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CAPITAL MARKETS
REGULATION AND SUPERVISION

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GLOSSARY

AMLA: Anti-Money Laundering Act
AMLC: Anti-Money Laundering Council
CMIC: Capital Markets Integrity Corporation
CIS: Collective Investment Schemes
CRA: Credit rating agency
DOF: Department of Finance
FSCC: Financial Stability Coordination Council
FSF: Financial Sector Forum
IAS: International Accounting Standards
IC: Insurance Commission
IFRS: International Financial Reporting Standards
IPO: Initial Public Offering
IOSCO: International Organization of Securities Commissions
MOU: Memorandum of Understanding
MMOU: IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information
NAV: Net Asset Value
NGO: Non-governmental organization
PDX: Philippine Dealing System Exchange Corporation
PDIC: Philippine Deposit Insurance Corporation
PSE: Philippine Stock Exchange
RCC: Revised Corporate Code
SCCP: Securities Clearing Corporation of the Philippines
SEC: Securities and Exchange Commission
SPV: Special Purpose Vehicle
SRC: Securities Regulatory Code
SRO: Self-regulatory organization
UITF: Unit Investment Trust Fund
VUL: Variable Universal Life insurance

EXECUTIVE SUMMARY[1]

1. The Securities and Exchange Commission (SEC) is the main regulator of the capital market in the Philippines, but its resources are insufficient to adequately address its core functions, especially the supervision of capital market participants, and yet it has to address other legal responsibilities unrelated to capital markets. The SEC budget is subject to approval by the Budget and Management Department and Congress. Budgetary funding comes from fees and fines it receives in pursuance of its regulatory functions. However, over the years, the SEC's authorized total expenditures have been less than the revenues collected, seriously affecting its ability to hire more personnel and fulfill its legal mandates. Other SEC responsibilities include registration of all corporations organized and/or doing business in the Philippines, registration of issuers' proprietary and non-proprietary club shares and membership or timesharing certificates, as well as registration and supervision of financing and leasing companies, lending companies, foundations and microfinance non-government organizations (NGOs). This task multiplicity has further intensified budgetary limitations to allocate the necessary resources to core capital market supervisory functions. There are only 14 staff members with direct or indirect oversight responsibility over 616 capital market participants. It is necessary to increase SEC's budget to have optimal staffing in number and qualifications. Yet, even if this were achieved, the focus on capital markets at the highest level of the organization would still be compromised, as Commissioners must devote time to address other legal mandates, which may be pressing at certain times and may lead to neglect some of its capital market responsibilities. Fewer legal obligations for the SEC would contribute to strengthen its focus on capital markets. Registration of corporations will continue to be a critical source of revenues for the SEC, but other functions, such as those related to registration of club shares and timesharing certificates, microfinance NGOs, foundations, lending companies, financing and leasing companies, could be transferred to other government agencies with less budgetary restrictions.

2. Other agencies also have capital market regulatory responsibilities, creating a fragmented regulatory framework that causes inconsistencies detrimental to the market and to investors' protection. The Central Bank (BSP) regulates, registers, supervises and enforces penalties on Unit Investment Trust Funds (UITF), a type of collective investment scheme (CIS) offered

[1] This Technical Note has been prepared by Eddy Rodríguez, external consultant for the WBG, as part of the assessment under the Financial Sector Assessment Program (FSAP) for Philippines conducted by an IMF and a World Bank (WB) team during June 1-21, 2019. This was a two-step full FSAP with the WB mission and the joint IMF-WB Basel Core Principles (BCP) for Effective Banking Supervision assessment mission taking place during June-July, 2019, prior to the IMF missions. In addition, the WB mission and the joint IMF-WB BCP assessment mission predated the outbreak of the global COVID-19 pandemic. The WB Technical Notes and the BCP Detailed Assessment of Observance have not been updated, but the FSA reflects the relevant policy reforms undertaken since the WB mission, and the findings and recommendations remain pertinent in light of the COVID-19 developments.

and distributed by banks, which are similar to mutual funds regulated by the SEC. The BSP also supervises investment houses with quasi-banking operations, banks with licenses as underwriters, government securities dealers and transfer agents, as well as investment banks, underwriters and brokerage houses that are part of banking groups. BSP conducts prudential and conduct supervision, including anti-money laundering (AML), suitability, conflicts of interest, frontrunning, best execution and insider trading and any relevant SEC rules. The Insurance Commission (IC) regulates and supervises Variable Unit-linked Insurance, also known as Variable Universal Life insurance (VUL), a CIS offered by insurance companies, a life insurance product that is similar to UITFs and mutual fund. The Capital Markets Integrity Corporation (CMIC), which is a self-regulatory organization (SRO) of the Philippine Stock Exchange (PSE) checks compliance of PSE broker/dealers with prudential regulations, AML rules, the PSE requirements and other SEC rules and regulations. This institutional arrangement has created:

a. An overlap in the scope of supervision of the SEC, CMIC and BSP. SEC oversees all capital market intermediaries, CMIC oversees PSE brokers, and BSP oversees any type of intermediary that is a bank or part of a banking group. In practice, both CMIC and BSP check compliance with prudential regulations, AML rules, and SEC rules and regulations. Despite the dire limitations of personnel assigned to supervision, SEC has been examining compliance with AML as well.

b. An unlevel playing field and supervisory gaps for some categories of market participants. Underwriters that are part of banking groups and investment houses with quasi-banking operations are subject to BSP supervision and, as such, they are thoroughly examined, whereas other underwriters/investment houses are supervised by SEC alone that has only examined AML in the past few years.

c. Regulatory arbitrage and enforcement gaps in collective investment schemes (CIS). Prospectuses of mutual funds provide enough information for investor protection but offering documents of UITFs and VULs lack some important aspects, such as information on pricing methodology of asset valuation, names and background of CIS managers, and policies for handling customer's complaints. Supervision by SEC and IC is weaker than BSP's in terms of methodology and coverage as both entities lack adequate resources. However, BSP does not have specific penalties applicable to CIS operation and, consequently, reprimands are often the only penalty imposed. Both, SEC and IC, have specific penalties applicable to CIS and CIS operators and the capacity to impose them. A draft bill intended to address CIS arbitrage was sent to Congress, but it has not been approved yet after 9 years.

A Financial Sector Forum (FSF) was created 15 years ago by BSP, IC, the Philippine Deposit Insurance Corp. (PDIC) and the SEC to provide an institutionalized framework for coordinating the supervision and regulation of the financial system. No initiatives have been taken to address the issues mentioned above yet.

3. The existence of regulatory arbitrage, supervisory overlaps and enforcement gaps evidences the need for an active periodic procedure with other financial system regulators to coordinate supervision activities and review unregulated products, markets, market participants and activities. It should include information sharing and analysis of areas where there may be arbitrage, overlap, gaps and risks to investor protection and market fairness, efficiency and transparency or other risks to the financial system. Such procedure would support the tasks of emerging risk identification and systemic risk management of the Financial Stability Coordination Council (FSCC), which is integrated by the heads of the BSP, the Department of Finance (DOF), IC, PDIC, and the SEC.

4. A clear and consistent risk-based approach for the SEC supervision of capital market intermediaries is needed. The current thematic approach appears to be rather ad hoc. A formalized methodology would provide a consistent basis for setting priorities and actions for both, off-site and on-site supervision, while taking into consideration supervision by CMIC and BSP. Furthermore, requirement of hard copies of periodic and disclosure reports for off-site supervision to be used by the Markets and Intermediaries Division puts an additional burden on its staff that must create digital versions for proper analysis. Automation of reporting requirements and monitoring procedures would enhance efficiency, improving supervision.

5. The bank secrecy legislation of Philippines impedes prompt access by the SEC to bank account information. The SEC can indirectly obtain bank records through the Anti-Money Laundering Council (AMLC)[2] that can file a petition for bank inquiry with the Court of Appeals setting out probable cause that the money or investment is related in any way to any of the unlawful activities, including violations of the Securities Regulatory Code (SRC) such as market abuse. The procedure affects the effectiveness of supervision of markets and market participants, as well as the possibility of taking swift actions to prevent further damage or to ensure the recovery of funds. This legislation also affects cooperation with foreign counterparts and SEC´s ability to become a full signatory to the IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information (MMOU).

[2] The AMLC is made up of the heads of BSP, SEC and IC.

