# NOTE

## REFORMS ON SECURITIES REGULATION

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### I. BACKGROUND

On September 29, 1998, then Senator Raul Roco delivered his sponsorship speech for the enactment of a law that would reform securities regulation in the Philippines. He pointed out some of the fundamental problems that the reforms should address, in particular: "(1) the asymmetric information problem, the incompatibility or lack of equality and access to information; (2) the uneven playing field between the insiders of the market and those who want to participate in the development of wealth in the country; (3) the static view of the securities market; and (4) the structural weaknesses of the regulatory body, the Securities and Exchange Commission, as far as the stock market is concerned."

With respect to the first problem which involves lack of equal access by investors to material information on the stocks or securities that are being traded, it has to be remedied by new rules on: firstly, full disclosure of all material information about the issues on the nature of the offering, prior to the sale of securities. According to Senator Roco, the law then "does not require the issuers and underwriters to make available the company prospectus to investors as a matter of law. This loophole had been the cause of great disappointment of investors who later lost money because they based their investment decisions on inadequate or misleading information. The new law will require mandatory distribution of prospectus and the regular filing of financial and operational reports as well as the risk factor associated with the business.

Secondly, the insider trading must be clear, the law then adopted terms that allow wide latitude of interpretation on what is non-public information used in insider trading violation.

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Thirdly, shareholders should be able to monitor the performance of their securities and therefore annual reports of the issuers should be mandatory.

With respect to the second problem of uneven playing field by exempting bank shares and issuance arising from merger and consolidation, the new law eliminated such exemption.

With respect to the third problem, the sponsorship speech cited cases of the law which hinders development of the securities market, to wit:

> First, the present law has a narrow and rigid definition of securities, which does not explicitly cover newly developed securities such as asset-backed securities, derivatives, etc. In addition to explicitly covering the existing traditional and newly developed securities, the proposed law is forward-looking in that it will include those securities which the market may develop in the future. The flexibility in defining securities recognizes and supports financial market innovations worldwide.
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> Secondly, the present law does not expressly provide for the securities market to adopt to newly developed cost-reducing practices, such as the use of uncertificated or dematerialized stocks, and to emerging efficient technologies, such as flexibility for the securities market to adapt to modern practices and trading technologies.
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> Third, the existing law does not explicitly allow for the adoption of modern approaches to securities market regulation. Presently, there is a worldwide trend towards self-regulation, which is found to be a more effective and efficient means of regulating the market. The proposed law, however, adopts the self-regulation approach towards securities market regulation and directs various market players, including the exchange, the clearing agencies, the stock brokers and the dealers, to develop the capability to operate as self-regulatory organizations or SROs. Under this approach, the SROs will have the primary responsibility of maintaining professionalism in its internal affairs, and to regulate and discipline its members. The SEC, in the exercise of its oversight functions, will review and approva the regulatory programs of SROs and will hold them accountable for failure to police their ranks.

On July 19, 2000 the Securities and Regulation Code (hereinafter, SRC) was signed into law. SRC repealed the Revised Securities Act (RSA) which in turn repealed the Securities Act (hereinafter, SA). Many of the provisions originally contained in the SA, which was adopted in 1936, are still contained in the SRC. The SA, as well as the RSA and SRC, are based on the United States Securities Exchange Act of 1934 (hereinafter, 1934 Act) and Securities Act of 1933 (hereinafter, 1933 Act) with a number of distinct differences.

During the effectiveness of the SA, Presidential Decree 902-A was issued. PD 902-A was not repealed when the SA was repealed in 1982, nor, except for sections 2, 4, and 8, was it expressly repealed under the SRC. In addition, two other Presidential Decrees regulating brokers commissions (PD 154) and multiple listings on a stock exchange (PD 167) are still in effect. All these decrees thus needed to be read in conjunction with the SRC.

The SRC also specifically amends provisions of the Corporation Code and PD 902-A – hence the use of the term "Code" which provides a wider coverage.

## II. OBJECTIVES

The SRC's goals are set forth in the Code Declaration of Policy. Briefly stated, the SRC seeks to:

(1) Develop the Philippine capital market;
(2) Encourage wider participation of share ownership;
(3) Promote self-regulation in the securities industry;
(4) Ensure full and fair disclosure about securities; and
(5) Minimize and eliminate fraud and manipulation which create market distortions.

