfolio management, full disclosure of information by companies, declaration of unlawful activities, and prohibition of activities that lead to conflict of interests.

#### **5. Increasing Supply of Stocks**

27. To encourage more long-term savings through increased supply of stocks, the Program called for divestiture of state-owned enterprises through public offerings, encouraging commercial banks to issue equity. The privatization of the Philippine National Bank and Petron Corporation began this process during the program period. In 1997, the Central Bank required that commercial banks list at least 10% of their paid-up capital. Many of the universal banks listed their shares by 2000.

28. The policy actions defined by the Program reflected either currently accepted best practice or a response to previously existing malpractices. However, many of them were eventually undertaken providing a basic framework within which to develop the stock market. But the current situation is still saddled with outcomes such as low investor confidence, broad-based initiatives to amend the SRC, and some duplicity in the clearing and settlement infrastructure. Therefore, the reforms need further fine tuning.

### **C. Program Management**

#### **1. Disbursement and Procurement**

29. The Program had a preparation period of 6 years and an implementation period of another 4 years after which the second tranche was cancelled, indicating that there were problems associated with program management. These delays were driven both by internal complications and external shocks (para. 30). The Government (through DOF) actively participated in crafting the details of the Program. While there was considerable delay in the preparation of the program loan, the reform commitment remained strong until its approval in 1995. A notable champion of reforms at that time was CMDC. Providing a policy venue for government-private sector interaction, CMDC epitomized the reform initiative under a mindset of consensus building among the major players. This joint concern by the Government and the major market players certainly made it easier to initiate and prioritize reforms and provide initial technical support.

30. The loan effectiveness was delayed by 8 months to provide DOF with sufficient time to secure final approval from the Monetary Board and the required legal opinions from the Department of Justice. The first tranche of the loan (\$75 million) was not released until May 1997<sup>18</sup> due to an amendment that was made to the Official Development Assistance Act. The

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<sup>18</sup> This release enabled the Government to cushion the impact of the Asian financial crisis that began in mid-1997.

PCR emphasizes that prior to the onset of the financial crisis in mid-1997, the securities market capitalization had doubled from 1992 to 1996.<sup>19</sup> However, this momentum was blunted by the financial crisis, delays in enacting key securities legislation, and as a result of changes in administration. The program loan was extended on two occasions to allow for the passage of legislation required in the Program. Despite the extended period of program implementation, the scope of the Program remained unchanged. The Loan Agreement indicated that the second tranche would be released if substantial progress had been achieved in carrying out the Program, and in particular, if the seven core conditions had been fulfilled. It was the lack of substantial progress in carrying out the Program (due to the delay in SRC to which 21 out of 49 conditions were attached) that led to the cancellation of the second tranche in December 1999. In fact, most of the policy actions were (ultimately) achieved with the passage of SRC and other administrative measures providing a framework for the development of the securities market.<sup>20</sup>

31. A negative list was used to define the imports allowed under the Program and no significant problems were encountered during liquidation of claims, imprest accounts, or disbursements.

## **2. Effectiveness of Technical Assistance**

### **a. TA 1640-PHI: Stock Market Development**

32. The work under the TA 1640-PHI (footnote 3) was based on a detailed terms of reference that covered six aspects of the stock market development. A team of seven consultants including staff of both existing stock exchanges worked on the TA from September to December 1992, drawing on their collective operating experience of working in 20 stock markets worldwide. They used 450 person-days and made detailed recommendations.<sup>21</sup> Given the consultative approach adopted under the TA, the consultants met with 10 related organizations and over 120 brokers, dealers, listed companies, investment houses, transfer agents, and other interested parties. They requested from them written or verbal communication of views about the developments in the capital market. Based on these interactions and their experience, the consultants provided a detailed report of good quality. In addition to the required six sections, the TA report covered additional areas and supported the recommendations<sup>22</sup> with appendixes on operational guidance including job descriptions, codes of conduct for different market participants, outline of training programs, and comparison of rules with other selected stock exchanges in the world. Under the technology component, the extensive work was done providing for (i) the automation of trading to achieve price integrity for each issue,<sup>23</sup> and (ii) the creation of a single central clearing and depository system. The policy matrix shows clear traces of the recommendations derived in this TA report. Subsequent to the TA, the two contending exchanges were unified into the PSE in 1993 and professional managers took over executive positions. Although two physical trading floors are still operative today, an automated system is

<sup>19</sup> The economy was strong with gross domestic product growing at an average of 5% from 1994 to 1996, unemployment declining, and foreign investments increasing.

<sup>20</sup> The scandal of March 2000 in relation to Best World resources provided an impetus for the passage of the SRC after the Program closed.

<sup>21</sup> The report contained 77 itemized recommendations with corresponding rationale and timeline for each, which appeared to have been the basis for the policy matrix at the formulation of the Program.

<sup>22</sup> The study included recommendations on (i) unification of the exchange, (ii) automation of trading, (iii) central clearing and depository; (iv) professionalization of exchange governance and management including its organizational aspects, (v) professionalization of intermediaries, (vi) listing procedures and rules, and (vii) review of securities investors protection fund, and (viii) general aspects.

<sup>23</sup> It was not uncommon to find that the same listed stock would have different prices in the Manila and Makati exchanges. Both exchanges were also subject to significant manual processing at that time.

in place to instill workflow improvements and price integrity. The PSE attained SRO status after receiving its accreditation from FIBV, and a new framework of governance was put in place with certain provisions put into law under the SRC. PCD was created in 1996 (para. 25). The TA was relevant and efficacious in achieving its objectives. It was implemented efficiently despite the use of large number of consultants and provided valuable recommendations, which were implemented during the Program.

**b. TA 1641-PHI: Institutional Strengthening of the Philippine Securities and Exchange Commission**

33. TA 1641-PHI (footnote 3) was complementary to the previous TA and was undertaken between October 1992 and March 1993 with the broad objective of providing for improvements in the regulation of the securities market and the institutional capacity of SEC to undertake its functions. Based on a detailed terms of reference covering three pages, the scope of work focused on two components: a regulatory component aimed at developing a more coherent framework over the capital market in Philippines; an organizational component aimed at creating and strengthening the organizational capacity of the SEC; and a program to implement the recommended regulatory strategy. The TA output detailed the responsibilities of each of the regulators working in the financial market. It also recommended changes to legislation in the Corporation Code, revised Securities Act, Investment House Law, Investment Company Act, Financing Company Act, Omnibus Investment Code-Foreign Investment Act, and several related presidential decrees. The TA noted that, at the time, it was difficult to determine which statutes and regulations were in effect and which had been superseded, because new legislation often claimed to supersede anything inconsistent with it, but seldom named the actual legislation being superseded.

