PD-ABE-951
ISN 80007

CAPITAL MARKETS DEVELOPMENT PROJECT

(492-0447)

PROJECT PAPER

USAID/PHILIPPINES
September 1992

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROJECT DATA SHEET

1. TRANSACTION CODE: A (A = Add, C = Change, D = Delete) — Amendment Number

DOCUMENT CODE: 3

2. COUNTRY/ENTITY: Philippines

3. PROJECT NUMBER: 492-0447

4. BUREAU/OFFICE: Asia — 04

5. PROJECT TITLE (maximum 40 characters): CAPITAL MARKETS DEVELOPMENT

6. PROJECT ASSISTANCE COMPLETION DATE (PACD): MM 09 DD 30 YY 97

7. ESTIMATED DATE OF OBLIGATION (Under "B." below, enter 1, 2, 3, or 4)
A. Initial FY 92 B. Quarter C. Final FY 93

8. COSTS ($000 OR EQUIVALENT $1 =)

A. FUNDING SOURCE	FIRST FY 92 B. FX	C. L/C	D. Total	LIFE OF PROJECT E. FX	F. L/C	G. Total
AID Appropriated Total			10,000			13,500
(Grant)	(4,102)	(5,898)	(10,000)	(6,050)	(7,450)	(13,500)
(Loan)	( )	( )	( )	( )	( )	( )
Other U.S. 1.						
Other U.S. 2.						
Host Country		500	500		4,500	4,500
Other Donor(s) Private Sector					9,750	9,750
TOTALS	4,102	6,398	10,500			27,750

9. SCHEDULE OF AID FUNDING ($000)

A. APPROPRIATION	B. PRIMARY PURPOSE CODE	C. PRIMARY TECH. CODE 1. Grant	2. Loan	D. OBLIGATIONS TO DATE 1. Grant	2. Loan	E. AMOUNT APPROVED THIS ACTION 1. Grant	2. Loan	F. LIFE OF PROJECT 1. Grant	2. Loan
(1) SAI				-		10,000		13,500	
(2)									
(3)									
(4)									
TOTALS						10,000		13,500	

10. SECONDARY TECHNICAL CODES (maximum 6 codes of 3 positions each)

11. SECONDARY PURPOSE CODE

12. SPECIAL CONCERNS CODES (maximum 7 codes of 4 positions each)
A. Code
B. Amount

13. PROJECT PURPOSE (maximum 480 characters).

To assist in the enhancement of the efficiency of the securities market in the Philippines, by improvement in the quality and transparency of information available to investors, the public, and other capital market participants.

14. SCHEDULED EVALUATIONS
Interim MM 01 YY 95 MM YY Final MM 06 YY 97

15. SOURCE/ORIGIN OF GOODS AND SERVICES
[X] 000 [X] 941 [ ] Local [ ] Other (Specify)

16. AMENDMENTS/NATURE OF CHANGE PROPOSED (This is page 1 of a ____ page PP Amendment.)

NOTE: The provisions of the payment verification policy regarding methods of implementation and financing, financial capability of recipients, and adequacy of audit coverage have been adequately addressed in this document.

J.C. Stanford, Controller

17. APPROVED BY
Signature: RICHARD A. JOHNSON
Title: Acting Director, USAID/Philippines
Date Signed: MM DD YY

18. DATE DOCUMENT RECEIVED IN AID/W, OR FOR AID/W DOCUMENTS, DATE OF DISTRIBUTION
MM DD YY

AID 1330-4 (8-79)

a

PROJECT AUTHORIZATION

Philippines

Capital Markets Development Project
Project No. 492-0447

1. Pursuant to the section entitled "Multilateral Assistance Initiative of the Philippines" in P.L. 101-513, and to P.L. 102-145, I hereby authorize the Capital Markets Development Project (the "Project"), for the Republic of the Philippines (the "Cooperating Country") involving planned obligations not to exceed $13,500,000 in grant funds over a four-year period from the date of authorization, subject to the availability of funds in accordance with the A.I.D. OYB/allotment process, to assist in financing foreign exchange and local currency costs of the Project. The planned life of the Project is five years from the date of initial obligation.

2. The Project consists of assisting the Cooperating Country and the Philippine private sector to enhance the efficiency of the securities market by improving the quality and transparency of information available. The Project provides funding for technical assistance, training, selected commodities, studies and research, as well as "seed capital" to encourage automation of the Philippine exchanges, and development of investor information services. The private sector component of the Project will be conducted on a one or two year basis initially, to determine whether the assistance is productive.

3. The Project Agreement, which may be negotiated and executed by the officer(s) to whom such authority is delegated in accordance with A.I.D. regulations and Delegations of Authority, shall be subject to the following essential terms and covenants and major conditions, together with such other terms and conditions as A.I.D. may deem appropriate.

4. a. Source and Origin of Commodities, Nationality of Services

Commodities financed by A.I.D. under the Project shall have their source and origin in the Cooperating Country or the United States, except as A.I.D. may otherwise agree in writing. Except for ocean shipping, the suppliers of commodities or services shall have the Cooperating Country or the United States as their place of nationality, except as A.I.D. may otherwise agree in writing. However, procurement of commodities and services whose source, origin, or place of nationality is in the Cooperating Country shall be subject to the requirements of Chapter 18 of Supplement B, A.I.D. Handbook 1. Ocean shipping financed by A.I.D. under the Project shall, except as A.I.D. may otherwise agree in writing, be financed only on flag vessels of the United States.

b. Conditions Precedent

Prior to any disbursement or the issuance of any commitment documents under the Project Agreement for commodities to be provided to the Philippine Securities and Exchange Commission ("SEC"), the Cooperating Country shall furnish, in form and substance acceptable to A.I.D., evidence of the establishment of an electronic data processing office in the SEC.