RECOMMENDATIONS

Action	Responsible	Time frame
General		
Increase budget allocation to SEC core functions, especially supervision	SEC	Short term
Amend the bank secrecy legislation of Philippines to enhance supervision powers and cooperation with foreign authorities	Congress	Long term
Capital Markets Regulatory and Supervisory Framework		
Adopt a risk-based approach to all activities related to monitoring, supervision and surveillance.	SEC	Short term
Increase as needed the number of SEC personnel in the related departments, hiring more people with business practitioner's knowledge and providing appropriate training.	SEC	Short term
Streamline SEC focus on capital markets. Transfer responsibilities related to registration of club shares and timesharing certificates, microfinance NGOs, foundations, lending companies, financing and leasing companies to other government agencies.	Congress	Long term
Introduce Commissioners' qualifications related to capital markets expertise and adopt a selection process for the appointment of Commissioners. Require a due diligence process with clear criteria for the removal of Commissioners	Congress	Long term
Require "due" instead of "extraordinary" diligence as criteria for staff protection from lawsuits in the bona fide discharge of their duties	Congress	Long term
Adopt an organization-wide policy to accept requests for interpretations in writing-only, create a follow-up control mechanism, and publish interpretations to benefit market as a whole.	SEC	Short term
Cooperation in regulation and supervision		
Harmonize regulation and coordinate supervision and enforcement of CIS across responsible supervisory agencies.	FSF	Short term
Coordinate the scope of inspections of investment houses with quasi-banking operations, banks or their subsidiaries that provide capital market intermediation services	SEC - BSP	Short term
Activate a procedure with other financial system regulators to review unregulated products, markets, market participants and activities, including assessing the potential for regulatory arbitrage	FSCC	Short term
Securities issuer registration and monitoring		
Coordinate with PSE supervision of registration and listing requirements to avoid overlaps	SEC-PSE	Short term

Review the suitability of some debt registration requirements, such as those on market price of equity and dividends, and compliance with corporate governance rules	SEC	Short term
Automate the registration and the subsequent monitoring procedures	SEC	Medium term
Introduce a prospectus summary with the characteristics of the instrument, risk disclosures, financial information and main issuer characteristics	SEC	Medium term
Introduce additional guidance for applicants on risk disclosure	SEC	Short term
Introduce a risk-based approach to registration and monitoring of registered companies to expedite the processes	SEC	Medium term
Information to market		
Modify Corporate Governance Rules to require the adoption of policies regarding inside information (awareness, registry of insiders)	SEC	Medium term
Implement examinations of credit rating agencies and ensure compliance with separation of business relationships from rating processes, especially in ratings committees	SEC	Short term
Increase personnel of the General Accounting Office for adequate supervision of external auditors and credit rating agencies	SEC	Short term
Review credit rating agency regulations to analyze options to enhance independence such as limits on income concentration from a single client	SEC	Medium term
Market intermediaries		
Increase personnel of the Market and Intermediaries Division, hiring staff with securities market practitioner's knowledge	SEC	Short term
Enhance business conduct supervision, changing routines from compliance-based to risk-based and hiring staff with practitioner's knowledge	SEC-CMIC	Medium term
Automate compliance of reporting requirements and monitoring	SEC	Medium term
Enforce consistently brokers' minimum capital requirements	SEC	Short term
Coordinate scope of supervision of capital market intermediaries	SEC-CMIC-BSP	Short term
Collective investment schemes		
Harmonize CIS regulation and supervision methodologies, and coordinate enforcement of penalties between BSP and SEC to the extent that is legally possible.	FSF (SEC-BSP-IC)	Short term
Approve CIS draft bill to eliminate regulatory arbitrage and to adopt a single-step registration process for mutual funds	Congress	Medium term
Ensure that all CIS managers use an appropriate and consistent methodology when market prices are not available at the measurement date	SEC-BSP-IC	Long term

Market structures and surveillance		
Review pre-trade information requirements (Brokers' IDs)	SEC - PSE	Short term
Consider replacing the auction mechanism at the close for a "random close"	SEC - PSE	Short term
Enforcement and investigation		
Adopt a risk-based approach to market surveillance consistent with supervision of market intermediaries	SEC-Congress	Short term
Consider the use of press releases and other means to inform the public	SEC	Short term

I. CAPITAL MARKETS REGULATORY AND SUPERVISORY FRAMEWORK

6. The SEC is the main regulator of the capital markets but has also been assigned other unrelated functions. The Commission mandate includes powers of licensing, supervision, inspection, investigation and enforcement for capital market participants, including brokers and dealers in securities, investment houses/underwriters of securities including derivatives, open/close-end investment companies, investment company advisers/fund managers, mutual fund distributors, exchanges, clearing houses, depositories, SROs, and transfer agents. The SEC also has the authority to issue a primary license[3] in the formation of any legal entity in the country, acting as the national registrar of all corporations organized and/or doing business in the Philippines. There are around 800,000 registered companies for which the SEC has to monitor compliance with the annual report requirements. This role also entails other responsibilities, including preventing imminent fraud or injury to the public in general, not just related to capital market activities. Other SEC responsibilities include registration of issuers' proprietary and non-proprietary club shares and membership or timesharing certificates (94), as well as the registration and supervision of financing and leasing companies (707), lending companies (2783), foundations (14,055) and microfinance non-government organizations (127).

7. The broad range of responsibilities is unusual for a capital market regulator and restricts the resources dedicated to core supervisory functions. The SEC budget is subject to approval by the Budget and Management Department and Congress. Budgetary funding comes from fees and fines it receives in pursuance of its regulatory functions, mainly from acting as a corporation registrar. However, over the years, the SEC's authorized total expenditures have been less than the revenues collected, seriously affecting its ability to hire more personnel[4] and fulfill its mandate over capital market participants, particularly the supervision of their activities. The focus on capital markets also is compromised at the highest level of the organization as Commissioners must devote time to address the SEC's other legal mandates, which may be pressing at certain times and may lead to neglect some of its core capital market responsibilities. For example, as a company registrar, the SEC is in charge of imposing penalties for violations of the Revised Corporation Code, which requires policing fraudulent activities by registered companies. Fewer legal responsibilities for the SEC would contribute to strengthening its focus on capital markets. The fees from registration of corporations will continue to

[3] Initial registration of any corporation. Registration for any securities market activities is deemed a secondary license.

[4] Although lower than BSP salaries, SEC appear to be competitive to attract qualified personnel but not enough to attract securities l market practitioners.

be critical for the SEC as long as the sources of revenue from capital market participants remain insufficient, but other functions, such as those related to microfinance NGOs, foundations, lending companies, financing and leasing companies, could be transferred to other government agencies. International experience regarding supervision of foundations shows a diversity of supervisory bodies, from local governments to ministries of central governments to comptrollers of public accounts. Supervision of microfinance NGOs, lending companies, and financing and leasing companies could be transferred to other agencies with less budgetary restrictions.

8. On a day-to-day basis, the Commission operates without interference from political, commercial or other sectoral interests, but SEC's governance faces limitations. Commissioners are chosen by the President based upon general qualifications and only serve for a single fixed term. Furthermore, there are no criteria for their removal. Introducing qualifications related to capital markets expertise and a selection process in which potential candidates may participate would strengthen SEC independence and capacity at the top of the SEC. Adopting a due diligence process with clear criteria for the removal of Commissioners based on integrity or performance failures would serve to consolidate SEC independence, complying with IOSCO Principles. The SEC is accountable to the President and Congress. Additionally, the SEC is attached to the DOF, which means that the Commission must coordinate policies and programs in a lateral relationship, not subordinated to DOF.

9. Importantly, SEC resources are insufficient to adequately address all its legal responsibilities, especially those related to capital markets. This is particularly evident and worrisome in the supervision of capital market participants. In total, the SEC has around 400 staff[5], but there are only 14 with direct or indirect oversight responsibility over 616 market participants, including 146 broker/dealers (in two exchanges), 48 bank-dealers in government securities, 22 transfer agents, 12 underwriters, 12 CIS managers, 7 accredited surety companies, 2 exchanges, 1 clearing house, 2 securities depositories, 4 SROs, 21 registrars of qualified buyers, 1 operator of an alternative trading system, 27 investment houses, 12 mutual fund distributors, 25 unlisted public companies and 274 publicly listed companies. The SEC has tried to address this weakness through supervisory reviews in the registration processes and through supervision by SROs and BSP, as mentioned further below. However, in terms of supervision coverage the optimal solution is to increase the number of personnel, hiring more people with securities market practitioner's knowledge for which higher salaries might be necessary, while providing appropriate training and implementing a risk-based supervision approach.

[5] Staff of the main functional areas: Company Registration and Monitoring 80, Investment Products and Services 13, Economic Research 24, Enforcement and Investigation 50, Securities Registration 12, General Accountant 22.

10. SEC Commissioners, officers and employees are subject to rules to ensure avoidance of conflicts of interest and there are mechanisms to protect them in the bona fide discharge of their functions although this can be refined. The Securities Regulation Code (SRC) provides a non-exhaustive list of situations that represent conflicts of interest. These rules apply to officers' spouses and children. In addition, they have to report any situation, which could be regarded as being of possible concern to the Commission. There are also rules to prevent disclosure of any information, discussion or resolution of the Commission of a confidential nature. Commissioners and staff have the right to be indemnified -in advance- in case of any civil or criminal actions, suits or proceedings to which they may be made a party, unless they are found guilty of negligence, abuse or acts of malfeasance or fail to exercise extraordinary diligence in the performance of their duties. This, however, requires them to show "extraordinary diligence", which is not legally defined, therefore difficult to prove and might not be perceived as adequate protection by SEC staff. Requiring just "due diligence", a concept based on standard procedures and job descriptions, is most often used in other jurisdictions in case of lawsuits.