34. The detailed TA output specified a new SEC organizational structure, human resource development strategies, and substantial improvements in the operating procedures in the areas of codifying rules and standards, controlling entry to the market, and monitoring market behavior. It also provided a program to implement the recommendations, as well as helpful appendixes on sample organizational structures of other SECs, sample net capital disclosure standards, sample insider trading provisions, and sample summary budgets as guidance. Among its main findings, the TA suggested (i) designating SEC as the regulator for securities, futures, and the activities of financial institutions related to the securities market; (ii) to leave the financial institutions under the purview of the Central Bank while pre-need companies would be the responsibility of the Office of the Insurance Commission; (iii) shifting the regulatory philosophy away from merit regulation and into full disclosure; (iv) introducing and emphasizing the self-regulation framework; (v) adopting international best practices as a means of attracting and assuring international investors; and (vi) streamlining the workflow and organizational setup of SEC. This last point was intended to include refocusing the functions of the commissioners, improving the core competence of the staff, and the assimilation of new technology.

35. TA 1641-PHI was both relevant and useful, and it was implemented efficiently within a short period of time providing institutional development suggestions, which have generally been pursued both prior to and under the Program.

**c. TA 2379-PHI: Capital Market Development**

36. The TA 2379-PHI (footnote 6), though approved together with the Program, was not directly related to its implementation. Instead, it showed how capital market could be used to better support the Government's build-operate-transfer program under the Private Sector Infrastructure Development Facility (PSIDF). The objective of the TA was to identify reforms that

would have to be undertaken to facilitate the creation of PSIDF. Although the Government had commenced the private infrastructure initiative in 1992, it was evident by the mid-1990s that it was difficult for build-operate-transfer companies to obtain particularly peso-denominated long-term debt to finance private sector infrastructure projects. As such, the Government wanted to catalyze the creation of a new privately owned financing company capable of undertaking such projects. The TA identified the financing constraints in the Philippines, and developed a phased program for the inception of PSIDF as well as a fiscal framework conducive to such a facility. It also provided examples of potential products (asset acquisition products and liquidity management products) and fee-generating services that could be used by PSIDF. In addition, it reviewed the demand for PSIDF in power, transport, water, and waste subsectors. While the TA was relevant and the quality of the TA report is good, the expected institutional development in terms of establishing a PSIDF has been delayed. The TA 2379-PHI is rated successful.

### **3. Program Monitoring and Evaluation**

37. The need for program monitoring and evaluation was recognized, and this was to be achieved through policy dialogue and quarterly reports on the implementation of the Program, particularly on the actions set out in the development policy letter and the policy matrix. The Government had provided a detailed implementation schedule, on a quarter-by-quarter basis, relating to each action to be accomplished. According to the September 1996 review mission, policy actions were proceeding on schedule, but the review mission of August 1997 reported that, while certain reforms had been completed, the reform process was delayed mainly due to delayed legislation. With the onset of the financial crisis followed by the changes in administration, the policy actions related to legislation became further and further delayed.

## **III. PROGRAM RESULTS**

### **A. Performance Indicators**

38. Neither performance indicators to capture the program impact nor monitoring mechanisms were specified in the report and recommendation of the President, as a program framework was not prepared. Typical progress reports provided by DOF commented only on the compliance of actions against their envisaged timeline. There was also no assessment of EA's ability to evaluate the program impacts, and the TAs provided with the Program had no provision to institutionalize this capability. If the impact of a program is to be correctly determined, program formulation must ensure that skills and resources are available and performance indicators are identified at the program design stage.

39. In addition to the design of the Program, its timing also does not lend itself well to empirical attribution of results, because there were several factors that affected the capital market at the time. The burden of the 1997 financial crisis changed not only the direction of the capital market but also its microfoundations. The OEM has also to take into account the changing political situation since 1998. A further complication arises because of the Program's focus on one submarket, namely the stock market, because there is a constant reallocation of resources to and from other submarkets. Therefore, the impacts discussed in this chapter need to be considered as a combined effect of all the factors, most of which worked against the intended objectives of the Program.

### **B. Program Impact**

40. Stock market activity has declined considerably since the mid-1990s. Data on public offerings provided in Table 2 show that the primary market enjoyed its best years prior to the

release of program funds, followed by a dramatic decline from 1998 onward. A similar pattern emerges in Table 3 for transaction volumes and values, which in principle generally reflect secondary market trading. In fact, the declines have been so significant that 2002 entries are less than 10% of their mid-1990s volumes and less than 2% in the case of the primary market. Table 3 points to a 34% year-on-year turnaround by year 2000 for market capitalization and may be indicative of improved conditions. This sharp increase should be taken in the context of declining trends in both transaction values and volume.<sup>24</sup> Complementing this decrease in the overall impact of the stock market as a repository of risk capital, the average value per share (as a rough indicator) has increased since 1998. This means that the transactions, while decreasing in volume, were increasingly geared toward stocks of higher price.

**Table 3: Stock Market Transactions**

Year	Volume (million shares)	Value (₱ million)	Average Value Per Share	Market Capitalization (₱ billion)
1990	266,772.2	28,568.9	0.11	161
1991	279,581.6	39,407.2	0.14	298
1992	551,229.3	77,031.7	0.14	391
1993	635,488.2	182,179.7	0.29	1,089
1994	704,273.6	364,296.3	0.52	1,386
1995	1,006,224.9	378,982.7	0.38	1,546
1996	2,273,835.2	668,866.4	0.29	2,122
1997	1,923,991.5	586,172.6	0.30	1,251
1998	287,791.4	408,679.4	1.42	1,374
1999	948,958.6	780,963.5	0.82	1,918
2000	659,423.9	357,659.9	0.54	2,578
2001	164,434.3	159,555.3	0.97	2,197
2002	99,845.1	159,727.3	1.60	2,083

Source: Philippine Stock Exchange.

41. The decline in capital-raising activity was, of course, not limited to the stock market. As is apparent from the data in Tables 1 and 2, all venues show such a decline by the second half of the 1990s. However, benchmarked to their respective 1995 levels, the decline in the stock market was actually the fastest and most pronounced among the alternative venues for capital funds. This may be taken as an indicator that either the decline in stock market activity reflected internal issues that were beyond the purview of the 1997 crisis, or that the Philippine stock market has been most vulnerable among the capital market components. In either case, this indicates that, although the basic policy actions were achieved, the outcomes were not apparent. One interesting side issue to the declining capital raising activity is the apparent improvement in the saving ratios. The OEM calculations using the national accounts data show that different measure of gross saving, both domestic and national, have actually been rising since 1998 (Table 4). This may be the most obvious indication that there is liquidity available for use and that this liquidity does not show up in the traditional venues in the capital market.<sup>25</sup>

<sup>24</sup> Some ₱139 billion of this increase in market capitalization can be explained by the listing, by way of introduction, of a major foreign institution. The listing of an internationally active foreign institution in 1999 also helped increase market capitalization in the previous year by ₱249 billion.

<sup>25</sup> Instead of merely showing up as new bank deposits, the monetary authorities have repeatedly mentioned in recent reports that there is anecdotal evidence to show that the increased saving is funding Philippine debt paper.