Both the SRC and its implementing rules (IRR) adopt the best practices developed and observed in mature and credible markets as well as provide standards consistent with those considered as internationally accepted, or those set by the International Organization of Securities Commission (IOSCO).

## III. STRENGTHENING THE SEC

The SRC laid the foundation for reforms by, first of all, providing for the institutional strengthening of the SEC. Up until the enactment of the SRC, SEC's role in developing the Philippine capital market was much less than what was called for. Previously, the SEC concentrated on company registration and monitoring, and the performance of its quasi-judicial functions over intra-corporate cases. In the process, not much attention was given to activities that would develop the capital market.

Recognizing that the evolving financial landscape needed a much stronger and more proactive SEC, a critical element of the SRC reforms was the redefinition of SEC's powers and functions.

These are provided in Section 5 of the Code; the section repealed the full control by SEC over all corporations provided in PD 902-A. section 5.2, in particular, enabled the SEC to transfer some of its quasi-judicial functions in the regular courts. The functions that were transferred pertain to cases on intra-corporate disputes, suspension of payments, and rehabilitation. The SEC retains jurisdiction over cases relating to administrative sanctions for non-compliance of the SRC, the Corporation Code, and other laws. SEC continues to have jurisdiction over the investigation and referral to the Department of Justice of criminal cases arising from violation of these laws.

Section 5.2 allowed the SEC to set the tone and pace of capital market development, having unburdened itself of the tedious job of resolving intra-corporate disputes. As a result, SEC has the full time task of determining policies necessary to address the changes arising from globalization, financial liberalization, and e-commerce.

After the aforesaid restructuring, and inspite of sec. 5.1(a) of the SRC limiting SEC's power to supervision, not control, over all corporations, SEC continued to receive complaints about corporations which do not have a secondary license from the SEC. To clarify the matter, SEC issued Memorandum Circular 11 dated August 5, 2003 (further clarified in the new rules), which provides that SEC supervision over all corporations would be as follows:

> 1. The business operations of corporations which are grantees of secondary licenses or franchises by this Commission, such as but not limited to financing companies, investment companies, investment houses, pre-need companies, brokers/dealers and exchanges, as well as public companies shall be under the direct supervision of this Commission, i.e.:
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> > a. Submission of reports (monthly, quarterly, operational, annual, etc.) required in the different laws governing the type of activity engaged in by these corporations; and
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> > b. Compliance with the provisions of the Corporation Code including those provisions requiring the submission of documents to effect compliance.
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> > Additionally, the Commission exercises regulatory authority over said companies except unregistered/unlisted public companies. For corporations with registered/listed issues, compliance with registration requirements and the conditions

imposed by the Commission for their registration shall likewise be under its direct supervision.

2. For all other businesses operations of companies with certificates of registration with the SEC, the extent of its supervision and monitoring shall be limited to their compliance with the Corporation Code, i.e.:

a. Submission of financial statements;
b. Submission of General Information Sheets (GIS)
c. Compliance with provisions in their by-laws on:
    i. Number of directors;
    ii. Qualifications, compensation of directors;
    iii. holding of meetings, etc.;
d. Declaration of dividends;
e. Inspection of books; and
f. Other provisions of the Code requiring submission of documents to effect compliance.

3. The business operations of corporations which are grantees of secondary licenses or franchises of other government agencies such as but not limited to banking and quasi-banking institutions, building and loan associations, trust companies and other financial intermediaries, insurance companies, public utilities, educational institutions, and other corporations governed by special laws, shall not be under the direct supervision of this Commission but under the direct supervision of the concerned agency granting such secondary license or franchise. The extent of the Commission's supervisory powers over such corporations shall be limited to those mentioned in item No. 2 hereof, except if it is a reporting company under Sec. 17.2 of the SRC.

4. Notwithstanding the foregoing, the Commission, as provided in Section 5 of the SRC and the effective provisions of PD 902-A, shall have the power to do any and all acts to carry out the effective implementation of the laws it is mandated to enforce, i.e.: constitute a Management Committee, appoint receivers, issue Cease and Desist Orders to prevent fraud or injury to the public, and such measures necessary to carry out its role as a regulator.

5. All complaints regarding their operations shall be directed to their primary regulator. However, in cases where the SEC and another agency are both primary regulators, e.g., investment houses with quasi-banking license, any complaint can be lodged with either or both regulators which must coordinate their actions.