Clearances:

PESO:BCornelio
OPE:PRDeuster
DRM:(Actg.)GImhoff
OFM:JCStanford
CSO:SHeishman
OLA:LChiles
OD:(Actg.)JAPatterson

By: Richard A. Johnson
Acting Director
USAID/Philippines

Date: SEP 18 1992

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PROJECT (492-0447)
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ACRONYMS AND ABBREVIATION

ADB	Asian Development Bank
ANTCS	Automated, National Trading, Clearing and Settlement
BAP	Bankers' Association of the Phil.
BED	Brokers and Exchanges Department, SEC
CB	Central Bank
CBD	Commerce Business Daily
CMDC	Capital Markets Development Council
CMDP	Capital Markets Development Project
COP	Chief of Party
CSO	Contracting Services Office-USAID
DOF	Department of Finance
DRM	Development Resources Management-USAID
EDP	Electronic Data Processing
FINEX	Financial Executives Institute of the Phil.
FSN	Foreign Service National
GDP	Gross Domestic Product
GOP	Government of the Philippines
HBCU	Historically Black College & Universities
IEE	Initial Environmental Examination
IFB	Invitation for Bid
IFC	International Finance Corporation
IG	Inspector General
IHAP	Investment Houses Association of the Phil.
IT	Information Technology
MAI	Multilateral Assistance Initiative
MIS	Management Information System
MKSE	Makati Stock Exchange
MOS	Market operations systems
MSE	Manila Stock Exchange
NEDA	National Economic & Development Authority
NFA	Non-Federal Audit
NGO	Non-Governmental Organization
OFM	Office of Financial Management-USAID
ONRAD	Office of Natural Resources, Agriculture, and Decentralization-USAID/Philippines
OPE	Office of the Program Economist-USAID/Philippines
PASS	Philippine Assistance Strategy Statement

PACD	Project Assistance Completion Date
PASBD	Philippine Association of Securities Brokers and Dealers
PESO	Private Enterprise Support Office-USAID
PIC	Project Implementation Committee
PICPA	Phil.Institute of Certified Public Accountants
PMO	Project Management Organization
PP	Project Paper
PROAG	Project Agreement
PSA	Procurement Services Agent
PSE	Philippine Stock Exchange
RAO	Regional Audit Office
RCA	Recipient Contract Audit
RFP	Request for Proposals
SEC	Securities and Exchange Commission
SISP	Strategic Information Systems Plan
SRO	Self-Regulating Organizations
TA	Technical Assistance
TCS	Trading, Clearing and Settlements
USAID	U.S. Agency for International Development, Philippines
WB	The World Bank

I. SUMMARY AND RECOMMENDATIONS

The Capital Markets Development Project (CMDP) is a five-year, $13.5 million project intended to enhance the efficiency of the Philippine securities market by improving the quality and transparency of investor information available to capital market participants. Project grant funds will come from the SAI appropriation account.

The project will address the over-arching need in the Philippines to transform the capital market, making it a more efficient mechanism for capital formation and investment creation. This will be accomplished by attacking the critical problems that currently constrain capital market expansion, i.e., segmented, outmoded, and inefficient market operations; inadequate supply of high quality equities; and limited demand for shares due in part to lack of timely and accurate market information which has a dampening effect on investor confidence.

The project employs a two-pronged approach, addressing the requirements of both public and private sector participants in capital markets. Funds will be provided for direct-contractor assistance to the public sector, i.e., the Securities and Exchange Commission (SEC), for procuring technical assistance; computer equipment and software; and training. Activities under this component will modernize and extend the reach of SEC's management and information systems; support regulatory reform; and develop human resources at SEC (particularly professional skills).

Funds provided to the private sector, through a cooperative agreement with the Financial Executives Institute of the Philippines (FINEX), will finance technical assistance needed for the design and implementation of computerized market operations and information systems as a means of integrating the current dual-Exchange market structure; establish education and research programs to increase the professional competence of capital market experts and promote policy advocacy and reform in conformance with international standards for securities exchange performance; and provide funding to assist in capitalizing a management information service company.

Grantee	: The Republic of the Philippines
Implementing Entities	: Financial Executives Institute of the Philippines (FINEX); Securities and Exchange Commission (SEC); National Economic and Development Authority (NEDA)
Grant Amount	: $13.5 million
Funding Source	: Special Assistance Initiative (SAI)
Project Purpose	: to assist in the enhancement of the efficiency of the securities market in the Philippines by improvement in the quality and transparency of

investor information available to investors, the public, and other capital market participants.

Description : The project will assist the SEC in implementing key administrative reforms; promote more efficient and transparent operations; and, expand its services to the investing public.

A private sector component, implemented through an NGO, will put into place a national, automated, securities market system and investor information service; and, establish a training, education, research and policy advocacy program that will enhance the capabilities of capital market institutions and participants.

Estimated Completion : September 30, 1997

Statutory Requirements : Statutory Requirements have been met.

Recommendation : That a $13.5 million project for the Republic of the Philippines be authorized based on the terms and conditions listed in the Project Authorization.

Design Team : Mission Project Design Team members were:

PESO:Bruno Cornelio	OPE:Gil Dy-Liacco	OFM:Sonia Cruz
PESO:Brad Wallach	DRM:Earl W. Gast	OFM:James Stanford
PESO:Gerardo Carranceja	CSO:Noel Ruiz	OFM:Monica Stein
OLA:Lisa Chiles	OLA:Gerry Banzon	

II. BACKGROUND AND RATIONALE

A. PROBLEM STATEMENT AND SITUATION ANALYSIS

Capital formation in the Philippines -- through equities markets and through long-term investments -- has not developed to the point that it presents a viable option for expanding financial resources. Issuance of long-term debt and equity securities, through stocks and bonds, is seldom used as a means of capital expansion. Consequently, the securities market in the Philippines has remained an underdeveloped and inefficient mechanism for raising equity funds that finance new business opportunities and stimulate business expansion.

The following are factors that contribute to the current situation in Philippine capital markets. As in most other developing countries, the Philippine financial system has expanded through savings mobilization, and by debt-financing, which involves deposit-type instruments that are subsequently re-allocated through the banking system in the form of short-term credit.

Commercial banks constitute the largest sector of the Philippine financial system, holding approximately 85 percent of total deposits, and 65 percent of the total loan and investment portfolio. The relatively dominant lending policies of the banking system, combined with the historical interest rate subsidy policies of the Central Bank, have encouraged excessive dependency on short-term credit. Nearly 80 percent of corporate funding is obtained through short-term bank loans which has resulted in a highly leveraged corporate sector.