42. Although the actions specified in the Program were eventually fulfilled, the intended outcomes of a diversified, competitive, and vibrant capital market have not been fully achieved. Instead, investor confidence is currently low and this is reflected in a very inactive equities market today. For example, the value of stock market transactions rose from ₱379 billion in 1995 to ₱669 billion in 1996 but has since then dropped considerably to less than ₱160 billion as of December 2002. In addition, initial public offerings have substantially dried up, completely in reverse to the prominence they enjoyed in the mid-1990s. As mentioned in para. 39, one predominant negative external factor that influenced this was the regional financial crisis of 1997. However, while some of the other regional markets have rebounded, the Philippine stock market activity continued to shrink.

**Table 4: Gross Saving**

<b>Year</b>	<b>Gross Domestic Saving (GDS) (₱ million)</b>	<b>GDS Rate (%)</b>	<b>Gross National Saving (GNS) (₱ million)</b>	<b>GNS Rate (%)</b>
1980	64,826	26.60	64,347	26.45
1981	75,389	26.77	74,336	26.50
1982	80,144	25.27	76,511	24.40
1983	101,046	27.38	95,237	26.22
1984	125,344	23.90	109,348	21.50
1985	107,531	18.80	91,722	16.49
1986	115,927	19.04	103,316	17.33
1987	143,101	20.96	131,163	19.55
1988	168,234	21.05	161,064	20.34
1989	187,982	20.31	174,565	19.14
1990	201,333	18.69	206,653	19.09
1991	207,742	16.65	225,801	17.83
1992	201,826	14.93	235,829	17.02
1993	202,872	13.76	228,702	15.24
1994	251,406	14.85	294,856	16.98
1995	277,379	14.55	329,983	16.85
1996	317,075	14.60	406,492	17.98
1997	349,443	14.40	449,591	17.79
1998	330,566	12.40	467,638	16.69
1999	426,022	14.31	585,286	18.66
2000	550,355	16.64	733,171	21.00
2001	634,258	17.42	854,538	22.14
2002	722,806	18.17	978,179	23.11

Source: National Accounts of the Philippines.

43. While the recommendations of the early TAs were necessary, they were certainly not sufficient to achieve the desired outcomes. The creation of PCD has not resulted in the bulk of securities holding/trading to be in dematerialized form. Similarly, although the presence of independent directors exceeds the program conditions, it has not stopped a very public dispute for the leadership of PSE and confusion over the nomination, election, and subsequent voting right of directors. Despite the recommendations for a more coherent regulatory framework in the stock market, there were instances where oversight responsibilities fell between regulator desks, until they were addressed through discussions and memoranda of understanding between the Central Bank, SEC, and Insurance Commission recently. It appears that while the recommendations in the TA were in the correct direction, more attention should have been given to implementing them to achieve the intended purpose of the reforms. This lack of focus on outcomes may well have been driven primarily by the lack of funds. Other contributory factors could be the lack of real ownership by some participants and the long gestation and implementation period involving many political regimes and administrators.

44. The Program entailed the creation of PCD for clearing and settlement purposes (para. 25), which had been funded in part by a grant from USAID. ADB's TA always recommended a single central structure to benefit from economies of scale. At present, however, there are three institutions—PCD, Securities Clearing Corporation of the Philippines, and ROSS—that provide similar services. While some market participants quite correctly refer to the diverse origins of the three, and the changes in technology and reduced cost over time for establishing separate systems, the intended consolidation of clearing and settlement functions has not yet been achieved. On the surface, the current approach appears to be a clear step backward.<sup>26</sup> The original recommendations for consolidation took into account the need to lower systemic risks, transaction costs, and the benefits of economies of scale, and these conditions are still valid and have not been addressed with the existence of separate systems.

45. Other signs of deterioration in the Program's substance are currently evident. First, the enacted law was somewhat different from the original bills, requiring a series of amendments to strengthen the law. Within months of the SRC's eventual passage, amendments were proposed by almost all sectors including the regulator. Currently, amendments have been drafted by PSE in coordination with the SEC for eventual presentation to the legislature. However, some of these amendments effectively change the original reforms and include issues on investor protection (tender rules), a host of corporate governance issues, and fundamental exchange ownership and broker capitalization requirements.<sup>27</sup> These proposed changes have to be carefully reviewed in follow-up operations.

### C. Socioeconomic and Environmental Impact

46. In principle, the Program is expected to have a socioeconomic impact since a vibrant capital market provides better opportunities for both savers and borrowers. To the extent that saving feeds investments and expansion in productive capacity and leads to higher incomes and thus more saving, the vibrancy and competitiveness of the capital market should propagate a virtuous cycle. However, there is no direct indication that the Program has had such an impact.<sup>28</sup> This could be partly explained by the absence of a strong link between the stock market and savings in the Philippines (para. 15). Since the Program dealt directly with the capital market policies, there is also no direct environmental impact.

## IV. CONCLUSIONS

### A. Overall Assessment

47. **Relevance.** The Program had a good fit with Government and ADB strategy, both at approval and at present. In fact, an obvious window of opportunity existed at the time of program approval amidst the other broader financial sector reforms being undertaken. The Program was comprehensive in terms of providing a basic policy framework for a well-functioning stock market. In hindsight, some weaknesses in the design are discernible (paras. 13–20). However, based on the need for and the Government's initial commitment to the Program, the Program is assessed as relevant.

<sup>26</sup> PSE is currently divesting its PCD holdings and is planning to set up its own clearing and settlement structures. It is expected that the proposed fixed income exchange will absorb PCD and eventually the functions of ROSS.

<sup>27</sup> While a few of the amendments were due to the over-reaction to the market scandal in March 2000, close scrutiny of the suggested amendments shows that the bulk of amendments refer to provisions drafted (and subsequently passed) well before the scandal.

<sup>28</sup> According to the 2000 Family Income and Expenditure Survey, the bottom half of Philippine families (i.e., deciles 1 to 5) account for less income in 1997 and 2000 than they did in the 1994 survey round and in contrast, the families belonging to the richest 10% actually account for a significantly higher proportion of income versus their 1994 figure. However, this is a result of many factors and has no exclusive link with the Program.

48. **Efficacy.** Most of the actions in the policy matrix were ultimately achieved with the passage of the SRC after loan closing, providing a framework for the development of the stock market. However, the intended outcomes of diversified, competitive, and vibrant capital market have not been fully achieved. Instead, investor confidence is currently low and the Philippine stock market has not rebounded similar to the other regional markets after the Asian financial crisis. Opposition to the reforms has also surfaced on basic structures such as the SRC itself, and complications still exist in the clearing and settlement microstructures. Therefore, the OEM assesses the Program as less efficacious.

49. **Efficiency.** The OEM assesses the Program as less efficient in achieving its objectives. Program implementation was cumbersome and time consuming mainly because of its high dependence on legislative action and the influence of vested interests. Initially, the release of the first tranche was delayed until May 1997. Changes in administration and the regional financial crisis further delayed the passage of the law and ultimately resulted in the cancellation of the second tranche in December 1999. There were limited funds allocated to convert the recommended policy actions into outcomes.