11. The SEC has a process for public consultation for new rules, but the handling of requests for interpretations raises risks that need to be addressed. As part of the approval of new rules, the SEC conducts a regulatory impact assessment. Once the Commissioners approve the rules, there is a period of public consultation. If, based on the comments received, some changes are introduced, then the revised version of the rules is sent for public consultation again[6]. The SEC is required to give reasons in writing for its decisions, final orders, and resolutions and these are subject to review by the Judiciary System. Some requests for interpretations are received and addressed verbally, which poses a risk for the organization. There is no central registry for requests for interpretations addressed to SEC departments and divisions. Apparently, SEC responses to requests for interpretations may take months or even years. . To provide timely interpretations of rules and requirements requested by market participants and to avoid informal over-the-phone staff opinions, which could be inconsistent, SEC should adopt an organization-wide policy to accept only requests for interpretations in writing, create a follow-up control mechanism, and publish interpretations for the benefit of the whole market.

[6] All relevant legislative and regulatory documents for market participants are downloadable from the SEC website and from open sources in the internet such as from the website of the Official Gazette, https://www.officialgazette.gov.ph/

Recommendations

Increase budget allocation to SEC core functions, especially supervision

Adopt a risk-based approach to all activities related to monitoring, supervision and surveillance, and then increase as needed the number of SEC personnel in the related departments, hiring more people with securities market practitioner's knowledge and providing appropriate training.

Streamline SEC focus on capital markets. Transfer responsibilities related to registration of club shares and timesharing certificates, microfinance NGOs, foundations, lending companies, financing and leasing companies to other government agencies.

Introduce Commissioners' qualifications related to capital markets expertise and adopt a selection process for the appointment of Commissioners. Require a due diligence process and with clear criteria for the removal of Commissioners

Require "due" instead of "extraordinary" diligence as criteria for staff protection from lawsuits in the bona fide discharge of their duties

Adopt an organization-wide policy to accept requests for interpretations in writing-only and create a follow-up control mechanism

II. COOPERATION IN REGULATION AND SUPERVISION

12. Other government agencies and SROs are also involved in the regulation and supervision of capital markets. Both the BSP and IC supervise aspects of the capital markets. BSP regulates, registers, supervises and enforces penalties on UITFs, a type of CIS offered and distributed by banks that are similar to mutual funds under the SEC's jurisdiction. The BSP also supervises investment houses with quasi-banking operations, banks with licenses as underwriters, government securities dealers and transfer agents, as well as investment banks, underwriters and brokerage houses that are part of banking groups. BSP conducts prudential and conduct supervision, including AML, suitability, conflicts of interest, frontrunning, best execution and insider trading. IC regulates and supervises VULs, which are CIS offered by insurance companies, a life insurance product that is similar to UITFs and mutual funds.

13. There is a Forum and related Memoranda of Agreements to coordinate activities among the relevant government agencies. In 2004, the FSF was created, by BSP, IC, PDIC and SEC to provide an institutionalized framework for coordinating the supervision and regulation of the financial system. In this forum, agencies are expected to update each other on the latest developments in their respective industries and on any concerns that may have systemic repercussions. Additionally, BSP, DOF, IC, PDIC, and SEC signed a Memorandum of Agreement formalizing the creation of the FSCC, whose key objective is to identify, manage and mitigate the buildup of systemic risks. This Council

created the SEC Financial Crisis Management and Resolution (FCMR) Core Group. The tasks of this group are to confirm a crisis situation as identified/reported by the SEC FCMR Technical Working Group; make the final decision on the necessary responses and policies to mitigate the systemic effect of identified financial crisis situation; and, make recommendations to the Governing Boards of the FSCC – member agencies to implement promptly the identified crisis management responses and policies. The SEC has drafted a Financial Crisis Management and Resolution Manual, which is a consolidation of relevant SEC Standard Operating Procedures for monitoring and surveillance during normal times and lays down the framework for crisis management and resolution in order to ensure coordinated efforts within the SEC as well as with other agencies.

14. Nevertheless, there exist regulatory arbitrage opportunities, supervisory overlaps and enforcement gaps that the FSF and MOAs need to address promptly. UITFs, mutual funds, and VULs are all CIS, but with different regulators, regulations, taxation, supervision, and enforcement rules (explained in more detailed below). These differences create ample arbitrage opportunities. Additionally, the legal framework for UITFs does not provide adequate sanctions for CIS, creating an enforcement gap. A draft bill intended to address CIS arbitrage was sent to Congress, but it has not been approved yet after 9 years and it may take a few more years. On the other hand, the FSF, which was created to address situations like these, can take steps to harmonize regulation and coordinate supervision and enforcement of CIS. Another coordination issue is the overlap in the scope of inspections of investment houses with quasi-banking operations, and banks and their subsidiaries that provide capital market intermediation services. BSP regularly conducts thorough examinations that include compliance with AML regulations. Yet, despite its limited resources, SEC also has conducted examinations of compliance with AML rules by market intermediaries, including those that are subject to BSP supervision as well, while allowing an unlevel playing field in other aspects of supervision. For example, underwriters/investment houses that are subject to BSP supervision are thoroughly examined whereas those supervised by SEC are not. This is an issue that should be addressed bilaterally between the SEC and BSP to avoid possible overlaps and ensure consistent application of regulations.

15. There is also a need for a periodic procedure with other financial system regulators regarding the perimeter of regulation[7]. This would entail a review of unregulated products, markets, market participants and activities, including the potential for regulatory arbitrage, so as to identify and assess possible risks to investor protection and market fairness, efficiency and transparency or other risks to the financial system. Such a process would strengthen emerging risk identification and, consequently, systemic risk management. In addition, as mentioned before, there is a clear need for

[7] IOSCO Principle 7.

skilled human and adequate technical resources at the SEC, especially in the supervision of capital market intermediaries, which is a necessary condition for effective systemic risk identification and management at the SEC.

16. The Philippine Bank Secrecy Law prevents the SEC from having direct access to bank records, limiting the effectiveness of supervision and the possibility of taking swift actions to prevent further damage or to ensure recovery of funds. If there is a presumed violation of the SRC, under Rules 11 and 3 h of the Anti-Money Laundering Act the SEC can obtain the necessary bank records through the AMLC, composed of the Governor of BSP as Chairman, the Chairperson of SEC and the Commissioner of the IC. The AMLC can file a petition for bank inquiry with the Court of Appeals, setting out probable cause that the money or investment is related in any way to any of the unlawful activities/predicate crimes. These include violations of the securities laws of a foreign authority. The proceedings of the Court of Appeals are confidential, ex-parte (not communicated to related parties), and summary in nature (24 hours to decide). However, this procedure affects the timeliness of an investigation and hampers the possibility of taking immediate actions to prevent further damage or ensure the recovery of funds.

17. This legislation also affects cooperation with foreign counterparts and SEC´s ability to become a signatory of Appendix A of the IOSCO MMoU. The SEC has bilateral MOUs on exchange of information with: (1) BAPEPAM or Indonesia Capital Market and Financial Institution Supervisory Agency signed in Manila on 5 June 2002; (2) Securities and Futures Commission of Hong Kong signed in Singapore on 25 November 2004; and (3) Securities and Exchange Organization of Iran signed in Manila on 25 March 2010. The SEC has not become yet an Appendix A signatory to the IOSCO MMoU, because of past limitations to share information on bank accounts. However, the SEC has been able to provide information as requested by foreign regulators based on bilateral MOUs and the IOSCO's MMoU.[8]

[8] Some of which are: US Securities and Exchange Commission request for bank information in September 2016; Australian Securities and Investment Commission referral in October 2016 for SEC's appropriate action with respect to its investigation of Titan Trade, Allianz Metro Party; Financial Supervisory Authority of Sweden on March 8, 2017 request for information on a Filipino individual as part of its fit and proper and prudential assessment requirements; Securities and Futures Commission of Hong Kong referral for appropriate action with respect to its investigation of a Filipino individual who apparently was engaged in internet-based boiler room operation promoting pre-IPO shares; Securities and Exchange Board of India request for information regarding the registration of a company listed in India.

Recommendations

Harmonize regulation and coordinate supervision and enforcement of CIS.