Despite an upswing in stock market activity from its low point in 1984, heaviest trading remains in a few major "blue-chip" issues. The number of private sector businesses listed with the Exchanges[1] is increasing, however, **the market is characterized by an inadequate supply of high quality equities; limited demand for shares; and, generally inefficient operations.**

Growth in the supply of equities has been retarded <u>inter alia</u> by the easy availability of risk-minimizing, short-term debt financing. It has been limited also by the reluctance of family-owned corporations to go public because they wish to: 1) retain their ownership and control; or, 2) conceal strategic information about the nature and extent of their operations. These attributes, common to many emerging capital markets, stem from fear of the loss of profits through higher taxation, or increased competition.

Lack of investor confidence also has constrained development of Philippine equities markets. Because of past abuses, such as insider

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[1] Throughout this paper "Exchanges" refers to the current Manila Stock Exchange and the Makati Stock Exchange.

trading, investors are reluctant to participate fully in these markets. Public skepticism regarding securities investment has deepened as a result of transactions soured through lack of adequate and accurate information. The availability of more attractive, alternative investments -- and the inability of regulatory authorities to monitor and control the market effectively -- has weakened demand for equity issues.

Operational inefficiency in the Philippine capital market is manifest in the way that the stock exchanges carry out their business. **Current trading procedures are entirely manual.** Based on a two-way auction, and "open-outcry" system where white boards are used to mark up offers and deals, these procedures constrain efficient order execution, transparent trading, and development of a liquid market. Moreover, the complexity of trading rules in the current system discourages the general public and foreign investors from participating. In addition, although semi-automated, **current settlement and clearing procedures are paper-based, time-consuming, and inefficient.** They do not conform to international, securities trading, clearing and settlement (TCS) standards: specifically, those for book-entry settlement; centralized securities custodianship; and delivery against payment. Transfer agents take as much as three weeks to execute transfers.

Lack of timeliness coupled with other inefficiencies in the settlement process, including a high ratio of unexecuted orders, are major constraints to market growth. **The standards and procedures for trading, settlement, and clearing of securities must be modernized to enable markets to expand; and to permit more efficient brokering of medium- and long-term debt and equity securities.**

Stronger Philippine capital market performance requires the collaboration of donors with public and private sector entities to modernize and expand current capital market operations. The key actors in ongoing efforts to expand Philippine capital markets are the Securities and Exchange Commission (SEC); the private Exchanges; the Capital Market Development Council (CMDC); and from the donor community, the World Bank, the Asian Development Bank (ADB) and USAID.

B. BACKGROUND - Operation of the Market

1. The SEC

The SEC started operations on November 11, 1936, under the executive supervision of the Department of Justice. During the ensuing years, and after the passage of key pieces of legislation, the role of the SEC greatly changed. Initially entrusted to administer and enforce provisions relating to primary public offerings of securities, and to trading of securities in the secondary market, the SEC currently administers and implements 20 different laws and presidential decrees.

At the SEC, 735 employees, working in nine departments, must implement the SEC's functions. These functions include: (a) registration of

companies and firms; (b) registration of securities that are offered to the public; (c) authorization of stocks to be listed on the two stock exchanges; (d) supervision of stock exchanges; (e) authorization and supervision of underwriters, brokers, dealers, financing companies, and mutual funds; (f) adjudication of all disputes; (g) examination of companies' annual financial statements; and, (h) investigation and prosecution of breaches of securities laws.

The SEC has encountered many problems in implementing its numerous responsibilities. Many stem from the existence of overlapping and redundant rules. The current regulatory mandate of the SEC far exceeds its capabilities and its effectiveness in the marketplace.

2. The Stock Exchanges

Two, privately-owned Exchanges presently operate in the Philippines: the Manila, and the Makati, Stock Exchanges, which were established in 1927 and 1963, respectively. The two Exchanges list a reasonable number of securities; have well-defined exchange structures; provide a basic level of market information; and retain an adequate number of broker-dealers.

For many years, USAID, the ADB, and the SEC have recommended a merger of the two Exchanges to improve market efficiency. Recently, both Exchanges have expressed agreement with the concept of one, national securities, trading venue. The two Exchanges have, however, been hesitant to a physical merger; particularly, if such a merger were decreed by SEC.

In May 1992, the preliminary legal documents for establishing the Philippines Stock Exchange (PSE) were finalized and signed by the presidents of both the Makati Stock Exchange (MKSE) and the Manila Stock Exchange (MSE). The documents constitute agreement to an eventual merger of the Exchanges in cooperation with the SEC. Despite this agreement, a significant amount of study on the operation of a unified Exchange is needed to effect the merger. The SEC has agreed to conduct this study.

The Exchanges and the SEC have defined similar objectives and development goals: a unified national securities market with automated TCS and central depositary systems; professionalized stock exchange management; and strengthened SEC capability to effectively regulate markets and manage their expansion. Both Exchanges and the SEC agree that market operations need to be automated and modernized. All view integration of the market through automated operations systems as a possible and necessary compromise to actual *physical* integration.

Such a move could also integrate the Philippine market with other modern international capital markets; could conform Philippine capital markets operations to international TCS standards; would lead to more transparent market operations; and could attract more foreign and domestic investors. Notwithstanding these potential benefits, both

Exchanges are wary of the costs involved in automation.

3. The Capital Markets Development Council (CMDC)

After nearly five years of planning and dialogue on its mandate, a private and public sector collaborative body called the Capital Markets Development Council (CMDC), was organized in November 1991. Tasked with spearheading sectoral reform and development of Philippine capital markets, the CMDC is chaired permanently by the Financial Executives Institute of the Philippines (FINEX). This non-governmental organization (NGO) is recognized by both the Government of the Philippines (GOP) and the private sector as the leader in capital market reform.

The CMDC is co-chaired by the public sector which is represented by the SEC, and the Central Bank (CB). Council members (and four technical committees, comprised of nearly 110 active participants) have reached consensus on an action agenda for sectoral reform. Among the important agenda items tagged for immediate implementation are: reduction of GOP administrative orders and policies identified as impediments to capital markets development; continued professional development of all market participants; improved automation of market operations; and, creation of a market-information-database corporation.

CMDC has been breaking down the barriers to communication between GOP regulatory agencies and private sector, capital markets participants. It has been instrumental in bringing together the two Exchanges, and in convincing them of the need for closer coordination through automation. With this private and public partnership of CMDC, the prospects for successful reform of the market in identified areas are higher than at any other time. Although faced with overcoming adverse GOP policies, and deep-rooted private sector rivalries and attitudes, the CMDC represents a medium for real change.