50. **Sustainability.** Strengthening of the regulatory and supervisory capacity of SEC and PSE undertaken under TA 1640-PHI and TA 1641-PHI continues. With the assistance of the subsequent loan and the follow-up TAs, recently there have been notable changes in their organizational structure, personnel training, and staff composition. In addition, SEC has made judicial and effective use of the flexibility allowed under the SRC, showing its ability and capacity to respond in real time to legitimate needs for reform. While sustainability concerns were certainly influenced by external factors and internal opposition, lately there appears to be efforts between PSE and SEC to come to working arrangements that are forward looking. Therefore, the OEM assesses the Program's sustainability as likely.

51. **Institutional Development and Other Impacts.** The OEM considers that the Program has had a moderate impact on institutional development, most evident in the reorganization of SEC and the passage of the SRC. ADB's early TAs helped to address some key issues and for the most part identified the major reforms included in the program framework. While the recommendations of the early TAs were necessary, they were insufficient to achieve the desired outcomes. There were no discernible social or environmental impacts from the Program.

52. Based on the five criteria and on the basis of the four-category scale, the Program is rated partly successful. This rating is consistent with the PCR rating.

## **B. Performance of the Asian Development Bank and the Executing Agency**

53. The performance of ADB was satisfactory. ADB conducted 10 missions in support of the program implementation and provided three TAs to aid its design and implementation. The first review mission was in September 1996 and the second in August 1997 after the onset of the financial crisis, and the frequency of missions increased since June 1999 with seven policy consultation missions during the 6 months preceding the cancellation of the second tranche. These policy consultations took place between staff and senior management of ADB and the senior government officials, PSE, CMDC, and other market participants. Policy dialogue continued even after loan closing as substantial economic and sector work was launched in



1998 and subsequently a one-tranche program loan was approved in 2001.<sup>29</sup> Presently, ADB is processing the second nonbank financial sector governance program.<sup>30</sup>

54. The performance of the EA was partly satisfactory. DOF and the CMDC worked together to push the reform agenda; however, the apparent disconnection between the recommendations of the Government's executive branch and the enactment of the changes in the law by the legislative branch delayed the compliance with this policy agenda. It may have been useful to provide more information to the legislative branch regarding the critical importance of the program agenda. However, with the change in the administration in 1998, the leadership persuasion diminished. Efficiency in the use of counterpart funds for the Program was also low. Although the report and recommendation of the President included indicative guidelines regarding the use of counterpart funds (i.e., ₱15 million to SEC) given the modality of the program loan, there was no direct link between the Program and the loan funds. Under the prevailing budgetary arrangements, the majority of the funds collected by SEC are also transferred to the Government budgetary pool.<sup>31</sup> Since very little additional funding for SEC operations was forthcoming during the program period, efforts to strengthen the institutional capabilities of SEC including enhancing its skill mix, surveillance capabilities, and enforcement capacity, were stifled.<sup>32</sup> Overall, there appears to have been a disconnection between the stated initiative of the Government to promote the capital market development and the allocation of resources to achieve the intended outcomes.

## **V. KEY ISSUES, LESSONS, AND FOLLOW-UP ACTIONS**

### **A. Key Issues**

#### **1. Availability of Operational Funds**

55. Program lending policy dictates that program loans are channeled to the general pool of the Government rather than to direct uses. While complying with the legislative conditions may appear to be costless, implementing the reforms to achieve the desired outcomes entails substantial adjustment costs. In the absence of earmarking, the key institutions like SEC that have to implement the reforms must compete for funds with others when the legislative branch makes budgetary appropriations.<sup>33</sup> Within the Program itself, there was no explicit funding arrangement made corresponding to the larger and more active regulatory role to be played by SEC. Lack of financial autonomy limited its flexibility in meeting its mandate and in modernizing its internal systems and controls to function effectively as a regulator of the securities market. Given this constraint, the focus of the Program became policy actions rather than policy outcomes.

<sup>29</sup> Loan 1858-PHI: *Nonbank Financial Governance Program*, for \$75 million, approved on 15 November 2001. It was formulated on the lessons learned from the Program, as well as the recommendations derived from the economic and sector work done previously. The loan amount was released at loan effectiveness based on the upfront conditionality and an agenda was prepared for the development of the second phase that aimed to broaden and deepen the actions undertaken under the first phase.

<sup>30</sup> This loan was at the appraisal stage during the OEM.

<sup>31</sup> In 1996 and 1997, SEC collected over ₱1 million each year as fees. In 2000, it collected ₱0.9 million.

<sup>32</sup> Subsequent TA 3245-PHI: *Nonbank Financial Sector Development*, for \$2,000,000, approved on 25 August 1999, helped to restructure the organizational structure of SEC and enhance its institutional capacity. Under the Nonbank Financial Governance Program (footnote 29), SEC was required to be partly self-financed.

<sup>33</sup> Fees collected by SEC go to the Government's general revenue budget.

## **2. Continuing Capacity Building of SEC**

56. The capacity building in SEC took far more time than anticipated under the Program. While the recommendations were made prior to loan approval, the proposal to reengineer SEC materialized only after the loan had been closed. These changes, however, occurred partly because of the authority granted by the SRC and the reform orientation of the current SEC chairperson. The advisory TA 3245-PHI (footnote 32) related to the loan approved in 2001 helped institutional streamlining within SEC and promoted the expansion of professional core competences of SEC through training and apprenticeships with counterpart agencies abroad. Following the main thrust of this subsequent TA, SEC has recently gone through a wholesale reorganization in structure, in its workflow, and its personnel. The current organization broadly follows the structure proposed by TA 1641-PHI, together with the restructuring of the old departments and streamlining of the functional responsibilities (Appendix 2). A good indication of its reform agenda was the creation of the Office of the General Accountant, which would provide the Commission with the in-house expertise on internally accepted accounting standards and to administer these principles in line with market practice. As far as the workforce, SEC was able to reduce its staff by 40% by the end of 2000 without the very public display of outrage that normally accompanies such a significant consolidation. With a leaner staff, there has been explicit emphasis given to upgrading their core competence through various training programs and apprenticeships, particularly in counterpart organizations in other economies. While all of these are encouraging signs, it is also clear that this remains work-in-progress for SEC and that capacity building is an ongoing process that has to cater to the market needs.

## **3. Need for Reforms in the Debt Market**

57. Although there was growing and important progress in the already scrippless, well organized, and conventional primary public debt market, the same could not be said about the private sector debt market. There was, and continues to be, little progress in the secondary trading of either debt market. The value of including the debt market in the overall capital market reform agenda has become very evident in recent years with the very drastic decline in the issuance of CPs. This has curtailed another venue to raise capital and use available savings. At the core, the absence of both binding industry standards and a formal trading platform has fed these difficulties since the price discovery function and the integrity of traded instruments have been compromised. In addition, the adverse effects of the taxation system, which favors equity over debt instruments by imposing significant transactions cost for secondary trading, also acts as another deterrent to the development of the debt market.