Coordinate the scope of inspections of investment houses with quasi-banking operations, and banks and their subsidiaries that provide capital market intermediation services

Activate a procedure with other financial system regulators to regularly review unregulated products, markets, market participants and activities, including the potential for regulatory arbitrage

Amend the bank secrecy legislation of the Philippines to allow proper supervision powers, information sharing and related cooperation with foreign authorities

III. SECURITIES REGISTRATION AND MONITORING

18. Public offering of securities in the Philippines requires registration with the SEC. Exemptions to this obligation include debt instruments issued by a banks or investment houses with quasi-banking operations, securities issued by BSP, bills of exchange from a bona fide sale of goods and services, securities issued or guaranteed by multilateral financial entities, and debt instruments issued to not more than 19 non-institutional lenders, or payable to a single person, or neither negotiable nor assignable and held on to maturity, or in an mount not exceeding Php150 millions (US$2,9 millions). Also exempted are offers or sales of securities to qualified investors, which include institutional investors and persons with high net worth, experience and knowledge. For those instruments subject to registration, except for dilution and description of securities, there are practically no differences between the SEC disclosure requirements for registration of equity and debt instruments.

19. Registration requirements, particularly disclosures, for debt instruments may be streamlined as they do not need to be as stringent as those for equity. Registration requirements, including the prospectus contents, are practically the same for equity and debt. Information requirements such as those on "market price of and dividends on registrant's common equity and related stockholder matters" and compliance with corporate governance rules may be simplified. All applicants for securities registration must file a Registration Statement that includes 5 hard copies of the prospectus and information on other expenses of issuance and distribution, exhibits and additional disclosures. A prospectus must include risk factors, use of proceeds, determination of offering price, dilution, selling security holders, plan of distribution, description of securities to be registered, interests of named experts and independent counsel, information with respect to the Registrant, and financial information. The regulatory requirement of risk factors just mentions a few examples: "absence of operating history of the registrant, no recent profit from operations, poor

financial position, the kind of business in which the registrant is engaged or proposes to engage, or no market for the registrant's securities". The company is expected to explain these and other risks and describe how these risks are managed. The SEC allows delayed and continuous offering and sale of securities (shelf registration). Securities may be registered following this procedure for a period not exceeding three (3) years from the effective date of the registration statement.

20. The use of hard copies in the registration and listing processes makes them less efficient and less environmentally friendly. Filing for registration using hard copies takes longer than on-line registration would take. Additionally, in the case of the SEC hard copies need to be scanned, consuming time from staff and limiting subsequent use of digital analysis tools that could expedite the process. Finally, the presentation of 5 copies of the SEC Registration Statement and 2 copies of the Listing Requirement, including 25 copies of the prospectus, could mean several thousand sheets of paper, which are probably not necessary. Automation of the registration and the subsequent monitoring procedures would enhance efficiency and reduce processing time.

21. The current approach does not facilitate proper assessment of risks and other relevant aspects by an investor. Prospectuses and accompanying documents may be several hundred pages long, making a difficult reading for investors. A separate summary with the characteristics of the instrument, risk disclosures, financial information and main issuer characteristics and disclosures could be used to facilitate reading and understanding by investors. Risk disclosure requirements do not distinguish between risks of the security (liquidity, market, credit) and risks related to the issuer: strategic risks (business risks, market risks, etc.), operational risks (information technology, legal, reputational, etc.) and financial risks. Further guidance to applicants on risk disclosure could lead to better investor protection.

22. The Commission must declare effective or reject the Registration Statement within 45 days, a limit that does not appear to be followed in practice. Through this period, the SEC may send one or more Letters of Comments to the applicant. Once the applicant's responses to the Letter of Comments are received, a new 45-day period starts. The SEC may issue another Letter of Comments, which may be related to responses from the applicant or to other aspects of the initial Registration Statement not mentioned in the first Letter. Upon receiving a new response from the applicant, a new 45-day period begins. In the case of initial public offerings (IPOs), the registration could take up to a year. In general, it may take 3 to 4 months, but in the case of seasoned issuers it may last two months. The time limit should be interpreted as a single 45-day period, excluding the waiting periods, to effectively make it a binding limit. Otherwise, market participants may interpret that the regulator does not comply with its own legal obligations.

23. Overall, the registration process is considered by the SEC as an opportunity to conduct an in-depth review of the issuance application and the applicant but strengthening monitoring of on-going reporting and disclosure requirements would be more appropriate. Apparently, this approach has been adopted to address weaknesses in the on-going monitoring of issuers. Although this approach appears reasonable, it delays the registration process, the optimal solution is to strengthen SEC's supervisory capacity. Additionally, SEC may introduce a risk-based approach to registration and monitoring of registered companies, based on the issuer's track record to expedite some aspects of the review process, phasing out in-depth registration reviews.

24. PSE conducts a thorough review of all listing application documents, even though they are also reviewed by SEC. The PSE listing process states that approval or rejection should not take less than 20 working days and not more than 30 working days, excluding waiting periods. The application with PSE must be filed at the same time as the application with SEC. There are 42 application requirements in an IPO application process, which could be streamlined in coordination with the SEC (see Box 1) as a good number of these, including requirements 2-7, 17-23, 25-26, and 31-33 are already included in the application to be registered by SEC or are parts of the approval records of the SEC. Two hard-copies and one digital version of all application documents must be presented for the listing process. The red herring or preliminary prospectus should be submitted in 25 copies 7 calendar days prior to its presentation to the PSE Board of Directors.

Box 1. PSE listing application requirements for an IPO

1. Listing application:
    - Application for Listing of Stocks,
    - Agreement with Registrar or Transfer Agent,
    - Distribution of Capital Stock of Corporation to its Stockholders, and
    - Listing Agreement
2. SEC certified true copies of the following:
    - Articles of Incorporation and By-Laws and the Certificate of Filing of Articles of Incorporation;
    - Latest Amended Articles of Incorporation and Amended By-Laws, if any, and the corresponding Certificate of Filing of Amended Articles of Incorporation and Amended By-Laws;
    - Certificate of Increase in Capital Stock, if any;
    - General Information Sheet
    - Pre-effective Clearance authorizing the issuance of the Registration and Licensing Order and Permit to Offer Securities for Sale; and
    - Registration and Licensing Order and Permit to Offer Securities for Sale
3. SEC certified true copy of the Applicant Company's latest Amended Articles of Incorporation
4. Sworn Corporate Secretary's Certificate of Increase in Authorized Capital Stock, if applicable.
5. Notarized Treasurer's affidavit showing the full payment of the issued and outstanding shares.
6. Sworn Corporate Secretary's Certificate stating:

a) All necessary and applicable taxes relevant to the issuance of the Applicant Company's issued and outstanding shares (pre-initial public offering) have been paid;
b) All necessary conditions and corporate approval for the proper and valid issuance of the Applicant Company's issued and outstanding shares (pre-initial public offering) have been obtained;
c) All necessary actions have been taken by the Applicant Company to ensure compliance with existing laws and issuances of regulatory bodies, including but not limited to the Securities Regulation Code, its implementing rules and regulations and the Corporation Code; and
d) No other actions are required in order to effect the validity and effectiveness of the issuance of the Applicant Company's issued and outstanding shares (pre-initial public offering).

7. Certified true copy of the Registration Statement filed with and duly received by the SEC.
8. Banks should submit:
   - A copy of the Applicant Company's letter to the BSP informing the latter of the former's initial public offering; and
   - A certified true copy of BSP's letter informing the Applicant Company of the formal action taken by BSP.
9. Affidavit of the newspaper publisher on the fact of publication as required under the Securities Regulation Code and pertinent laws.
10. Offer Terms Sheet signed by the authorized signatory of the Applicant Company.
11. Detailed Timetable of Activities for the Applicant Company's initial public offering.
12. Sworn Corporate Secretary's Certificate on the following:
    a) Approval by the board of directors and by the stockholders of the initial public offering;
    b) The Applicant Company's total number of shares issued (indicate if there are treasury shares);
    c) The Applicant Company's total number of shares outstanding;
    d) The percentage of ownership of Filipino citizens and alien shareholders;
    e) The Applicant Company has no subscriptions receivable at the time of the filing of the application;
    f) The total number of holders or recipients of options, if any, showing the nature, total number of shares, the price, manner of payment, and basis of grant. If there is none, the Applicant Company shall submit a sworn undertaking that should the same be granted in the future, the Exchange and the SEC shall be immediately informed of the details of the option upon approval by the board of directors;
    g) List of officers and members of the Applicant Company's board of directors indicating therein the date of the last regular stockholders' meeting when they were elected and the date of any subsequent special stockholders' meeting held;
    h) List of shareholdings of each of the Applicant Company's officers and directors and their related parties, indicating therein their percentage of ownership, and amount paid up **before** the initial public offering;
    i) List of shareholders prior to the initial public offering subject to the lockup requirement indicating the number of shares, percentage owned and lock-up period;
    j) Dividend declaration history of the Applicant Company during each of the three (3) fiscal years immediately preceding the filing of the listing application, indicating therein the year, rate of dividend, record date and amount paid, with corresponding details of any waiver of dividend in such years;
    k) History of issuances and subscriptions of shares from the time of incorporation, indicating therein the date, nature, number of shares issued, investors and the respective number of shares subscribed, amount paid by each and date of full payment; and

l) List of stockholders indicating therein their respective number of shareholdings, percentage ownership, and amount paid up **before** the initial public offering.