The Commission's new organizational structure is described in SRC Rule 4. The Code of Conduct for the Commissioners and staff is set forth in SRC Rule

6.2 to address conflict of interest situations and notify the public of the high standards of conduct imposed on the Commission.

## IV. SELF-REGULATORY ORGANIZATION

Despite the stronger roles given to the SEC under the Code, there is, nonetheless, the recognition that the SEC cannot and must not bear the sole burden of regulation. This is in accordance with IOSCO principles. Hence, a second major reform introduced under the SRC is the delegation of regulatory powers to Self-Regulatory Organizations, or SROs, which include Stock Exchanges and Clearing Houses, allowing them to police their own rankis. Once granted SRO status by the SEC, the SRO is authorized to discipline its members and market participants in accordance with its rules, which require approval by the SEC for its effectivity.

The SRC's IRR imposes additional requirements to support the role of, and promote self-regulation by, market participants. Specifically:

- SRC Rule 28.1-1(e)(1)i requires all broker dealers to become a member of an SRO;
- SRC Rules 28.1-1(E)(2)viii and 28.1-4 address the requirement to appoint a registered Associated Person and the duties thereof;
- SRC Rule 28.2 requires broker dealers to comply with qualification requirements and rules of the Exchange as an SRO; and
- SRC Rules 28.1-1(1)xiv and Rule 30.2-7 requires broker dealers to implement internal training programs for their staff to ensure that their staff is aware and understands regulatory requirements.

In view of the listing of the PSE shares by introduction, the regulatory powers to oversee the trading of PSE shares has been carved out of the SRO status of the PSE. For obvious reasons, PSE cannot regulate trading of its own shares. SEC has recently signed a Memorandum of Understanding (MOU) on the subject. Overseeing trades of PSE shares would be SEC's responsibility.

Since the listing by introduction resulted only in a reduction of brokers' shares to less than 1% of the total shares, the SEC directed the PSE to offer their unissued shares to the institutional buyers or offer them to the public to dilute control of the brokers.

## V. DEMUTUALIZATION

A third reform, following closely at the heels of delegating regulatory powers to SROs, is the mandated demutualization of the Philippine Stock Exchange.

Demutualization involves the conversion of the PSE from a non-stock organization (mutual structure for broker-members) to a stock corporation. After demutualization, the PSE is expected to become a publicly-held corporation with a diverse ownership, governed by a majority of non-brokers, and managed by an independenta and professional group. Ownership rights will be segregated from trading rights. To date, 40% of the exchange are in the hands of GSIS, PLDT, Meralco, and a Singaporean company complying with the SEC mandate to offer PSE shares to institutional buyers. The law mandates further reduction of brokers' control.

The Code also requires the Board of Exchange to include in its composition the president of the Exchange and no less than 51% of the remaining members of the board to be comprised of three independent directors and persons who represent the interest of issuers, investors, and market participants, who are not associated with any broker or dealer or member of the Exchange.

SRC Rules further clarify the role of an Exchange to operate in the public interest. Thus,

- SRC Rule 33.2(c)-1(c) clarifies limitations on ownership of an exchange, i.e. no one person or business group can own 5% or 20%, respectively, of the Exchange;
- SRC Rule 39.1-1 defines requirements governing an SRO and authorizes the Commission to prescribe rules over an SRO for the public interest;
- SRC Rule 39.1-2 provides procedures for the registration of associations of brokers and dealers and other SROs; and
- SRC Rule 39.1-3 provides for the allocation of regulatory responsibilities among SROs, the duties as a self-regulatory organization, and attendant Commission powers.

In some jurisdictions with demutualized stock exchanges, the brokers still own 99% of the exchange, e.g. Tokyo Stock Exchange. In the Philippines, the SRC deems it necessary to reduce the broker's control to erase the perception that the PSE is an "old boys' club."

## VI. DISCLOSURE APPROACH

A fourth reform introduced under the SRC is the codification of the full disclosure approach to the regulation of public offering. The objective of this particular reform is to inculcate higher standards of disclosure, due diligence and corporate governance by shareholders, thereby ensuring that investors are properly apprised of the risks and merits of their investments. It puts equal responsibilities on the shoulders of both shareholders and investors alike, by making them responsible for their own actions.