## **4. Sustaining Reforms in the PSE**

58. The key to sustaining these initial reforms must of course rest on the PSE because it is the juridical entity that governs the market framework and its day-to-day activity. However, as a young entity, the institutional development of PSE has been turbulent at best. The contending groups that used to operate separate exchanges have continued to disagree on several key policy issues. This has brought the forum of disagreements under the single roof of PSE and, in many ways, deepened the divide in what should be a unified stock market. Reforms, despite the good intentions behind them, have had their momentum stymied in part because the policy direction has not been consistently followed and in part because poor market conditions render affected parties reluctant to undertake uncertain change. PSE's 2000 annual report describes its position regarding the SRC as follows:

The passage into law of the new Securities and Regulation Code (SRC) intensified the PSE's infrastructure to regain investor confidence. However, some provisions still remain under contention. Considering the serious and irreversible consequences foreseen as a result of the SRC, we have requested the SEC to hold the said implementation of the Rules until such time that both parties can hear, assess and determine the validity of the issues brought forth by the PSE.<sup>34</sup>

## B. Lessons

59. **Setting An Overall Capital Market Reform Agenda.** In undertaking financial reforms, the need for interaction between the component submarkets must be recognized. Therefore, an explicit overall holistic capital market reform agenda has to be formulated carefully and painstakingly considering the unique features of the economy and issues confronting it. The provision of additional resources for SEC through industry funding might allow SEC to be more proactive in market development and supervision.

60. **Passage of Laws.** The legislative process in the Philippines and in other countries is designed to take time to ensure that all concerns from various stakeholders can be raised and to prevent the possible abuse of dominant institutional parties. The long delays associated with passage of law have been evident in implementing many of the program loans approved for the Philippines. Therefore, the passage of a law could be a program condition in a cluster program loan approach where its passage may be a precondition for the next phase of the program. This could be a useful way of promoting legislative reforms without undermining the ongoing Program to the prolonged and unpredictable process. In addition, if improvements to regulations are required, alternatives to legislation through rules and administrative orders should be explored prior to formulating legislative action as program conditions.

61. **Implementing Laws.** The creation of new laws does not guarantee meaningful reforms and the desired development. To achieve the desired development, many other conditions have to be fulfilled. First, the intended legislation needs to correspond with the final form of the law, and this is not always true especially if the passage of the law is delayed over many years. In addition, the relevant institutions must also have the capacity to enforce the new provisions of law, and finally private sector participants should be willing to abide by the new legal framework. Therefore, it is important that prior to the enactment of legislation, a new set of dynamics is set in motion in the form of administrative measures and memoranda of understanding through a participatory dialogue. By doing so, in effect, the implied actions of the proposed law can be put into place at the same time the law is passed.

62. **Program Period.** Development of a new market structure and associated institutions is time consuming and the program loan modality though used for this purpose should not have a quick-disbursing nature when applied to an overall sector development agenda. Instead, multi-tranche loans spread over a longer time horizon associated with key components of the program or a cluster program approach is preferable.

63. **Collective Voice for Stakeholders.** The overall capital market agenda works best if it is designed through the collective voice of stakeholders. Not only should there be active and

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<sup>34</sup> What makes this quote rather significant is that it is the same SRC that had gone through extensive public discussion and technical debate that PSE would now prefer to hold in abeyance. This could only suggest that PSE felt that they were either not properly represented or their views unfortunately were unheeded during the crafting of the law.

formal discussion among stakeholders, but the means for reform must emanate from a visible high-level entity that is seen as representing the spectrum of interests in the capital market. This is not only an issue of participation but also that of transparency in the ownership<sup>35</sup> of ideas and delegating responsibility for specific endeavors. In the Philippines, this was attempted through CMDC, which helped in crafting a reform agenda agreed by consensus between the regulators and the regulated, speaking in a collective voice while trying to dissipate both political sensitivities and potentially conflicting interests among stakeholders. Based on the positive impetus created by CMDC, a lesson could be learned about establishing and finding a means to sustain such forums during the development of capital markets in any country. While the establishment of such markets could initially be funded by grants for demonstrative effect, it may be possible to generate a long-term fund through a levy imposed on the members of CMDC when the importance and the usefulness of the forum become evident.

64. **Technical Assistance.** Given that institutional development is a continuing process that needs continuing monitoring, short-term TA modality that enables international consultants to only provide recommendations may not be the most suitable way to address this continuing capacity building. Instead of TA grants, which are limited to short-term small infusion of funds from ADB, longer term TA loans, sector development programs, or cofinancing arrangements with other institutions may be more appropriate for such capacity-building initiatives. These TAs should be geared to clearly identifying capacity-building needs and should include sufficient funds and duration, not only to derive recommendations but also to implement them.

### C. Follow-Up Actions

65. **Fragmented Oversight.** The Central Bank's role in supervising the underwriting activities of the universal banks and commercial banks and SEC's role in the rest of the securities market have created regulatory fragmentation and segmentation. Owing in part to some peculiarities with the Philippine financial market (i.e., the existence for example of "quasi"-banks) and in part to the provision allowing universal banks to invest in nonallied undertakings, a single and unique regulator for each market player is currently not possible. While there is an attempt by both agencies to address these gaps through memoranda of understanding, more needs to be done. Both agencies have different priorities, record keeping, and reporting requirements as well as different types of budgets and staff skills at their disposal. Under this fragmented regulatory structure and differing capacities of regulators, some financial entities can still effectively escape the appropriate oversight.<sup>36</sup> SEC and the Central Bank should, within the next 3 months, increase already commenced joint efforts for more unified supervision of nonbank financial institutions, and the necessary resources should be made available to each to ensure effective compliance with existing regulations.

66. **Demutualization.** PSE conducted a study in 2001 to examine the feasibility of converting the stock exchange from a mutual—or a member-owned and governed entity—to a for-profit, shareholder-owned corporation. The study recommended the options for privatization or demutualization of PSE based on its business prospects, and a plan for good governance and regulatory framework within the SRO framework.<sup>37</sup> While the first step of issuing 100% of shares to its members has been completed, there is yet neither listing nor a plan for distribution, indicating that a firm timetable has been set for the demutualization effort. While this delay may

<sup>35</sup> In 2002, SEC introduced a rule requiring brokers to submit subaccount details as part of the order input record, but this rule was deferred for 12 months.

<sup>36</sup> For example, pre-need companies have now been identified to be under the oversight Insurance Commission that has limited capacity to perform this function.

<sup>37</sup> However, while demutualization study indicates who a nonbroker is, it does not show how nonbroker directors are to be chosen, and this is still a contentious issue.

have been exacerbated by a major management change at the PSE in 2002, it is essential to undertake the reforms recommended within 3 months to regain investor confidence.

67. **Carry-Over Legislation and Enforcement of Existing Laws.** Approval of the Revised Investment Company Act was the one action of the program loan that was never complied with. Its value has not been diminished by time, but given the varying views regarding the current draft bill, there is a need to review the contents of the draft immediately. Other contentious issues regarding the existing laws include the manner in which directors are selected into the PSE board and the enforcement of the net/risk-based capital rule. These issues also have to be resolved immediately if investor confidence is to be regained in the market.