13. Sworn Transfer Agent's Certification to the effect that, upon filing of application for listing:

a) It has no backlog in the transfer and registration of the shares of the Applicant Company; and

b) It has the capability and capacity to handle the issuance and transfer of uncertificated securities.

14. Sworn Undertaking from the Corporate Secretary that the Applicant Company shall hold itself jointly and severally liable for all acts of its Transfer Agent in relation to the Applicant Company's shares.

15. An external legal counsel's opinion stating that all applicable permits and licenses of the Applicant Company and its subsidiaries (if applicable) are valid and subsisting.

16. Background on its top 20 stockholders. In case of corporate stockholders indicate its nature of business, capital structure (subscribed and paid-up), ownership structure, board of directors and key officers.

17. Audited financial statements for the last three (3) fiscal years of the Applicant Company and its subsidiaries. Such financial statements must be accompanied by an unqualified external auditor's opinion.

18. For a newly formed holding company which uses the operational track record of its subsidiary, audited financial statements for the last three (3) fiscal years of the subsidiary. Such financial statements must be accompanied by an unqualified external auditor's opinion.

19. Interim financial statements as of fiscal quarter immediately preceding the filing of the listing application, in accordance with the requirements of the Securities Regulation Code.

20. Offering Prospectus prepared in compliance with the requirements of the Securities Regulation Code.

21. Detailed work program of the application of the proceeds, the corresponding timetable of disbursements and status of each project included in the work program. For debt retirement application, state which projects were financed by debt being retired, the project cost, amount of project financed by debt and financing sources for the remaining cost of the project.

22. Basis and/or computation of the offer price range as required under the Securities Regulation Code.

23. Copies of all material contracts entered into by the Applicant Company for the past two (2) years immediately preceding the filing of the listing application with a tabular summary indicating therein the date, type of considerations received by the Applicant Company).

24. When required by the Exchange, the Applicant Company shall engage the services of an independent appraiser duly accredited by the Exchange and the Commission in determining the value of their assets.

25. Certified true copy of the mandate letter of the Underwriter.

26. Sworn Undertaking from the Issue Managers and Underwriters manifesting their conformity to comply with and be bound by all the applicable listing and disclosure rules, requirements and policies of PSE in relation to the initial public offering of the Applicant Company.

27. Sworn Corporate Secretary's Certification on:

i. All pending material legal cases in which the Applicant Company is a party or has an interest therein before any judicial, quasi-judicial, administrative or regulatory body/entity. The Certification should state the following minimum information: case title, names of the parties, case number, judicial, quasi-judicial, administrative, executive or regulatory body entity where the case is filed, nature of the case, brief description of the facts and issues involved, amount involved (if applicable) and current status; and

ii. Reason(s) why the Applicant Company should not be disqualified from listing with the Exchange, in view of the legal cases stated above.

28. Sworn Corporate Secretary's Certification on the compliance by the Applicant Company and all of its directors, officers, promoters and/or control persons with each of the provisions under Article I, Part B of the Revised Listing Rules concerning the grounds for disqualification from listing of securities ("Suitability Rule").

30. Sworn Certification from each director, officer, promoter and/or control person:

i. On all pending material legal cases filed by or against said director or officer or any business in which he is a director, officer, promoter and/or control person, before any judicial, quasi-judicial, administrative, information: case title, names of the parties, case no., judicial, quasi-judicial, executive, administrative or regulatory body/entity where the case is filed, nature of the case, brief description of the facts and issues involved, amount involved (if applicable) and current status; and

ii. Reason(s) why the Applicant Company should not be disqualified from listing with the Exchange despite the existence of any of the foregoing circumstance/s.

31. Sworn undertaking of the highest-ranking corporate officer and Corporate Secretary to disclose to the Exchange within twenty-four (24) hours from the Applicant Company's knowledge of any material information, corporate act, development or event which would reasonably be expected to affect investors' decision in relation to the subscription to the Applicant Company's securities that transpired from the date of filing the application until listing date, including any change or development on any matter stated in all the Certifications submitted by the Corporate Secretary and each director, officer, promoter and/or control person; and/or the filing of any case by or against the Applicant Company and/or any of its directors, officers, promoters and/or control persons.

32. Detailed information on the Applicant Company's Investor Relations Program which shall include, among others, a corporate website that contains, at the minimum, the following information:

a) Company information – organizational structure, board of directors and management team;
b) Company news – analyst briefing report, press releases, latest news, newsletters (if any);
c) Financial report – annual and quarterly reports for the past two (2) years;
d) Disclosures – recent disclosures to PSE and SEC for the past two (2) years;
e) Investor FAQs;
f) Investor Contact – email address and phone numbers for feedback/comments, shareholder assistance and service; and
g) Stock Information.

The organizational structure information in the Offering Prospectus must indicate an Investor Relations unit and provide a brief description of such unit, including the name of the Head of its Investor Relations unit and its Corporate Information Officer (CIO) and/or Investor Relations Officer. The said detailed information on the Applicant Company's Investor Relations Program must be included in the Offering Prospectus.

33. Copy of the Applicant Company's Manual on Corporate Governance.

34. For a newly formed holding company which uses the operational track record of its subsidiary, a sworn certification/undertaking duly signed by the Applicant Company's two (2) highest-ranking officers and Corporate Secretary that the Applicant Company will not divest its shareholdings in said subsidiary for a minimum period of three (3) years from the listing of its securities.

35. For companies that are exempt from the track record and operating history requirements, such as mining, petroleum and renewable energy companies and newly formed holding companies, sworn certification/undertaking duly signed by the Applicant Company's two (2) highest-ranking officers and Corporate Secretary that the Applicant Company will not conduct a secondary offering during the Initial Public Offering.

36. Public Ownership Report (POR) form duly accomplished by an authorized officer of the Applicant Company. The POR may be submitted upon determination of final number of Offer Shares or at least one (1) week prior to the listing of the Offer Shares.
37. Copy of the draft Lock-up/Escrow Agreement covering the Applicant Company's shares subject of the lock-up requirement under Article III, Part D (Main Board Listing), Section 2 or Article III, Part E (SME Board Listing), Section 2, whichever is applicable.
38. Copy of the draft Domestic and International (if applicable) Underwriting Agreements.
39. Copy of the draft Implementing Guidelines for the Reservation and Allocation of the Applicant Company's Offer Shares for Trading Participants and its Procedures.
40. Copy of the draft Application Procedures for Local Small Investors under the Small Investors Program of the Securities and Exchange Commission and the PSE.
41. Copy of the draft Application to Purchase or Subscription Agreement for the Offer Shares of the Applicant Company.
42. Other documents which may be required by the Exchange, including but not limited to updates on previous documents submitted.

25. In the process of registration and listing of equity, better coordination between the SEC and PSE could expedite the whole process. Although there are specific rules that define each other's scope of action and responsibilities, most of SEC registration requirements are also required by PSE. Furthermore, both entities conduct a thorough review of the documents filed under their respective requirements, which means an overlap over common requisites, particularly the prospectus. This results in duplicated effort by these entities and additional work for the issuer. This overlap does not appear to unduly prolong the process, as PSE listing approval is often granted before -but conditional on- SEC's authorization for public offering. However, through better coordination between SEC and PSE, a better use of the resources could reduce the time required for approval by both entities and reduce the scope for inconsistencies.

Recommendations

Coordinate with PSE supervision of registration and listing requirements to avoid overlaps

Review the necessity of some debt registration requirements, such as those on market price of equity and dividends, and compliance with corporate governance rules

Automate the transmission of documents in the registration and subsequent monitoring processes

Introduce a requirement for a prospectus summary with the characteristics of the instrument, risk disclosures, financial information and main issuer characteristics

Introduce additional guidance to applicants on risk disclosure

Introduce a risk-based approach to monitoring of registered companies to expedite the processes, phasing out in-depth reviews in the initial registration process for companies that have previously issued securities.

IV. INFORMATION TO MARKET

26. Companies registered for public offering of securities must file with the Commission an Annual Report 105 days after the end of the fiscal year, a Quarterly Report, and Current Reports for disclosure of material events. The Annual Report must have 5 sections: "Business and General Information", "Operational and Financial Information", "Control and Compensation Information", "Corporate Governance", and "Exhibits and Schedules". The section on financial information includes a Statement of Financial Position, Comprehensive Income, Changes in Equity, Cash Flows, and Notes to Audited Financial Statements. Such reports must be audited by an external auditor accredited by the SEC. Quarterly Reports basically have financial Information, for which unaudited financial statements may be used. Accounting and auditing principles in the Philippines are in line with international standards.

27. Current Reports must be used to make a full, fair and accurate disclosure to the public of every material fact or event that occurs which would reasonably be expected to affect the investors' decisions. These Reports must be filed with the exchange, if listed, and the SEC within 10 minutes after the occurrence of the event and prior to its release to the public though the news media, which is required to be done "promptly".