4. USAID Experience

USAID has monitored the conditions in Philippine capital markets over the past years. In 1987, USAID commissioned a detailed study of the markets. Based on study recommendations, and on meetings with the SEC, the Mission designed a comprehensive project aimed at reinforcing the Aquino Administration's commitment to privatize government-controlled corporations while supporting much needed operational reforms in the capital markets. During project negotiations with the National Economic and Development Authority (NEDA), USAID and the GOP failed to reach agreement on the extent of capital market restructuring. Thus, USAID deferred the capital markets development strategy, and successfully negotiated a separate project with the Department of Finance to support privatization.

In succeeding years, USAID continued its dialogue with the GOP and the ADB on opportunities for making improvements in the Philippine capital market system. In 1991, the GOP acknowledged the need to act

immediately to restructure and expand Philippine capital markets. This change in attitude permitted USAID to assist public and private sector entities in the creation of CMDC. The present environment is now ripe for further change.

C. RATIONALE

Twenty years ago the Philippines was an economic leader in the region. Now, it is lagging behind as other Asian nations forge ahead. In the International Finance Corporation's (IFC) publication *Emerging Markets Factbook, 1991*, the Philippine capital market held the penultimate ranking in the world with respect to market performance.

Dominated by a relatively small number of families and groups, Philippine business and its capital market operations traditionally have been closed systems. These systems are opening up now for a number of reasons: e.g., generational change; conflicting interests; competition and market pressures; and, the need for additional capital.

Concomitant with signs of change in the capital market sector, there are very significant opportunities for change within the present GOP policy framework. As previously stated, the Philippines capital market has been the subject of renewed interest by the GOP and donors. All view the development of Philippine capital markets as essential to catalyzing capital formation; private-sector-led economic growth; and improvement in the level of national employment and living standards.

Studies conducted by donor agencies in the past five years have outlined the causes and effects of capital market stagnation, providing recommendations for improving various segments of the capital market. These studies have all been consistent on one point: i.e., the Exchanges should be linked as one, efficient, processing body through automated systems. The automation effort should be effected by an independent, fees-for-service firm that can provide TCS services and market information; and, can perform the back-office functions of managing customer orders, and producing customer statements and confirmations in a timely manner.

CMDC has been successful in implementing some of the recommendations for improving the capital market, leading to improvement in performance in 1992. Stronger capital market performance has encouraged the SEC and Exchange leaders to consider moving more forcefully in the area of market reform. Success in this endeavor will require: (1) commitment on the part of the market's private and public sector participants; (2) expertise and professionalism in both public and private sector securities market institutions; (3) training of staff; (4) acquisition of capital equipment and information technology software; and (5) education of the general public, primarily through provision of readily available market information services.

D. ISSUES TO BE ADDRESSED BY THE PROJECT

Project assistance will target several areas in which the Philippine capital market must improve to achieve market efficiency and expansion. These areas include market self-regulation; market operations modernization; market and price information service; human resource development; and, conformity to international standards for securities market operations.

1. Self-Regulation

Systems for self-regulation are operating successfully in a number of capital markets throughout the world, the largest of which are in the United States and Great Britain. Appropriate models for self-regulatory organizations (SROs) also exist in Hong Kong, Singapore and other established and emerging markets in Asia. The primary benefits of a properly operating, self-regulatory structure are that it makes maximum use of the expertise of private sector participants; fosters improved compliance with established standards; minimizes government interference in market processes; and minimizes government expense, while permitting government to ensure that certain investor protection and market operation standards are maintained.

For self-regulation to work in the Philippines, the Exchanges must be active and responsive in fulfilling self-monitoring requirements. The SEC must effectively execute its oversight role without contravening self-regulation of the market. In the self-regulated market, broker-dealers and investment advisory firms are responsible for monitoring business activities of their employees and agents; and, for ensuring that they conform to ethical standards of operation, integrity and fairness.

Standards are based on SEC and Exchange rules and regulations; and conform to ethical codes and standards established by applicable professional associations, and by the firms themselves. The Exchanges are responsible for establishing and enforcing appropriate rules and regulations to ensure fair and efficient trading in securities; free entry to members who meet reasonable qualification requirements; settlement of differences between members; and enforcement of securities laws, rules and regulations as they apply to members.

Self-regulation requires coordination and cooperation between the SEC and Exchanges. Direct SEC oversight activities should be limited to licensing and de-licensing Exchanges, and broker-dealers; reviewing and approving Exchange rules and any rule changes; reviewing disclosures provided in registration statements for public offerings of securities; and declaring such registration statements to be effective. In all other activities, the SEC's oversight should be indirect to the maximum extent possible.

The Exchange should regulate its members and listed companies, continually improving trading and after-trading systems. The SEC

should encourage these activities and suggest remedial actions if they are needed, giving the Exchange a reasonable period of time to respond. The SEC should not task Exchange management with requirements for actions. It should not mandate such things as the number of seats on the Exchange; seat price; automation; the name of the Exchange; sources of funds; or, approval of listings. Except in unusual cases, the SEC should not discipline an Exchange member, or order a member to take specific action, without first discussing the matter with the Exchange. The Exchange should be the primary arbiter on matters of appropriate discipline and problem resolution.

2. Modernization of Trading, Clearing and Settlement Practices

Table 1 compares the elapsed-time aspects of current TCS operations with those possible where operations are fully automated.

Table 1. Comparison of elapsed times for Trading and Clearing Settlement Practices

where: T = the date of transaction or trade;
T+1 = one (1) working day after transaction

Processes*	Present Manual System	Proposed Automated System
Completed Buy and Sell; Purchase and Sales Report prepared/sent to broker.	T	T
Report reviewed by broker.	T+1	T
Report prepared/sent to Clearinghouse.	T+2	T
Advice/Summary Tickets sent to brokers; Debit advice to brokers with net clearing balances.	T+4	T
Payment made to Clearinghouse by broker.	T+5	T+1
Clearinghouse to transfer agent to corporate registrars and back to Clearinghouse.	T+9 to 26	T+1
Clearinghouse to centralized securities custodian (transfer agents/corporate registrars) investors receive written confirmation of transaction.	T+9 to 26	T+1 to 2
Clearinghouse processes new certificates for release to brokers.	T+27	T+1 to 2
Review by brokers; release of certificates to clients.	T+29 to 30	T+1 to 2
Custodian processes certificates for direct release to clients	T+29 to 30	T+2 to 3

Automation would reduce, by an estimated 27 days, the time required to process stock transactions. Annex H provides a detailed discussion of the steps involved in current market operations; and describes the processes that make the current TCS system inefficient.