## STATUS OF REFORMS

Policy Action	Status at Project Completion	Current Status of Outcomes
<b>Allocation of Regulatory Functions</b> The Department of Finance is to prepare a strategy paper and propose an action plan to rationalize and allocate regulatory responsibilities among the appropriate government agencies taking into account the recommendations made under the Asian Development Bank (ADB) technical assistance (TA 1641-PHI) for (i) money market instruments (commercial paper); (ii) securitized assets; (iii) investment houses; (iv) standard rules of accounting; (v) common trust funds and mutual funds; (vi) preneed companies; and (vii) finance companies, pawnshops, and lending investors.		
	Substantially complied with. With support from the technical assistance, the Capital Market Development Council and the Securities and Exchange Commission (SEC) have been examining ways to rationalize and allocate regulatory responsibilities of various capital market institutions. In line with this objective, the Central Bank has transferred to SEC regulation of investment houses that operate without quasi-banking and trust functions or investment management authority, and are not a subsidiary or affiliate of a bank. Regulation of securities dealers and brokers not affiliated with a bank was transferred from the Central Bank to SEC. Discussion is under way on how best to regulate pre-need companies. Department of Finance's authority over the application and development of accounting rules has been removed.	There is no evidence present that any such action plan has been proposed. There is no strategy paper existing. Various memoranda of agreement do exist (many in multiple versions) between and among regulators, supported in the main by technical working group meetings of lower level staff. Most recent weakness of this "oversight overlap" were major banking and Investment House scandals in 2000–2001 and the ongoing pyramid/ponzi (footnote 15) scheme problems.
<b>1. SEC Operations</b> SEC to cease applying rules and procedures derived from a merit-based regulatory approach and adopt a disclosure basis of regulation and supervision, including		
(i) <b>establishing minimum disclosure requirements and requiring that a prospectus containing specified information be issued for all new public offers and made available to all prospective purchasers (core condition); and</b>	Complied with. In October 1996, SEC adopted comprehensive full disclosure rules that established a new process for the registration of financial statements and other reports to be filed with SEC and distributed to investors. Three issues (Armstrong Securities, Inc.; Philippine Seven Corporation; and Euro-Med Laboratories Philippines, Inc.) have been registered under the full disclosure rules.	Complied with. Agree with project completion report (PCR).
(ii) <b>discontinuing SEC's requirement that the initial offering price be specified in the registration statement (core condition).</b>	Complied with. SEC adopted a revised approach to initial public offering pricing in consultation with ADB. The purpose of the condition was to prevent SEC from influencing the determination of the initial offering price.	Complied with. Agree with PCR.

Policy Action	Status at Project Completion	Current Status of Outcomes
	With the shift from merit-based regulation to a full-disclosure-based framework, SEC is no longer involved in setting or approving the initial offering price, even though it requires the initial offering price to be specified in the registration statement. Underwriters, subject to due diligence of companies, indicate the initial offering price to allow investors the opportunity to make a prudent investment decision.	Complied with. Agree with PCR.
<b>2. The Corporation Code</b>		
a. SEC is to issue rules and regulations for publicly listed companies to		
(i) strengthen the provisions of the Corporation Code relating to the protection of minority shareholders;	Complied with. SEC has issued proxy rules to allow shareholders the opportunity to indicate how they would like their shares to be voted and to issue a proxy, which is good only for one meeting. In addition, SEC has issued the “tender offer rules and reports” to be filed by certain beneficial owners. The Corporation Code is amended to ensure that when an offer is made to majority shareholders, the same offer must also be made to minority shareholders.	Complied with. Agree with PCR. There is still, however, no linkage between the stockholders of record and the actual beneficial shareholders. 80% of certificates are still in scrip. Please confirm and apply universally] form and in the form of “street certificates” in the main. No provision exists nor was called for in the policy for transparency of neither how the vote was actually cast nor the proxy given by the beneficial shareholder. Tender offer provisions under the Securities Regulation Code (SRC) have undergone major and constant criticism and are now in the process of amendment *Section 3 – Subsection 19.1 (a) and (d) of the SRC.
(ii) require directors and officers to act in good faith to exercise reasonable business judgment and carry out fiduciary responsibilities to act in the best interest of the corporation and its shareholders;	Complied with. This is addressed in amendments to the SRC. Under proposed provisions, persons who have a controlling interest are liable where any director or officer hinders or delays the filing of information that is required to be filed under law.	Complied with. Agree with PCR. Unfortunately, a “fit and proper rule” was not required. This is now being amended to be consistent with such requirements under the General Banking Law of 2000.
(iii) prohibit voting on resolutions on proposed transactions by interested directors; and	Complied with. SEC business conduct rules cover this requirement.	Complied with. Agree with PCR.

Policy Action	Status at Project Completion	Current Status of Outcomes
(iv) increase the notice period for shareholder meetings for resolutions that have a material impact on a company to at least 10 business days.	Complied with. The SRC requires companies to issue and mail notices of meetings at least 15 days before a meeting.	Complied with. Agree with PCR (notice is actually 15 days).
b. A minimum number of outside nonexecutive directors for publicly listed companies must be chosen.	Complied with. The SRC requires companies to have at least two independent directors or a sufficient number to represent at least 20% of the members of the board of directors.	Complied with. Agree with PCR. The SEC has recently re-issued Circular 16 Series of 2002 and is proposing amendments to the SRC. This will result in more independent directors required (at least 30%) and mandatory appointment of same by the SEC itself. Needless to say, this is a contentious issue with some market participants and is not yet resolved.
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<b>3. The Revised Securities Act (1982)</b>		
a. Registration of Statement and Prospectus		
(i) <b>SEC is to adopt rules imposing an expressed due diligence on underwriters to certify the accuracy and adequacy of information in the registration statement and prospectus provided by the issuer (core condition).</b>	Complied with. The rule took effect in September 1995. A work cell concept was adopted whereby process management and centralized SEC receiving procedures are combined into a “one-stop shop” service for securities registration and monitoring, and the regulation of various market participants.	Complied with. Agree with PCR.
(ii) SEC is to require prominent disclosure of all fees and expenses relating to an offering in the prospectus.	Complied with. Since October 1996, SEC has maintained a comprehensive system of full disclosure rules.	Complied with. Agree with PCR.
(iii) SEC is to exempt private placements of institutional investors from registration requirement.	Complied with. SRC allows private placement of securities to be exempt from normal registration requirements.	Complied with. Agree with PCR.
(iv) SEC is to eliminate the requirement to obtain a permit to offer securities and instead provide that (a) offers may be made only upon the effectiveness of the registration statement, and (b) the registration statement will become effective 45 days after filing unless delayed by the issuer or SEC brings proceedings to reject the registration.	Complied with. SRC allows (a) offers for the sales of securities to be made only upon the effectiveness of the registration statement, and (b) the registration statement to become effective 45 days after filing unless delayed by the issuer or SEC brings proceedings to reject the registration.	Complied with. Agree with PCR.