28. Compliance with market information requirements is enforced by the Securities Registration Department of the SEC. In addition to securities registration for public offering, this Department with 14 staff supervises compliance with periodic reporting obligations and, daily, monitors social media, including relevant internet sites, to detect possible disclosure violations. In 2017 and 2018, it imposed penalties on 47 companies for different violations, such as failure to disclose information and late filing of reports. The General Accountant Office provides support reviewing financial statements and auditors' compliance with specific disclosure requirements.

29. There is a need for clearer guidelines on disclosure of material information, as well as further policies to promote awareness on inside information. In practice, there appear to be circumstances where disclosure of material information may be omitted or delayed, because the information may be related to trade secrets, incomplete negotiations or to similar business reasons. However, the Implementing Rules and Regulations do not include this type of derogation. There are no publicly available interpretations about it either. Clearer guidelines about this type of circumstances would facilitate compliance with disclosure requirements and with insider information regulations as well. Another step that may be taken in this direction is requiring, as part of the Revised Code of Corporate Governance, the adoption of policies to promote awareness of what inside information is, including a registry who has been given access every time material information is disclosed to board members and other employees (insider registry). One more issue regarding disclosure of material

information is the time limit: within 10 minutes after the occurrence of the event. It is difficult to effectively comply with the rule. In practice, there is flexibility in its application, but there are no publicly available interpretations about it. An interpretation in this regard would facilitate compliance, reducing the legal contingency for non-compliance.

30. The SEC has required the accreditation of external auditors of SEC-regulated entities since 2003. The General Accounting Office of the Commission is in charge of accreditation and examination of external auditors. The accreditation serves as a quality assurance review on the audit work of the accredited external auditors. Supervision of external auditors is conducted through the review of financial statements of registered companies and through examinations of auditors following a risk-based approach. This Office has 22 staff to oversee 110 firms and 439 individuals. All current International Financial Reporting Standards (IFRS) have been adopted by the Philippine Financial Reporting Standards Council and renamed Philippine Financial Reporting Standards. The generally accepted auditing standards in the Philippines are promulgated by the Auditing and Assurance Standards Council and are based on the standards and practice statements issued by International auditing and Assurance Standards Board. Auditors may not engage in non-audit services for statutory audit clients, unless the safeguards under the Code of Ethics have been undertaken.

31. The Revised Code of Corporate Governance applies to corporations that have registered issues for public offering. Besides compulsory provisions related to board governance, such as composition, independence, responsibilities, qualification requirements, meetings, committees, and remuneration, the Code contains an article on stockholders' rights, which include the right to vote on all matters that require their consent or approval, pre-emptive right to all stock issuances of the corporation, right to inspect corporate books and records, right to information, right to dividends, and appraisal rights. The Code also states that boards should give minority stockholders the right to propose the holding of meetings and the items for discussion in the agenda that relate directly to the business of the corporation. Furthermore, regarding minority stockholder's rights, the SRC and its Implementing Rules and Regulations require tender offers for any person or group of persons that intends to acquire 35% of the outstanding voting shares or such outstanding voting shares that are sufficient to gain control of the board.

32. There are 2 accredited local credit rating agencies in the Philippines capital markets, but credit rating agencies have never been examined. These agencies are subject to regulation, accreditation, and supervision by the SEC. The SRC Implementing Rules and Regulations contain provisions to ensure the quality and integrity of the rating process; the independence and avoidance of conflicts of interest; information, procedures, methodologies and assumptions behind a rating; and the protection of non-public information. Credit rating is required for bond issues by corporations.

Currently, there are 8 bond issues rated by credit rating agencies, 7 of which are rated by one of the two agencies. Given current public credit ratings by rating agencies, it appears that one agency may be dependent on a single client. It may have other clients with private ratings, but the case serves to exemplify a possible situation of high concentration of income on a single client, which could compromise the agency's independence. The actual case requires supervision to ensure compliance with separation of business relationships from rating processes, especially in ratings committees. Depending on market growth, some regulation may be adopted to require some degree of income diversification to ensure independence. Overall, the SEC General Accounting Office has been given the task of supervising credit rating agencies, but it has yet to start examinations. In addition to this task, the General Accounting Office is responsible for the accreditation and supervision of external auditors (110 firms and 439 individuals) and for the review of financial statements of companies registered for public offering (299. The General Accounting Office is another SEC case of excessive supervisory burden relative to its staff of 22. The budget allocation to the SEC should be increased to be able to fulfill its responsibilities.

Recommendations

Modify Corporate Governance Rules to require the adoption of policies regarding inside information (awareness, registry of insiders)

Implement examinations of credit rating agencies and ensure compliance with separation of business relationships from rating processes, especially in ratings committees

Increase personnel of the General Accounting Office for adequate supervision of external auditors and credit rating agencies

Review credit rating agency regulations to analyze options to enhance independence such as limits on income concentration on a single client

V. MARKET INTERMEDIARIES

33. Market intermediaries are registered and supervised by the SEC under different laws. Brokers, dealers and transfer agents are regulated by the SRC; investment company advisers/fund managers and fund distributors by the Investment Company Act; and investment houses and underwriters of securities by the Investment Houses Law. These intermediaries are required to report any material changes in their licensing conditions and are subject to prudential obligations. There is a minimum capital requirement for each type of license. In addition, there are risk-based capital adequacy requirements and net liquid capital requirements for brokers and dealers, capital adequacy requirements and limits to underwriting commitments for underwriters and investment houses, and a capital adequacy ratio requirement (BSP regulation) for OTC dealers.

34. Intermediaries are subject to sound regulation of business conduct. They are required to have client agreements, clients' periodic statements, and fees disclosure. Broker-dealers may be custodians but must have segregated client accounts. Investment company advisers/fund managers must deposit all investment company assets with an independent custodian bank. Broker-dealers, investment company adviser/fund managers, and investment houses/underwriters are subject to corporate governance requirements. Broker-dealers and investment company adviser/fund managers must adopt risk identification and management procedures, internal control, management of conflicts of interest, ethical standards, suitability procedures, and customer complaint management. Broker-dealers are subject to confidentiality rules, due-diligence requirements including best execution. Also, broker-dealers, as any other person, are prohibited from engaging in securities-price manipulative practices, insider trading, and front-running.

35. The SEC Markets and Intermediaries Division has off-site and on-site supervision powers over market intermediaries. 110 days after the end of the fiscal year, all market intermediaries must file an annual general information sheet, annual audited financial statements, certificate of attendance of directors in meetings of the Board of Directors, and certificate of compliance with the Manual of Corporate Governance. Broker-dealers, in particular, also file a monthly risk-based capital adequacy report and 10 additional reports, depending on changes or amendments in information to other forms. Investment company adviser/fund managers and mutual fund distributors must send an annual report, quarterly report, and current reports (material information). Investment houses/underwriters have similar reporting requirements as investment company adviser/fund managers, but there is a special form for investment houses' activities. Government securities dealers' reporting requirements include a risk-based capital adequacy report, and other reports depending on changes or amendments to information on other forms. Many of these reports must be filed on paper and then must be digitalized by SEC personnel, taking time away from proper analysis and supervision. Electronic filing of reports and automation of monitoring procedures would enhance efficiency, improving supervision.

36. On-site supervision is planned according to thematic priorities and applied to all intermediaries. Nonetheless, the current approach to supervision appears to be rather ad hoc and compliance based. The most recent theme has been AML, probably reflecting a priority across agencies to address common weaknesses in this area, but also reflecting a limited capacity to oversee business conduct and other issues.

37. A clear and consistent methodology for the SEC supervision of capital market intermediaries is needed. A risk-based approach would provide a consistent basis for setting priorities and actions for both, off-site and on-site supervision, while taking into consideration

supervision by CMIC and BSP. Implementation of this approach requires significant capacity building, practical experience and detailed knowledge of the activities of the firms to properly risk-rate firms. Risk-based supervision of business conduct issues is particularly challenging, given the lack of objective risk metrics.

38. In addition to adopting a risk-based approach, the Markets and Intermediaries Division needs more personnel with appropriate qualifications to be able to oversee business conduct and other risks of all market participants under its supervision. As has already been mentioned above, 616 capital market participants are, directly or indirectly, under the supervision of 14 staff members. Adequate oversight of all these market participants requires additional staff with the qualifications mentioned above to support current staff.

39. Minimum capital requirement of brokers is not consistently enforced, weakening discipline. Some brokers comply with the former minimum capital, Php 20 million (US$389,430) instead of the current one, Php100 million (US$1,947,150). Although risk-based capital requirements adequately address risks taken by brokers (operational, position, counterparty and large exposures) and there have been no broker failures in the past, the inconsistent application of minimum capital requirements weakens discipline and sends a wrong signal to all market participants, leading them to doubt that other regulations are fairly applied as well. Regulations should be consistently enforced.