With full disclosure, the SEC's role in public offerings is to define disclosure requirements, and review disclosure documents to make sure that these requirements are complied with. It will be the issuer corporate secretary, underwriters and directors who will be liable for the accuracy of such disclosure.

SRC rules provide generally for public access to information filed with the Commission except when requested for confidential treatment of information filed therewith if so determined by the Commission. Confidential information includes "trade secrets, commercial or financial information that has been prepared by analysts within or outside a company for strategic purposes and similar information which raises concerns for business confidentiality."

Prior to the adoption of the disclosure approach, securities are evaluated on the merits. Since this is a task which cannot be fully performed by a regulator, it is for the regulator to require full disclosure about a company and leave it to the investors to decide for themselves to invest in the company or not. However, when Pre-Need plans are involved, SEC does not rely on full disclosure alone but adopted some amount of prudential measures such as actuarial evaluations and trust fund requirements.

The protection of minority shareholders is a fifth category of reforms under the SRC. It seeks to provide better protection to investors, particularly to small investors or minority stakeholders. This protection is essential to attract new investors to a stock market where ownership is highly concentrated.

Section 19.1 of the SRC requires mandatory offers is any person or group of persons intends to acquire 15 percent of the equities of a listed or other public company, or intends to acquire at least 30 percent of such equity over a period of 12 months.

After the September 11, 2001 crisis, the SEC provided exemptive relief to the Mandatory Offer Rule, consistent with section 72.1 of the SRC. Under Special Resolution No. 103, the threshold for making a mandatory tender offer has been raised to 35 percent, for the following reasons:

> a. With the ownership of 35 percent of the total shares, the tender bidder may obtain a seat in the Board of the issuer, allowing the bidder to have some amount of participation in decision-making;
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> b. Under the Corporation Code, a 35 percent share has an effective blocking minority vote, since major decisions require a 2/3 vote in a corporation; and
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> c. The 35 percent threshold has been adopted in other jurisdictions such as Hong Kong under the Hong Kong Take Over Code – Hong Kong's version of the SRC's tender offer provision.

The new rules now provide that:

> A. Any person or group of persons acting in concert, who intends to acquire thirty five percent (35%) or more of equity shares in a public company shall disclose such intention and contemporaneously make a tender offer for the shares sought to all holders of such class.
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> In the event that the tender offer is oversubscribed, the aggregate amount of securities to be acquired at the close of such tender offer shall be proportionately distributed to all shareholders.
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> B. Any person or group of persons acting in concert, who intends to acquire thirty five percent (35%) or more of equity shares in a public company in one or more transactions within a period of twelve (12) months, shall be required to make a tender offer to all shareholders.
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> C. If any acquisition of even less than thirty five (35%) would result in ownership of over fifty one percent (51%) of the total outstanding equity securities of a public company, the acquirer shall be required to make a tender offer for all the outstanding equity securities to all remaining stockholders of the said company at a price supported by a fairness opinion provided by an independent financial advisor or equivalent third party. The acquirer in such a tender offer shall be required to accept any and all securities thus tendered.

The mandatory tender offer requirement shall not apply to the following:

> 1. Any purchase of newly issued shares from unissued capital stock provided that the acquisition will not result to a 50% or more ownership of shares by the purchaser;
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> 2. Any purchase in connection with the foreclosure proceedings involving a duly constituted pledge or security arrangement where the acquisition is made by the debtor or creditor;
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> 3. Purchases in connection with corporation rehabilitation under court supervision;
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> 4. Purchases through an open market at prevailing price;
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> 5. Merger or consolidation.

In addition to the Mandatory Offer Rule, the SRC likewise requires that any corporation with a class of equity securities listed for trading on an exchange or with assets in excess of P50M and having 200 or more holders, at least 200 of which are holding at least 100 shares of a class of its equity securities or which has sold a class of equity securities to the public, shall have at least two (2) independent directors or such independent directors as shall constitute at least 20% of the members of such board, whichever is less. This is to discourage "insider boards," where directors are chosen on the basis of their relationship with the dominant shareholder or the size of their own shareholding.