In addition to improving timeliness of order processing, an automated system accommodates volume upswings; provides for rapid settlement, and payment of brokers; eliminates the volume of paper work that is involved in manual or semi-automated processes; and, reduces the numbers of staff currently required to perform clearing and settlement (back-office) tasks.

Markets cannot function efficiently without credible information that is disseminated quickly to participants. A unified, and fully automated, national trading, clearing and settlement (ANTCS) system is critical to the transformation of the Philippine capital market. ANTCS operations would ensure a fair market where no order is forgotten, and where price-time priority is rigorously observed. This would improve on the current system where order execution is subject to inaccuracies and abuses that are hard to detect.

Implementation of a modern, market operations system (MOS) would dramatically reduce the management burden embodied in current Exchange operations. For instance, the proposed system would have built-in surveillance capabilities, reducing the frequency of inspections of broker-dealers.

The following are among specific attributes of an automated MOS that contribute to its efficiency and utility. It achieves for an investor the guaranteed-lowest, best-possible price in a completely fair market regardless of place of execution; enhances the ability for increased volumes to be processed according to agreed upon trading rules; helps ensure uniformity in reporting and permits a single focus for regulation enforcement; avoids the need to dismantle and reorganize the current exchanges and the resulting time loss and associated risks; permits flexibility in policy changes (such as rescinding the dual listing requirement by permitting trades to be executed only by brokers of certain exchanges); allows the creation of additional exchanges in the future regardless of location, such as in the regions; permits listing requirements to vary by exchange, thereby accommodating or encouraging exchange specialization by industry or location; and, allows management of customer orders on an automated basis (e.g., allows the broker to verify customer credit and track the order until it is executed or canceled). This means that no client's order is forgotten, and broker-dealers are protected against credit risks.

Finally, an automated MOS allows for transparency of assessment of charges. When the trade is executed, the system automatically calculates the broker's commission, debits the investor's account, and credits the broker's account with the custodian for the amount of the commission. In a modern, automated system, brokers are obliged to settle promptly, whether or not they receive the money or securities

from their clients.

Modern markets use central book-entry settlement which means that shares and money are exchanged by accounting entries in a special centralized depository institution which eliminates the risk of counterfeit certificates or bad checks. Fully automated settlement means that transactions are completely settled electronically within 2-3 days after trade execution; and, without effort on the part of the broker. Automated settlement increases brokers' profits; and, improves the quality of service to investors. Both factors are believed to contribute to market expansion.

3. Changes in Custodianship and the Structure of Securities Instruments

An essential feature of modern securities market operations is the revised structure of stock certificates and the fungibility of securities. Securities are said to be "fungible" when all securities or stock certificates of the same type and class are interchangeable for the purpose of settlement transactions. This means that the serial number of a share is irrelevant for the purpose of settlement. Investors and brokers agree that they are trading the "rights to a certain number of shares" of a given type or class, but not the actual shares with specific serial numbers.

Securities should be held in collective safe custody through a centralized securities depository. A detailed explanation of collective safe custody is provided in Annex H. This capital market technique is used in developed and emerging markets to achieve "fungibility," and to make book-entry settlement practical.

Investors and issuers are drawn to markets that offer custodianship through a Centralized Securities Depository. Centralized depository custodianship is advantageous to investors because it ensures safekeeping of physical securities; efficient book-entry and physical movement of securities; substitution of ownership into book-entry records; and, ease of linkage with other depositories. For the issuer, centralized depository offers ease in the administration of the collection and disbursement of dividends and earnings; the initiation of ownership transfer of registered securities; and, administration of ownership records.

A significant amount of planning and restructuring of current market operations, as well as the restructure of specific sections in the Securities Act, will be required if a Centralized Securities Depository is to become reality. The GOP will have to revise its legal infrastructure to incorporate concepts of, and guidelines for, ownership through "fungible securities;" and to make provision for issues on authenticity and acceptability of such ownership records for normal business transactions.

4. Automated Market and Price Information Services

Investors will bid a stock at the best possible price on the market at a precise moment. In the current system, information on price changes is not made available in a manner that is timely and transparent enough to ensure bid optimization. Through automation, detailed information on all offers to purchase and sell a security can be transmitted rapidly to market participants -- e.g., broker-dealers, the press, and potential domestic and international investors. Thus, buyers and sellers receive more precise information with which to determine effective market strategy. Change in this aspect of Philippine capital market procedures is key to attracting more investors, and will assist to conform the Philippines capital market to international market standards.

5. Conformity to International Market Standards

Modern securities market operations in developed and emerging markets are based on the recommendations on securities clearance, settlement and custodianship developed by the Group of Thirty (G-30) in 1990. The Group of Thirty -- composed of international bourses and exchanges, markets leaders, securities settlement firms, and market institutions -- developed these recommendations soon after the October 1987, world-wide market collapse.

The Philippine market would do well to adopt these recommendations which form the globally-accepted framework for efficient clearance, settlement and custodianship; and, for improving international cross-border securities portfolio transactions. They are the basis for international market standards which enable emerging markets to attract and retain international and professional investors in their respective markets.

6. Organization and Human Resource Development at the SEC

The expansive mandate and limited resources of the SEC combine to create a considerable, supervisory "execution gap." The SEC's inability to execute the range of duties it is mandated affects its image in the marketplace.

The SEC must be strengthened and revitalized if it is to discharge effectively its responsibility to administer and enforce market rules and regulation. Recommendations for strengthening SEC should proceed from an examination of the organizational structure of the SEC to determine what changes would improve performance. The perception now is that SEC's structure hinders it from executing its responsibilities, e.g., one department may be charged with disparate and unrelated functions, while related functions may be scattered among two or three different departments.