Policy Action	Status at Project Completion	Current Status of Outcomes
(v) SEC is to require an updated short form prospectus for rights issues.	Complied with. Since October 1996, SEC has maintained a comprehensive system of full disclosure rules.	Complied with. Agree with PCR.
(vi) Amend the Revised Securities Act to (a) provide objective standards for registration and delete provision that enables SEC to reject a registration statement on the basis of merit judgments as long as there is full disclosure; (b) provide for exemptions from registration not enumerated in the act by adopting rules, including sales to qualified investors; eliminate the need to apply for exemption; (c) require registration of bank or bank - guaranteed offerings and merger-related offerings; and (d) reduce disclosure threshold for substantial acquisition or sale of shares from 10% to 5%, and the notice period from 10 days to 1 business day.	Complied with. SEC maintains proper standards for registration and disclosure as stipulated in the full disclosure rules.  Compliance pending enactment of legislation. Amendments in the SRC exempt sales to qualified investors from registration requirements.  Complied with. SRC requires registration of bank or bank-guaranteed offerings and merger-related offerings. Complied with. SRC allows the reduction of the disclosure threshold to 5% and notice period is fixed by SEC.	Complied with. Agree with PCR.  Agree with PCR.  Complied with. Agree with PCR.  Complied with. Agree with PCR.
b. Registration of Brokers and Dealers		
(i) Amend the Revised Securities Act to	Complied with. Amendments in the SRC insert a registration category called an “associated person” of a broker and dealer to be defined as an individual acting in a managerial or a supervisory capacity including executive officers.	Complied with. Agree with PCR.
(a) add a registration category called an “associated person” of a broker and dealer to be defined as an individual acting in a managerial or a supervisory capacity including executive officers;	Complied with. SRC requires a registered exchange to submit substantive amendments of its rules to SEC for prior of its internal approval.	Complied with. Agree with PCR.
(b) delete the requirement that all broker and dealer, investment house, and vendor registrations terminate at the end of each calendar year;	Complied with. Amendments in the SRC have deleted the requirement that all broker and dealer, investment house, and vendor registrations terminate at the end of each calendar year.	Complied with. Agree with PCR.

Policy Action	Status at Project Completion	Current Status of Outcomes
(c) provide only objective grounds for refusing or revoking registration of securities professionals; (d) delete the requirement that SEC provide at least 5 days' prior notice of any on-site examination of the books and records of a broker or dealer;	Complied with. Amendments of the SRC provide for only objective grounds to refuse or revoke registration of securities professionals. Complied with. SRC has deleted the requirement of at least 5 days' prior notice to SEC for any on-site examination of the books and records of a broker or dealer. Currently, this is being implemented administratively by SEC under the books and records rules.	Complied with. Agree with PCR. Complied with. Agree with PCR.
(e) introduce civil liability provisions for fraud in secondary trading transactions and for insider trading; and (f) amend the definition of securities brokers to include banks.	Complied with. SRC provides civil liability provisions for fraud in secondary trading transactions and for insider trading. Complied with. SRC extends the provision for definition of securities brokers to banks.	Complied with. Agree with PCR. Complied with. Agree with PCR.
(ii) SEC is to add requirement, as a condition of registration as a broker or dealer, that applicants must pass an appropriate examination demonstrating competence.	Complied with. The requirement that applicants must pass an appropriate examination demonstrating competence has been in effect since 1992.	Complied with. The quality and administration of such an examination is, however, now in question. The SEC (which is now solely responsible for the exam's design, execution, training courses, and licensing, does not have either the funding, the time, nor the staff for the activity. This was initially designed, executed, and administered by a Capital Market Development Council-funded private sector entity that no longer exists.
(iii) SEC is to provide a risk-based net capital requirement for brokers and dealers, with specific capital items to be defined explicitly in the rules.	Complied with. The net capital rule, August 1996, has resulted in introduction of risk-based net capital requirement for brokers and dealers.	The application of the net capital was met with major opposition resulting in numerous delays in its implementation and numerous changes in the level and/or reporting frequency of such net. This will become exacerbated with the expressed change to shift from a net to a risk-based capital rule, considerably more difficult to both implement and achieve for the typical Philippine Stock Exchange (PSE) broker. As of this writing, six brokers are already in violation of the "120%" rule.

Policy Action	Status at Project Completion	Current Status of Outcomes
c. Stock Exchanges		
(i) SEC is to require that all transactions by brokers in unlisted securities be traded in a centralized market under the supervision of a registered self-regulatory organization.	Compliance pending enactment of legislation. Amendments in the SRC require transactions by brokers in unlisted securities to be traded in a centralized market under the supervision of a registered self-regulatory organization.	There is no formalized or any other form of “centralized market,” self-regulatory organization, present for unlisted securities. There is no legislation of any kind pending to effect this requirement nor has any ever been drafted or filed.
(ii) SEC is to expressly require a registered exchange to enforce its rules, including rules designed to prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade, and protect investors and the public interest; provide that failure to enforce rules will constitute grounds for revoking registration of the exchange or imposition of other sanctions on the exchange or its officials.	Complied with. SEC requested that the PSE introduce the code of conduct and professional ethics for traders and salesmen, in effect since 21 April 1999.	Complied with. Since the PCR however, the self-regulatory organization status of the PSE has been revoked and subsequently reinstated.
(iii) SEC is to require a registered exchange to submit substantive amendments to its rules to SEC for prior approval.	Complied with. SRC requires a registered exchange to submit substantive amendments of its rules to SEC for prior of its internal approval.	Complied with. Agree with PCR.
(iv) Make explicit that officers of a stock exchange need not be directors.	Complied with. SRC stipulates that officers of a stock exchange need not be directors.	Complied with. Agree with PCR.
<b>4. Investment Houses</b>		
a. Allow brokers to engage in guaranteed underwriting, provided they meet the same net capital and other requirements as underwriters, as specified by SEC.	Complied with. All brokers with the requisite net capital can have established subsidiaries to conduct guaranteed underwriting.	Complied with. Brokers have, however, fought, and continue to fight, for underwriting privileges as brokers, without the need for establishing (via additional, separate capital) an investment house subsidiary. This has been opposed by both the Investment House Association of the Philippines and SEC.
b. Increase the financial and other penalties specified under the Investment Houses Law to make them true deterrents.		