The rules define *independent director* as a person who, apart from his fees and shareholdings, is independent of management and free from any business or other relationship which could, or could reasonably be perceived to, materially interfere with his exercise of independent judgment in carrying our his responsibilities as a director and includes, among others, any person who:

> a. Is not a director or officer or substantial stockholder of the corporation or of its related companies or any of its substantial shareholders (other than as an independent director);
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> b. Is not a relative of any director, officer or substantial shareholder of the corporation, any of its related companies or any of its substantial shareholders. For this purpose, relatives include spouse, parent, child, brother, sister, and the spouse of such child, brother or sister;
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> c. Is not acting as a nominee or representative of a substantial shareholder of the corporation, any of its related companies or any of its substantial shareholders, pursuant to a deed of trust or contract;

> d. Has not been employed in any executive capacity by that the company, any of its related companies or by any of its substantial shareholders within the last five (5) years;
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> e. Is not retained as professional adviser by the corporation, any of its related companies or any of its substantial shareholders within the last five (5) years, either personally or through his firm;
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> f. Has not engaged and does not engage in any transaction with the corporation or with any of its related companies or with any of its substantial shareholders, whether by himself or with other persons or through a firm of which he is a partner or a company of which he is a director or substantial shareholder, other than transactions which are conducted at arms length and are immaterial; and
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> g. Does not own more than 2% of the shares of corporation and/or related companies.

In electing the independent directors, a Nomination Committee which shall have at least three (3) members, one of whom is an independent director, shall promulgate the guidelines or criteria to govern the conduct of the nomination. The same shall be properly disclosed in the company's information or proxy statement or such other reports required to be submitted to the Commission.

The nomination of independent director/s shall be conducted by the Committee prior to a stockholders' meeting. All recommendations shall be signed by the nominating stockholders together with the acceptance and conformity by the would-be nominees.

The nominating committee shall pre-screen the qualifications of the candidates and shall prepare a final list of all candidates and shall put in place screening policies and parameters to enable it to effectively review the qualifications of the nominees for independent director/s.

After the nomination, the Committee shall prepare a Final List of Candidates which shall contain all the information about all the nominees for independent directors. The name of the person or group of persons who recommended the nomination of the independent director shall be identified to such report including any relationship with the nominee.

Only nominees whose names appear on the Final List of Candidates shall be eligible for election as Independent Director/s. No other nomination shall be entertained after the Final List of Candidates shall have been prepared. No further

nomination shall be entertained or allowed on the floor during the actual annual stockholders'/memberships' meeting.

Any problem in the election of independent director shall be decided by SEC who shall choose the independent director from a list provided by the stockholders.

SRC Rules which provide additional protection to investors include the following:

- SRC Rule 19 on tender offer as previously discussed;
- SRC Rule 28.1-1(E)iv & v, which imposes unimpaired paid-up capital requirement of P10 Million for existing broker dealers. New brokers shall have a minimum capitalization of P100M. This is in addition to the net capital requirements of P5M or total aggregate indebtedness, whichever is higher. The SEC may set a different requirement for those firms authorized to use the Risk-based capital adequacy model;
- SRC Rule 30.2-1, which promotes international best practice standards of conduct on Broker-Dealers;
- SRC Rule 30.2-3, which imposes standards on the content of an agreement between a broker dealer and a customer; and
- SRC Rule 30.2-8, which provides for transparency and fairness to investors in block sale transactions.

To deal with market abuses and fraud, the SRC contains new prohibitions on insider trading, affiliated transactions by brokers and dealers, and generally segregates the functions of a broker and dealer. The pertinent sections of the SRC in this regard are:

- Section 30.1, or the Broker-Director Rule, which prohibits a broker/dealer from dealing in securities if its stockholders, directors, associated persons, salespersons, and their relatives are, at the same time, directors and officers of the issuer. Section 30.1 is intended to prevent insider trading, which involves transactions based on sensitive corporate information available to the officers or employees of a company, but not to the public;
- Section 34.1, or the Broker-Dealer Prohibition, which is intended to prevent front-running, an illegal activity in which a broker/dealer buys or sells securities ahead ahead of news or publicity that may affect a security's price.

The SEC has granted temporary exemptive relief to sections 30.1 and 34.1. With regard to section 30.1, although legitimate concerns about insider trading persist, the SEC has recognized that the provision may be unduly restrictive. It has thus adopted a disclosure approach to regulation, the appropriate guidelines for which are set out in SEC Memorandum Circular No. 12 (Series of 2001). This

requires the broker/dealer claiming exemption to submit a report within five days from the date of transaction. The report must indicate the number and values of shares traded and the relationship of the broker/dealer with the issuing company.