40. The bank secrecy legislation impedes expedite access by the SEC to bank account information, limiting effectiveness. A basic investigation principle is to "follow the money" to determine how a scheme was perpetrated and who was involved. The lack of direct access limits the effectiveness of an investigation as every time a new lead is discovered, a new request would have to be presented before the AMLC and, subsequently, filed with the Court of Appeals. Amendment of this legislation might face obstacles, but it is necessary to enhance the general financial supervisory framework of the Philippines

41. The CMIC, the SRO created by PSE as a separate company, is in charge of the direct supervision of 134 PSE brokers and needs strengthening. To support its internal 9 examiners, CMIC has partially outsourced its supervision process, hiring 10 external auditors every year. Supervision of brokers is a fundamental role of an SRO, requiring experience and a thorough knowledge of business operations to be able to conduct inspections to detect business conduct issues, which is harder to achieve when there is outsourcing. The Regular Examination Unit conducts a monthly audit of the trading activities of trading participants and monitors their compliance with reporting requirements, whereas the Risk Management Unit assesses the financial and risk profiles, such as the risk-based capital requirement and other related financial matters. All brokers are examined every year to check for compliance with SEC Implementing Rules and Regulations. However, there are no specific on-site

supervision routines to detect potential business conduct issues, like failure to disclose conflicts of interest, "churning" or "frontrunning".

42. The Philippine Dealing & Exchange Corporation (PDX), as an SRO, has a special operating unit, the Market Regulatory Services Group, that supports rulemaking, surveillance, investigation and enforcement activities. It is under the Market Governance Board, which is separate from the PDX Board, to address potential conflicts of interest of the latter. The Market Regulatory Services Group does not engage in the supervision of business conduct of PDX members (dealer banks) through regular examinations.

43. Finally, as noted earlier, there is an overlap in the scope of supervision of the SEC, BSP and CMIC, creating an unlevel playing field in some cases. BSP supervises investment houses with quasi-banking operations, universal banks licensed as underwriters, dealers that are banks, and brokers -or any other type of intermediary- that are part of banking groups. All of them must comply with the SEC regulations corresponding to the services provided, including business conduct rules. Investment houses with quasi-banking operations, universal banks licensed as underwriters and dealers that are banks also have to comply with BSP prudential regulations. In the case of brokers, SEC prudential requirements -minimum capital, capital adequacy requirement- are applicable. The BSP Financial Services Department is in charge of both, on-site and off-site, supervision of these entities. In principle, a risk-based approach is followed as the rest of the BSP does for banks in general. During examinations, they review compliance with SEC regulations, including business conduct issues, such as AML, suitability, conflicts of interest, frontrunning, and insider trading. Therefore, there is an overlap when the SEC conducts inspections to check compliance with AML rules and in the case of brokers that are PSE members and part of banking groups there is even a third overlap with CMIC. These issues should be addressed through bilateral coordination between the SEC and BSP and between SEC and CMIC, modifying current memorandums of agreement as needed.

Recommendations

Increase personnel of the Market and Intermediaries Division, hiring staff with practitioner's knowledge

Enhance business conduct supervision, changing routines from compliance-based to risk-based

Automate compliance of reporting requirements and monitoring

Enforce consistently the current brokers' minimum capital requirements

Coordinate scope of supervision of capital market intermediaries among BSP-SEC-CMIC

VI. COLLECTIVE INVESTMENT SCHEMES

44. There are three types of CIS in the Philippines, which are regulated, registered and supervised by different entities, creating ample opportunities for regulatory arbitrage. As mentioned before, there are three types of CIS in the Philippines, UITFs, VULs, and mutual funds. The vehicles used in these cases are different: a trust, an insurance product, and a company. This creates differences in the registration process. Trusts and insurance products follow a single authorization process, whereas mutual funds have to go through two stages, first the authorization of the company and then the authorization for the company to be operated as a mutual fund, taking more time for final approval than the other products. A CIS draft bill has been in Congress since 2009 that would eliminate the potential for regulatory arbitrage. Registration fees are also different. The different vehicles also create differences for CIS operators. In the case of mutual funds, single purpose CIS operators are required, separate from other capital market intermediaries, with specific minimum capital requirements and other requisites related to fund managers, including organization and staff. In the case of VULs and UITFs, insurance companies and banks, respectively, can operate them as part of their regular business with some additional basic conditions.

45. In general, SEC regulations comply with international standards for CIS. They include several aspects related to business conduct, such as ethical standards, suitability, conflicts of interest, disclosure requirements, complaints handling procedures, limitations on affiliation of fund manager, and asset segregation with specific requirements for an independent custodian (bank). Reporting requirements include monthly information on shares (sales and redemptions), quarterly reports, annual reports, and current reports (material information). Prospectuses must contain detailed information on the fund and its managers, including a description of the terms, features, rights, and privileges of the shares or units to be registered; investment objective, policy and strategy; profile of the prospective investors and investment suitability; risk factors and other information on the investments; manner in which the shares or units are to be offered to the public/ plan of distribution including sub-distributions; determination of the offering price; pricing method/methodology of net asset value (NAV); and procedure for issuance and redemption/payoff structure, redemption centers and the costs involved. Asset valuation must follow fair value standards (IFRS 13) and may be calculated by the fund manager. NAV must be calculated on a daily basis and be made available to the public. Regulations distinguish 8 different types of funds according to investment objectives: Equity, fixed income, balanced, feeder, fund-of-funds, index, money market, and multi-asset/asset allocation. Funds may invest in transferrable securities, money market instruments, deposits, financial derivatives, tradable securities, other CIS, and securities issued by or guaranteed by the Philippine government or BSP.

46. UITFs are established and managed in accordance with a written trust agreement drawn by the trustee (a bank), called the "Plan". Among other information, it must include objectives, policies and limitations, risk disclosure, investment powers of the trustee, daily NAV calculation methodology based on fair value, external audit, and fees. In addition, a Key Information and Investment Disclosure Statement with basic information must be made available to the public. All marketing materials must state investment policy and risk profile, marketing details, valuation, charges, and client and product suitability standards. Assets are segregated and held by independent custodians that are also in charge of mark to market asset valuation. UITFs may invest in securities issued by or guaranteed by the Philippine government or BSP, tradable securities issued by foreign governments, exchange-listed securities, marketable instruments tradable in an exchange, loans traded in organized market, loans arising from repo agreements, CIS, and other instruments allowed by BSP.

47. VULs, as insurance products, must have IC approval of the Variable Life Insurance Contract, mandatory policy benefit and design requirements, mandatory policy provisions, and other policy provisions. Reserve liabilities have to be established in accordance with actuarial procedures. Sales materials include a description of the benefits, an investment policy statement, investment risks, charges, fees, mortality charges, basis for computing all benefits, asset valuation method, guarantees, etc. Statements to clients must have number of units bought, sold and held, charges, and current death benefit at the end of the period. NAV calculation is based on mark to market principles and calculated by the insurer. Assets must be in segregated accounts of the insurer, but they may be held by a custodian. Although there is legal protection of the account with the insurer, a change in the regulation to require an independent custodian would enhance asset protection against fraud and the possible failure of the insurance company. VULs may invest in securities listed in an exchange, bonds issued by the government, or political subdivisions, new bonds expected to be listed, short-term instruments.

48. Prospectuses of mutual funds provide enough information for investor protection but offering documents of UITFs and VULs lack some important aspects. Sales materials of VULs do not provide information on risks, pricing methodology of asset valuation, related party transactions, conflicts of interest, names and background of CIS managers, policies for handling customer's complaints, and fund financial/performance information. The Key Information and Investment Disclosure Statements of UITFS lack information on pricing methodology of asset valuation, names and background of CIS managers, and policies for handling customer's complaints.

49. VULs, UITFs and mutual funds use fair value principles to calculate CIS net asset value, but when quoted prices are not available, the practice seems to be to maintain the quoted price

from the previous measurement date. This practice could lead to the use of older quotes that do not necessarily reflect current fair values. Furthermore, for VULs and mutual funds, NAV calculation is made by the same CIS operators, creating a potential conflict of interest as the portfolio manager may have an incentive to hide falls in portfolio valuation as these may be interpreted as mismanagement or affect their compensation. All regulators should ensure that CIS managers use a proper and consistent methodology, such as a discount rate based on a credit risk premium with respect to the sovereign yield curve in the case of corporate bonds, when quotes are not available at measurement date and, in the case VULs and mutual funds, require that NAV calculation be subject to procedures to avoid potential conflicts of interest and ensure consistency, such as regular review by a third party.

50. Supervision of UITFs by BSP is thorough, checking for general compliance and business conduct issues, but lacks specific penalties for CIS. In principle, a risk-based supervision approach is used UITFs as it is for banks in general. Supervision by SEC and IC is weaker than BSP's in terms of methodology and coverage as both entities lack adequate resources. However, BSP does not have specific penalties applicable to CIS operation and, consequently, reprimands are often the only penalty imposed. Both, SEC and IC, have specific penalties applicable to CIS and CIS operators, such as business conduct rules, and the capacity to impose them. As part of the coordination and cooperation efforts between BSP and SEC, cases of violation by UITFs could be transferred to the SEC that has a broader range of sanctions.