SEC management and staff recognize, and articulate, the need for technical training and professional development at all levels. The

GOP, however, devotes limited funding to human resources development. Budgets for training have been a paltry $10,000 per year which in an agency of 735 persons translates into about $14 per person for training annually. Proposed changes in the Philippine capital market -- including automation of capital market operations and possible redefinition of the SEC role -- will further strain SEC's capacity. Support for human resources development, including professional development, is essential.

7. Continuing Professional Development in Securities Market Institutions

Proposed changes in the Philippine capital market environment will link the Philippines to more competitive, international capital markets. This raises the immediate concern that, in the short-term, Philippine market professionals may be unable to match world-class standards of expertise. Despite the talent that exists in the Philippine capital markets, professionals lack knowledge of, and skill in automated market operations environments; particularly, those integrated with international markets.

Private sector efforts at investor education -- currently through technical courses conducted by FINEX at selected business schools -- are significant. There is, however, no concerted approach in place to prepare market professionals and participants for operations under international market standards and practices. Market participants need assistance in assessing and addressing training requirements consistent with skills and knowledge requirements of modernized market operations systems.

E. PROJECT APPROACH

CMDP will focus primarily on working with the private financial sector -- and secondarily on assisting the public sector regulatory agencies (through the SEC) -- to improve the efficiency of the Philippine securities market in the areas previously discussed. The private sector component will be implemented through a cooperative grant agreement with the Financial Executives Institute of the Philippines (FINEX). The public sector component will be implemented through a direct contract with a contractor to be selected.

The private sector component will be given three years' trial to become operational and self-sustaining: i.e., from year 2 through year 4 of the five-year project. This component will be dropped if unproductive within the three-year, trial period. (See State 144294, Annex D.) This provision supports the assumption that ANTCS and the market information system will be commercially viable, attracting private sector financing. Criteria for performance are embodied in the outputs section of the Logframe (Annex B). It is assumed that completion of private sector activities will occur as scheduled in the Implementation and Management Schedule, Annex L.

FINEX will administer assistance to the private sector through sub-grants made to groups in the business community on a cost-sharing basis. Technical assistance, commodities and institutional support provided in the project are structured to build on FINEX's base as a leader in the financial community; and, to expand its physical presence nationwide in support of policy advocacy and reform. The identification and selection of FINEX, as the Private Sector Project Implementor, provides a broader appeal to the financial community, whose support and commitment is required for the project to succeed.

The SEC is targeted for project assistance because of its role and mandate relative to capital markets and their expansion. The project will assist the SEC in making the transition from the purely regulatory role it plays in the current system to one where it guides sectoral development and participates in regulatory oversight. This requires support for organizational and institutional capability building which the project will provide through technical assistance and training in the areas of: professionalization; automation and information technology; market regulation; and, organizational development.

Organizing the private sector to take the lead responsibility for introducing innovations in market operations increases the chances for success of this project. Efforts to modernize the Philippine capital market must move rapidly and will require flexibility of response -- which means immediacy in decision-making. This project features a strategy intended to co-opt the private sector -- i.e., gain its commitment and employ its resources -- in efforts to transform the Philippines capital market. This private-sector-led approach to financial sector development has been determined as appropriate, cost effective, and sustainable.

This approach recognizes and builds on the fact that developing the capital markets is primarily the concern of the private sector. Moreover, the private sector can contribute financial expertise and resources more readily than the public sector to project activities. Specific cost-sharing and/or leveraging mechanisms for funding of project activities have been developed and tested in previous private sector projects financed by AID in the Philippines.

In this project, private-sector beneficiaries will share the costs required to implement ANTCS and achieve a unified market operations and investment information service. This leveraging strategy ensures cost-effectiveness and sustainability of the project's outputs.

F. RELATIONSHIP TO MISSION'S STRATEGY

The Philippines Assistance Strategy Statement (PASS) of 1990 remains essentially relevant in terms of the current strategy for the Philippines. The over-arching program goal continues to be: broad-based, sustainable economic growth through the active partnership of the public and private sectors in fostering open and efficient markets and an open society. An explicit stratagem in achieving PASS

objectives is the fostering of open and competitive markets. CMDP will directly support this objective and the over-arching program goal by promoting a more open and efficient capital markets system that will allow businesses to have increased access to expansionary capital -- through equity and long-term debt rather than through high-cost, short-term debt financing.

The project also exemplifies two of the missions three cross-cutting themes: i.e., policy reform and private sector focus. CMDP will complement the World Bank's and the ADB's capital markets programs in promoting policy reform. CMDP will provide specific targeted technical assistance to assist the SEC in achieving internal reforms as well as provide assistance for private sector-led financial sector reform and capability development.

As indicated earlier, the project will be implemented for (and largely by) the private sector which will take a leadership position in a majority of the project activities. Direct beneficiaries of the project will be the Exchanges themselves; businesses that choose to go public and register with one or both of the Exchanges; and the investing public. The SEC will also benefit directly from project inputs through the up-grading of skills of personnel, automation of operations, and administrative reforms which should lead to operational efficiencies.

G. GOP POLICY FRAMEWORK

Development of the capital markets became a GOP priority in the late 1980s. In preparation for the Philippine Assistance Program (PAP), the GOP in May 1990, finalized its most recent development strategy, "The Philippine Agenda for Sustained Growth and Development." The document marks a watershed for Philippine development strategies.

Prior to this, the GOP objective was to reverse the downward trend in economic growth and to complete a full recovery. With a recovery generally achieved by 1989, the strategy turned to sustained economic growth through both the private and public sectors. Of high priority is the increased efficiency of the capital markets. The GOP acknowledges this to be a long-term process; and has requested foreign donor assistance from the World Bank, the ADB, and USAID. Its objectives in the capital markets are to strengthen the banking sector (through a policy loan from the World Bank); and to deepen the capital market by restructuring the stock market and making it more efficient.

H. DONOR COORDINATION

A stratified donor approach to capital markets development has been adopted wherein the World Bank will focus on macro-environment enhancements affecting the entire financial sector; the ADB will target sectoral policy reform for the capital markets through the Department of Finance; and USAID will direct project assistance for the implementation of these policy reforms, as and when they occur, through

a private sector-led effort, and assistance to the SEC.