On the other hand, implementation of section 34.1 was relaxed as there is a need to give Member-Brokers some elbow-room to provide liquidity and spur the market, especially during times of high volatility or general market decline. Thus, alternative market-making activities by Member Brokers and their associated person's own account are now exempted from the Broker-Dealer prohibition, subject to the condition that these transactions are guided by the "Customer First Policy," i.e. broker must give way to a customer's order unless he can increase the price by at least 3 fluctuations.

The SRC rules which further clarify and help eliminate abusive market practices are the following:

- SRC Rule 24.1(b)-1, which clarifies the types of practices which are deemed manipulative and requires Broker Dealers, prior to executing an order to buy or sell securities, to conduct due diligence by reviewing objective factors which may indicate that a proposed transaction is manipulative;
- SRC Rule 30.1, which sets forth procedures, including a mandatory disclosure form, for monitoring affiliated Transactions by Broker Dealers;
- SRC Rule 34.1-1 which clarifies when a Member broker may trade for his own account only pursuant to the exemptions set forth in Section 34.1 of the Code or under the Customers First Policy described above;
- SRC Rules 34.1-2 and 34.1-3, which requires broker firms acting in dual capacities to segregate functions that may raise conflict of interest/insider trading concerns and implement chinese wall procedures; and
- SRC Rule 30.2-5 which requires disclosure of minimum commission and charges for services performed by a Broker Dealer to ensure that Member Brokers do not indirectly violate Section 34.1 of the Code by segregation through commission rebates.

Finally, having provided for regulatory measures that would prevent market abuses, the SRC enabled SEC to resolve cases more expeditiously during an investigation, by providing it with stronger prosecution and enforcement procedures.

The SRC provides for civil liabilities for market misconduct, such as making false registration statements, prospectuses, communications and reports, fraud in securities transactions, manipulation of security prices, and insider trading.

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In addition, Section 54 (d)(iv) of the SRC empowers SEC to provide administrative sanctions of disgorgement of at least three times the profit gained or loss avoided as a result of the purchase, sale, or communication proscribed under Section 34. These liabilities are considered as sufficient deterrents to market misconduct in the sense that where the would-be violator is made aware that he will, when found guilty, be deprived of such profits, he will think a hundred times before committing such misconduct. Moreover, the imposition of administrative penalties is without prejudice to criminal charges for such violation.

## VII. OTHER MAJOR REFORMS

For the protection of the public, public offering is defined as "a random or indiscriminate offering of securities in general to anyone who will buy, whether solicited or unsolicited." Any solicitation or presentation of securities for sale through any of the following modes shall be presumed to be a public offering.

> i. Publication in any newspaper, magazine or printed reading material which is distributed within the Philippines or any part thereof;
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> ii. Presentation of any public or commercial place;
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> iii. Advertisement or announcement in any radio or television, or in any online or e-mail system; or
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> iv. Distribution and/or making available flyers, brochures, or any offering material in a public or commercial place, or mailing the same to prospective purchasers.

In the past, SEC has been unable to prosecute violation cases because of the interpretation that the public offering needs 20 complainants.

With respect to creeping sale of securities to more than 19 not qualified investors in a given year, instead of subjecting the 20th investor to a lock-up, this creeping sale is in fact a public offering of securities without SEC registration and should be penalized accordingly.

SEC will now require credit rating of commercial papers unless it is of a minimal amount or there is some other protection for the investor, like a bank

New rules have been adopted for propriety and non-propriety shares. Hereunder are some of these new rules.

> a. The registrant in its prospectus shall clearly indicate an undertaking that, in the event the project or the underlying asset for which the securities are sold is for whatever reasons, not completed as disclosed, it shall refund the amount of the investment of the purchaser of the securities within (10) days from receipt of the written demand.
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> b. Proceeds from the sale of said shares shall be deposited or kept with a bank under as escrow or custodianship arrangements, and withdrawal of the same shall not only be allowed upon presentation of the company's work progress report.
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> c. The certificates of shares shall be issued within 60 days from the date of full payment of the same.
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> d. The Club shall:
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> > i. Qualify the prospective club members before actual sale/transfer of share/s executed;
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> > ii. Not collect membership due unless the project is 50% usable unless the contract provides a higher percentage of usability;
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> > iii. Submit to the Commission a report under oath of any increase in fees and rationale for said increase within 30 days from Board approval;
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> > iv. Notify club members of any increase in fees upon the Board's approval of the said increase;
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> > v. Cause the posting of proper notices and other communications on the charging of fees on bulletin boards situated at conspicuous place/s at the site, for the benefit of secondary markets.