Recommendations

Harmonize CIS regulation and supervision methodologies and coordinate enforcement of penalties between BSP and SEC

Approve CIS draft bill to eliminate regulatory arbitrage, adopting a single-step registration process for mutual funds

Ensure that all CIS managers use an appropriate methodology, such as a discount rate based on a credit risk premium with respect to the sovereign yield curve in the case of corporate bonds, when market prices are not available at the measurement date

VII. MARKET STRUCTURES AND SURVEILLANCE

Equity trading

51. The PSE was formed after the merger in 1992 of Manila Stock Exchange (1927) and the Makati Stock Exchange (1963). Since its demutualization in 2001 brokers' shares are not supposed to represent more 20 percent of total, but they still represent a higher share (around 22 percent). The trading system, PSEtrade XTS, utilizes NASDAQ's X-stream Technology. Through the PSE trading

platform and website, market participants can access pre and post-trade information and company disclosures.

52. The settlement of trades is T+3 on a delivery-versus-payment multilateral net settlement basis. Upon uploading the trades into the central clearing and settlement system of the Securities Clearing Corporation of the Philippines (SCCP), a central counterparty subsidiary of PSE, multilateral netting takes place, and novation of the original trade contracts occurs. To address market/price risks, SCCP computes the exposure of each clearing member on each of the 3 days' worth of unsettled trades. Collateralization of 100 percent of the exposure is required. In addition, SCCP has established a Clearing and Trade Guaranty Fund to be used only if it is unable to meet its obligations as central counterparty. Cleared funds must be deposited in the clearing member's cash settlement account in the settlement bank and securities must be made available in the clearing member's securities accounts in the central depository's system, the Philippine Depository and Trust Corp (PDTC). PDTC serves both the equity and debt markets providing secure settlement, core safekeeping and corporate action activities for community members. It also provides electronic, real-time access for members to keep track of balances.

53. PSE provides members with access to relevant pre-and post-trade information on a real-time basis, but pre-trade information includes the disclosure of brokers' IDs in each order. Disclosing this as pre-trade information to all traders is not necessary in an exchange with multilateral net clearing and settlement system with central counterparty. It might affect trading activity and pricing. Therefore, it is advised to review the need for this requirement in the system.

54. PSE has adopted an end-of-session auction mechanism that creates excessive volatility at the close. Orders introduced in the last 5 minutes may be matched, but not executed to allow for competing orders. In the last 2 minutes, however, only new competing orders are allowed. Orders introduced in the first 3 minutes of the auction period may be outbid in the last 2 minutes. Therefore, to ensure execution in the last 2 minutes, brokers have the incentive in the first 3 minutes to introduce prices that most likely would not be outbid. This incentive induces excessive volatility at the close. Other mechanisms such as a "random close" may be introduced instead of the auction to deter marking the close while avoiding the auction-induced volatility.

55. PSE penalties for violation of compliance with the disclosure of material information requirement unjustifiably impact investors' ability to trade. PSE penalties for violation of compliance with disclosure of material information requirement include trading suspension for a month for the 3rd violation and delisting as a penalty for the 4th violation. Temporary trading suspension to allow for disclosure of material information is a sound practice. However, once there is full disclosure, a month-long trading suspension and delisting are penalties that unjustifiably affect

investors' ability to trade. These penalties should be replaced by fines on the officers and director of the company concerned or, if imposed, an alternative trading mechanism should be offered to investors.

Fixed-income trading

56. The PDX operates the organized secondary market for the trading of fixed income securities, including government and corporate debt instruments. The PDX was incorporated in 2003 and in essence is an OTC market with a trade reporting system. It also operates an exchange with an order-driven engine. Trades are executed bilaterally, using the banks' payment system for cash and PDTC accounts for securities.

Market surveillance

57. PSE has several measures to monitor and manage the volatility of a particular stock and the market in general. Dynamic and static thresholds are implemented per security, whereas for the whole market there is an automatic halt if the PSE Index falls 10% with respect the previous closing level. CMIC Market Surveillance Department monitors daily trading activities of the market participants to identify market activity deemed unusual. The Department has 4 staff and uses the Total Market Surveillance System acquired by PSE from the Korea Stock Exchange. It features detection rules, statistics analysis models, and pattern recognition logics to enhance monitoring of stock market transactions, providing up to 60 different types of alarms.

58. The SEC Enforcement and Investor Protection Division has direct access to trading data of PSE in real time. The Division has 15 staff dedicated to market surveillance. They monitor movements of all listed issues using Technistock Software System. Tools available from Technistock include Time and Sales Report, Chart Analysis and Stock information, Volume Review, Buyers and Sellers Information. Staff also checks the PSE Website, specifically, its Online Disclosure System for counterpart disclosures filed via SEC Form 17-C (Current Report), as well as any other information available in newspapers, internet and data from other SEC Departments.

Recommendations

Review pre-trade information requirements (Brokers' IDs)

PSE penalties for violation of compliance with the disclosure of material information requirement should be replaced by fines on the officers and director of the company concerned or, if imposed, an alternative trading mechanism should be offered to investors

Consider replacing the auction mechanism at the close for a "random close"

VIII. INVESTIGATION AND ENFORCEMENT

59. Some SEC units impose penalties for failure to comply with particular filing requirements, and the Enforcement and Investor Protection Department conducts all other investigations and enforcement actions. These actions may start with cases originated in the same department (market surveillance is one of its responsibilities), referred by other SEC departments and SROs, or started because of complaints received. This Department receives monthly reports from SROs with information on examinations and investigations being conducted and quarterly reports on the result of investigation. The Department may initiate its own investigations ahead of, parallel to or following an investigation conducted by an SRO. Furthermore, it can take over the activities of an SRO pursuant to SRC Rule 40.5.

60. The sanctioning regime contains both administrative and criminal penalties. Administrative sanctions include, among others, suspension of registration of securities and monetary fines of Php10,000 (US$192.80) up to Php1,000,000 (US$19,278.50) or 3 times the profits made, or the loss avoided. Administrative penalization does not preclude prosecution of criminal violations, which may be penalized with a fine of no less Php 50,000 (US$964) and no more than Php 5,000,000 (US$96,392.5) or imprisonment of no less than 7 years and nor more than 21) years. The Enforcement and Investor Protection Department reached a settlement agreement in 8 cases in 2017 and 2018. The Securities Registration Department imposed fines on 47 companies in the same period for belated filing of reports, failure to file reports, material deficiencies and non-compliance in annual audited financial statements, failure to conduct a mandatory tender offer, material deviation and material disclosure deficiency, etc. All criminal complaints for violations, such as those related to market abuse, are referred to the Department of Justice (DOJ) for preliminary investigation and prosecution before the proper court. In this process, the SEC plays a supportive role. As of June 2018, there were 10 cases pending in Court and one conviction, all related to market manipulation. A case of insider trading was under review by the Supreme Court.

61. PSE penalties may vary from Php 5,000 (US$96.40) to Php 500,000 (US$9,640) including suspension from trading and delisting. CMIC, with oversight responsibilities over 134 PSE brokers, may impose penalties that can go from Php 10,000 (US$192.80) to Php 200,000 (US$3895,10), including suspension and barring from trading. PDX penalties go from Php 10,000 (US$192.80) to Php 50,000 (US$964), including suspension and barring from trading.

BOX 2. PSE Listed Companies: Number of cases sanctioned[9]

Year	Total Sanctioned
2016	295
2017	301
2018	225

BOX 3.PSE Trading Participants: Number of cases sanctioned[10]

Year	Total Sanctioned
2016	19
2017	21
2018	10

BOX 4. CMIC Trading Participants: Number of cases sanctioned

Year	Penalties by Investigation and Enforcement	Penalties by Audit and Compliance
2016	14	4
2017	22	12
2018	7	17

BOX 5. PDX Trading Participants: Number of cases sanctioned[11]

Year	Total sanctioned
2016	63
2017	46
2018	31

62. While the number of penalties by the SEC and the SROs indicate an active enforcement of rules, a good number is related to formal compliance issues as opposed to conduct and market abuse issues. This may be, in part, a consequence of the SEC weakness in the supervision of capital markets intermediaries. A risk-based approach could contribute to strengthen supervision of market intermediaries and market surveillance to detect market conduct and market abuse practices by making a more efficient use of resources.

63. Finally, penalties are published in the websites of the SEC and SROs, but market participants appear not to be aware of the number of penalties imposed, losing some of the penalties' deterrence effect. Authorities are advised to use press releases and other means to inform

[9] Total: 274 listed companies.

[10] Total: 134 brokers.

[11] Total: 40 dealers and 32 brokers.

the public at large and ensure a larger reputational cost. Furthermore, the SEC website may have a tab with a list of penalties and agreements to make it easier to identify.

Recommendations

Adopt a risk-based approach to market surveillance consistent with supervision of market intermediaries

Consider the use of press release and other means to inform the public