The World Bank, at first, targeted the capital markets as a whole. After several detailed studies, it turned its attention to the financial problems of the Central Bank. The World Bank now plans to lend the GOP $200 million to arrest the high losses experienced by the Central Bank (CB) by restructuring the CB's accounts; and by assisting the GOP to change its monetary and exchange rate policies. A $1 billion effort by the World Bank over several years, in phases, is envisioned for the policy reforms in this area.

The World Bank's macroeconomic approach would make the CB an independent monetary authority, de-linked from the GOP Treasury and from the practice of deficit financing. This should facilitate CB concentration on long-term monetary policy, changing from an instrument of fiscal policy which has short-term, public sector debt orientation. Over the long-term this should lead to declining peso interest rates which will make equity investments more attractive and fuel increased activity for the private sector stock exchanges. Actual accomplishments of these outputs will increase the probability of, but is not critical to, the success of CMDP.

The proposed ADB program supports reform of the Philippine stock market. Aside from some limited technical assistance in areas such as stock market development, the program will aim predominantly at transforming the SEC from a "judicial body" into a service organization: one that promotes as well as regulates the capital market. Legislative changes to the operations of the SEC will be required to accomplish this objective. This may pose difficulties for ADB, perhaps delaying execution of its loan program. While ADB program accomplishments could ensure the success of the USAID project, delayed execution of the program will not prevent successful implementation of CMDP. USAID has reviewed the latest policy matrix developed by ADB (but not yet accepted by the GOP) and sees no duplication, and more importantly, no contradiction between the ADB program, the objectives of the World Bank activity, and those of CMDP.

III. PROJECT DESCRIPTION

A. GOAL, PURPOSE, AND END-OF-PROJECT STATUS

1. Goal and Purpose

The goal of the CMDP is to enhance the operational capacity of the capital market so that an increase in the number and types of equity and debt securities becomes available to investors, thereby attracting additional investments and contributing to overall economic growth.

The project purpose is to assist in the enhancement of the efficiency of the securities market in the Philippines by improvement in the quality and transparency of investor information available to investors, the public, and other capital market participants.

Transparency of market information is a long-standing problem in the Philippines. By improving "transparency", that is, the assurance that all information is up to date and available to all interested participants, confidence in the market will increase. Increased investor confidence will translate into more firms registered with the SEC; an increase in the number of public issues; and the stimulation of trading through a modern national securities market operations system. The use of a private-sector-led effort to transform the market in tandem with public sector reform action will be stressed.

2. Project Components

Technical assistance, training and commodities for both components will be provided in order to achieve project objectives. USAID has chosen to work with FINEX through a cooperative agreement (Component 1) because FINEX already has in place the structures, and some of the programs, required to gain commitment and consensus from the business community to reform the way market institutions operate. In the business community, FINEX leads the campaign to improve professionalism and technical capabilities in the capital market system; and, to develop an integrated and automated national market system. Assistance will be provided to the SEC under project auspices (Component 2) to help SEC implement administrative reforms needed to make transformation of the market operation system possible; and to fund organizational enhancements that will improve operational efficiency in the public sector.

3. End-of-Project Status

By the end of the project, it is expected that:

- The modern, private sector-owned and operated ANTCS, will integrate the two Exchanges and SEC into one network, improving access to the latest and most accurate information and thereby promoting efficiency in a transparent environment.

- A reformed SEC (in terms of policy and personnel skills) will exist with fully functional sub-offices, equipped to provide both information services and surveillance through its integration with the ANTCS system.

- A private sector-owned and operated market information service will be created (using transaction information from the automated system and providing analysis of this information). Information will be provided on a fees-for-service basis.

- Self-sustaining, private sector-led training and education, research and policy advocacy programs in capital markets development will be in place.

- The CMDC has established effective patterns of policy dialogue and collaboration in financial sector policy reform between and among private and public sector capital market participants.

- The Exchange(s) are reorganized and are operating within standards of proficiency that are established and practiced in Exchanges in developed markets.

- A self-sustaining private sector center for capital market education, training, research, and policy development is established and operational. The Center will be composed of existing organizations and affiliated with a distinguished institution for higher learning.

- Establishment of a revised regulatory strategy for encouraging registration and listing business entities on the Exchanges; and encouraging public offering of securities. The new rules should conform with principles of self-regulation and disclosure, as well as the ANTCS system.

- Revised rules and regulations are approved and implemented. These rules and regulations will deal with matters regarding disclosure, monitoring, and surveillance, and are intended to promote confidence in the system.

- Internal operational procedures to improve SEC operations, thereby reducing response time to the private sector, are prepared, approved and implemented.

- Management information system (MIS) and departmental capability for systems automation is created.

B. PRIVATE SECTOR COMPONENT

1. Technical Assistance

a) Technical studies for the development and implementation of ANTCS

An estimated $1 million will be provided through the cooperative agreement with FINEX to assist the private sector in designing, planning, organizing and implementing ANTCS. The system will be based on commercially available, off-the-shelf software appropriate to the Philippine capital market environment; will be linked to an enhanced SEC regulatory and surveillance capacity; and will facilitate disclosure and self-regulation. FINEX will use the results of ongoing feasibility studies to plan actual interventions. Among the issues being considered are the advantages and disadvantages of partial versus full automation; and, joint automation of the Exchanges to avoid duplication.

Studies conducted through this element will facilitate: **System Design** which entails defining the requirements and specifications of a single automated national market operations system -- including computer-based trading, clearing, settlement and back-office capability -- that would serve the operational needs of both Exchanges and the SEC. **Consensus Building** which requires developing acceptance, support and resources in favor of the proposed system among broker-dealers, officials of the SEC, custodians, registrars and other market participants. **Business Organization** which covers evaluating alternative methods of organizing, financing and managing the provision of an automated system. **Implementation Planning** which will define the transition process (all key planning and action steps) that the Exchanges and the SEC would need to undertake once they choose to convert to an automated system of their choice. **Contracting** the acquisition of the automated system from international vendors and providing contract management assistance during the implementation of the automated system. **Technology Transfer and Assimilation** to ensure that technology transfer is effected in the process of acquiring the new system by requiring the vendor to train local personnel in all aspects of running, maintaining and programming the system.