A major reform in the new rules refers to unregistered commercial papers issued by companies and sold to banks and investment houses which are in turn sold by these intermediaries to their clients. The documents issued by the bank are normally without recourse to the bank or investment house. The SEC believes that these are unregistered securities which should have been registered with the SEC before public distribution. At present, because their distribution went thru investment houses and banks, they escape SEC registration for public offering. SEC has now clarified that the exemption from registration by issuances of banks and

investment houses apply only to their own papers and therefore with recourse to them.

## VIII. SUSTAINING CORPORATE GOVERNANCE

SEC has been at the forefront of corporate governance for public companies and those requiring a secondary license from the SEC. It has come up with a Code of Corporate Governance and a Manual to be adopted by companies to comply with the Code. To sustain corporate governance, SEC has done certain things, such as the following:

> 1. Adopted Guidelines on Accreditation of External Auditors for Secondary Licensees for the purpose of promoting audit responsibility and enhancing the quality of financial reporting in the Philippines. The following are the significant features of said Circular:
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> - Audit experience of the external auditor on the specific industry to which he shall be engaged in as such;
> - Existence and disclosure of the firm's quality assurance policies and procedures for monitoring professional ethics and independence;
> - Operational requirements that must be complied with i.e. non-engagement on non-audit services for statutory clients unless the safeguards under the Code of Ethics for CPAs are undertaken, compliance with SRC Rule 68 and other relevant pronouncements of the Commission;
> - Reportorial obligation of the external auditor to disclose to the Commission any material finding involving fraud, error, losses, or going concern issue;
> - Accredited external auditors are required to go through continuing professional education as a condition for the renewal of their accreditation with the Commission.
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> 2. Conducted training sessions on Corporate Governance in Metro Manila and the provinces;
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> 3. Introduced phased amendments of SRC Rule 68 to cover adoption/implementation by batches of International Accounting Standards (IASs) until 2005;

4. Reviewed in-depth audited financial statements of regulated companies filed with the Commission;

5. Developed a program to validate the self-assessment made by covered corporations on corporate governance in July 2003. An independent body shall be designated to conduct said activity.

6. Included the following disclosure requirements in the amended Implementing Rules and Regulations of the Securities Regulation Code:

- Management Discussion. For both full fiscal years and interim periods, disclosure of the company's and its majority-owned subsidiaries' top five (5) key performance indicators. It shall include a discussion of the manner by which the company calculates or identifies the indicators presented on a comparable basis.
- Internal Control. Disclosure of the minimum internal control policies and procedures of the company. The company's internal accounting controls shall be sufficient to provide reasonable assurances that: (a) transactions and access to assets are pursuant to management authorization; (b) financial statements are prepared in conformity with th generally accepted accounting principles that are adopted by the Accounting Standards Council and the rules promulgated by the Commission with regard to the preparation of financial statements; (c) recorded assets are compared with existing assets at reasonable intervals and differences are reconciled.
- Disclosure on Corporate Governance. The following information, as declared and approved by the Board of Directors of the company, shall be required to be in the covered companies' annual reports and information/proxy statements: (a) Description of the evaluation system established by the company to measure or determine the level of compliance of the Board of Directors and top-level management with its Manual of Corporate Governance; (b) discussion of any deviation from the company's Manual of Corporate Governance. It shall include a disclosure of the name and position of the person/s involved, and the sanction/s imposed on said individual; and (c) discussion of any place to improve corporate governance of the company.

## IX. CONCLUSION

The Asian financial crisis has shown that too much reliance on banks for capital can have a disastrous effect on the economy if there is a crisis in the banking system. Business should have more diversified source of capital for growth. The capital market thru various financial investments such as equities, bonds, and other commercial papers can fill in this gap. For investors, however, to provide this capital they must have confidence in the fairness of the rules and the regulator.

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