Policy Action	Status at Project Completion	Current Status of Outcomes
<b>5. Philippine Stock Exchange</b>		
<b>a. PSE is to be recognized as a self-regulatory organization in accordance with International Organization of Securities Commission standards as evidenced by accreditation by Fédération Internationale des Bourses de Valeurs (FIBV) (core condition).</b>	Complied with. PSE was accredited as an FIBV member on December 1996. PSE was formally granted self-regulatory organization status by SEC, giving it the power to regulate its own members and to formulate and implement its own rules and regulations, subject only to the oversight authority of SEC.	Complied with. Agree with PCR.
<b>b. PSE is to ensure that investor concerns are addressed through the appointment of at least three members from the nonbroker community to the PSE board of governors (core condition).</b>	Complied with. The first nonbroker governor was appointed in September 1993; the other two nonbrokers were appointed in March 1997.	Complied with. Out of a 15-person board, the PSE now has seven nonbroker directors plus the president (a nonbroker) or eight nonbroker directors. This requirement has, however, totally failed in its real objective since the election of 2002–2003 PSE board clearly showed that the issue of how such nonbroker directors are selected, how they are actually elected, and their rights as elected, are not clear and can lead yet again to deep divisions in the governance of the PSE.
<b>c. PSE is to eliminate the mandatory allocation of shares of initial public offers to PSE members (core condition).</b>	Complied with. Until 1997, initial public offering distributions included a retained portion for PSE members, giving them an advantage over genuine investors. In November 1997, an SEC memo, Circular No. 4, Series of 1997, set out new distribution rules: <ul style="list-style-type: none"> <li>• qualified institutional investors, 30%</li> <li>• local small investors (applications up to ₱20,000), 10%</li> <li>• general public, 60%</li> </ul>	Complied with. This has become less of an issue (after very acrimonious implementation) due to the almost total lack of new listings. On the other hand, the increased frequency of “back-door” listings contributed to both major scandals of recent years the practice has drawn numerous shareholder complaints about the PSE’s lack of transparency and fairness. [Sentence needed revising for clarity; please amend as necessary if my changes inadvertently altered the meaning.]
<b>d. SEC is to prohibit PSE management or listing committee from involvement in setting prices of securities offerings.</b>	Complied with. Setting prices of securities offerings is now the prerogative of the issuer and underwriter.	Complied with. Comments from preceding box also apply here.

Policy Action	Status at Project Completion	Current Status of Outcomes
e. PSE is to introduce a code of conduct of best practices for its members along the lines recommended by FIBV.	Complied with, implemented since 1996 with the introduction of the Business Conduct Rules.	Complied with. There has however been no attempt by either the PSE or the SEC (on record) to compare such a code with actual FIBV recommendations in detail. As already noted, the SEC is drafting an amendment to the SRC requiring a "fit and proper" rule, similar to that in the General Banking Law of 2000.
(i) Define and require adequate disclosure of conflicts of interests.	Complied with, under full disclosure rules.	Complied with. Agree with PCR.
(ii) Define and require adequate disclosure of all material information.	Complied with, under full disclosure rules.	Complied with. Agree with PCR.
(iii) Prevent insider trading.	Complied with, under full disclosure rules.	Complied with. However, it did not prove to be of any consequence in the Best World (BW) case of 2002, among others.
(iv) Impose a fiduciary duty to act in the client's best interest.	Complied with, under code of conduct.	Complied with, under code of conduct
(v) Ensure segregation of customer funds to protect customer savings from bankruptcy of intermediary.	Complied with, under code of conduct.	Complied with. Agree with PCR.
(vi) Set rules for maintenance of customer and trading records.	Complied with, under code of conduct.	Complied with. Agree with PCR.
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<b>6. Central Depository System</b> <b>Philippine Central Depository Inc. is to establish a central depository system substantially in accordance with standards set by the Group of Thirty (core condition).</b>	Complied with. The central depository system was established in December 1997 to help modernize brokers' back-office systems resulting in significant efficiencies in the transfer of securities.	Complied with. The PSE has, however, indicated its intention to widen the Securities Clearing Corporation of the Philippines scope to include another clearing and settlement platform.
a. Arrange for the Department of Finance to conduct independent studies on the operations of mutual funds and preneed companies, and the rules, regulations, and policies governing them.	Substantially complied with, activity is ongoing. Studies on mutual fund and pre-need issues have already advanced into the stage where legislation has been proposed. For mutual funds, double taxation has been eliminated with the passage of the Comprehensive Tax Reform Law.	The Pre-Need Code and the Revised Investment Company Act are not past first reading nor does the president certify them as urgent. It is highly unlikely that their passage is forthcoming during the term of this Congress.

Policy Action	Status at Project Completion	Current Status of Outcomes
b. Implement the recommendations of the studies to improve the efficiency and transparency of the operations of mutual funds and pre-need companies.	Substantially complied with, activity is ongoing. Double taxation on mutual funds has been eliminated with the passage of the Comprehensive Tax Reform Law; and Senate Bill 152 entitled Revised Investment Company Act reflects major development including (i) prohibition of activities and relationships that could lead to conflict of interest, (ii) declaration of unlawful acts for the protection of public interest, (iii) prudential restrictions of portfolio management and financial structure, (iv) full disclosure of information, (v) reinforced supervisory functions of SEC, and (vi) self-regulation of industry association. Action on this reform measure has been satisfactorily initiated.	This has not been complied with except for tax relief measures on Mutual Funds.
c. The Government is to divest its equity shares in state-owned enterprises by public issues (if appropriate and if market conditions permit).	Substantially complied with. Ongoing activity. About ₱32 billion has been generated by public issues (i.e., the Philippine National Bank and Petron Corporation). Further privatization is expected as market conditions improve.	There have been no significant privatizations since the PCR. The two largest remaining privatizations, Manila Electric Company and National Power Corporation, are well short of finalization.
d. The Central Bank is to encourage commercial banks to raise equity by listing their shares and require a 10% listing to obtain a unibank license.	Substantially complied with. Ongoing activity. Board resolution dated 27 December 1997 requires expanded commercial banks to list at least 10% of their paid-up capital to broaden their ownership. To date, 15 of 21 universal banks have listed their shares.	Complied with. Agree with PCR. What is not evident, however, is the decline in the public float (the 10%) following the "listing."

## SECURITIES AND EXCHANGE COMMISSION REORGANIZATION

**Table A2.1: Staff Numbers Before and After Reorganization**

Details	Before	After	Change	%
Total Number of Positions	708	428	(280)	(40)
Number of Regular Departments	10	8	(2)	(20)
Number of Ad Hoc Departments	3	0	(3)	(100)
Number of Divisions	36	26	(10)	(28)
Number of Extension Offices	11	7	(4)	(36)
Number of Other/Special Offices	1	2	1	100

Source: Securities and Exchange Commission Annual Report 2000.

**Table A2.2: Changes in Structure**

Before Reorganization	After Reorganization
<ul style="list-style-type: none"> <li>• Brokers and Exchange Department</li> <li>• Money Market Operations Department</li> <li>• Pre-Need Ad Hoc</li> <li>• Supervisory and Monitoring Department</li> <li>• Examining and Appraisers Department</li> <li>• Corporate and Legal Department</li> <li>• Prosecution and Enforcement Department</li> <li>• Administration and Finance Department</li> <li>• Human Resources and Management Department</li> <li>• Investment and Research Department</li> <li>• Financial Management Department</li> <li>• Securities Investigation and Clearing Department</li> <li>• Executive Director</li> </ul>	<ul style="list-style-type: none"> <li>• Market Regulation Department</li> <li>• Corporation Finance Department</li> <li>• Non-Traditional Securities and Instruments Department</li> <li>• Company Registration and Monitoring Department</li> <li>• Compliance and Enforcement Department</li> <li>• Human Resources and Administrative Department</li> <li>• Economic Research and Information Department</li> <li>• Financial Management Department</li> <li>• Abolished</li> <li>• Abolished</li> </ul>

Source: Securities and Exchange Commission Annual Report 2000.