An ADB assessment to determine the potential for automating the Exchanges and for developing capital market financial instruments is scheduled for completion by December 1992. Its findings and recommendations will be reviewed by USAID, and will form the basis for technical assistance interventions. CMDP technical assistance is expected to produce a **final** technical design, business organization and implementation plan for the ANTCS.

Studies implementation will occur in four phases. The first phase will be fully funded by the project. The next three phases feature progressively greater cost-sharing with the private sector. FINEX will be required, in the cooperative agreement, to secure capital resources from interested private sector business groups to cover the costs of project implementation. The major expenditure for technical studies will be the cost of consulting services. These include professional fees, and out-of-pocket expenses to be incurred by the consultants. The four phases are as follows.

PHASE 1- Preliminary Systems Definition.

Using inputs from the ADB, "Preliminary Systems Definition" study, consulting firms will document how the Exchanges should effect integration through the ANTCS system; define functional specifications of the automated systems; estimate systems set-up costs; and prepare the preliminary implementation plan for ANTCS. The automated system will be consistent with the capital markets standards as recommended by the G-30, and consistent with the standards of other applicable international organizations.

Staffing Requirements-Phase 1: The level of effort is estimated at a total of 9 person-months for the following categories:

Short-term Specialists	Person-months
- Legal specialists (domestic)	1.0
- Securities industry specialists (domestic, international)	3.0
- Capital market specialists (international)	2.0
- Regulatory specialists (domestic, international)	1.0
- Automation specialists (domestic, international)	3.0

PHASE 2- Consensus Building and Business Organization

Specialist consulting services will be procured to assist FINEX in:

- o Developing consensus in favor of ANTCS/MIS among the various participants in the capital markets (Exchanges, broker-dealers, SEC officials, registrars and other market participants).

- o Evaluating alternative methods of organizing, financing and managing the automated systems. Financial services consultants will assist in promoting investment, and soliciting investors in the corporation that will own and operate the automated systems. The contractor will be expected to define the organization and management structure of the MOS service company (including, ownership, capitalization structure, staffing requirements, broker- dealer compliance standards, operational rules, and guarantee systems); and, to develop financial and operational Plans (e.g., review and develop feasible ownership structures; prepare a preliminary model for operations/organizational systems;, prepare financing options and elements of financial plans).

Staffing Requirements-Phase 2: The level of effort is estimated at a total of seven (7) person-months for the following categories:

Short-term specialists	Person-months
- Legal specialists (domestic)	1.0
- Securities industry specialists domestic, international)	1.0
- Capital market specialists (international)	1.0

- Investment banking/finance specialists (domestic, international) 3.0
- Automation specialists (domestic, international) 1.0

During Phase 2, FINEX will secure capital resources from interested private sector businesses and/or groups to fulfill cost-sharing arrangements. These arrangements will be established early in project implementation under the terms of the cooperative agreement between USAID and FINEX; and will provide for FINEX's graduated assumption of all costs within the life of the project.

PHASE 3- System Implementation/Installation

This phase involves defining the transition process that the exchanges and the SEC will undergo once they choose to convert to an automated system of their choice. The contract for acquisition of the automated system from international vendors will be executed. The objective is to make the system operational in the shortest possible time-frame and in a manner consistent with the complexities of this undertaking in the Philippines. This work is expected to be performed by the same consultants tasked with Phase 1 and involves:

- o implementation planning and system design and adaptation -- i.e., defining strategies and steps for implementation of the automated systems by the various participants; and,

- o contract management -- i.e., executing a contract for assistance in facilitating the acquisition of the automated systems from international vendors (including provision of guidance on bidding procedures and selection of vendors); for assistance during implementation of the ANTCS system; and for monitoring vendors' compliance with contract provisions.

Staffing Requirements-Phase 3: The level of effort is estimated at a total of fourteen (14) person-months for the following categories:

Short-term specialists	Person-months
- Legal specialists (domestic)	1.0
- Securities industry specialists (domestic, international)	3.0
- Procurement specialists (domestic, international)	4.0
- Automation specialists (domestic, international)	6.0

Project funding for activities under this phase will decrease incrementally from the level of Phase 2, consistent with increased cost-sharing arrangements worked out in early stages of implementation.

PHASE 4- Technology Transfer and Assimilation

In this phase, technical specialists will assist the Exchanges and other participants to "migrate" to a new system, so that technology transfer is effected in the process of acquiring the new system. Specialists will ensure that the personnel will be trained in all aspects of running, maintaining, and programming the system. The work will cover consulting services to assist FINEX in:

- o ensuring that vendor training provided to the users of the new automated systems is developed and completed as specified, and monitoring and evaluating results of vendor training; and,
- o providing technical guidance to the users of the automated systems in operations, maintenance and programming.

Staffing Requirements-Phase 4: The level of effort is estimated at a total of eleven (11) person-months for the following categories:

Short-term specialists	Person-months
- Training assistance (domestic, international)	6.0
- Securities industry specialists (domestic, international)	1.0
- Capital market specialists (international)	1.5
- Automation specialists (domestic, international)	2.5

Cost-sharing during this phase is expected to have reached a level where FINEX provides most of the capital required to implement and maintain project activities.

2. Technical Assistance for Market Information Services

The MIS will be set up in the private sector, through a national network of information providers and users; and, linked to the SEC and other government agencies. This service will provide information that is not yet available, or if available, not in a form conducive to making sound investment decisions. Data will be housed centrally with a service company; and gathered from providers such as the CB, Bureau of Internal Revenue, banks and financial institutions, the SEC, and international Exchanges. Information obtained will be transformed and made available (e.g., as trends analyses) to the investment public through a data-telecommunications-network linkage with the central database. Use of the database will be on a for-fee basis.

The basic parameters of this system are being developed through an ADB technical assistance project; and are scheduled for completion in December 1992. This study will recommend the mechanism for developing long-term bonds and securities, as well as define the requirements for credit rating services. Findings will be used by project implementers.

Initial funding of $750,000 will be provided to FINEX for the purpose

of developing and upgrading a market information service company with a national network. The cooperative agreement will allow FINEX to enter into a contract with a service company which will be tasked with development and provision of market information (such as credit and bond ratings, securities investment analysis, corporate and industry performance, and other economic performance indicators). To this end, FINEX will work in collaboration with the service company to: develop contractor specifications; issue requests for proposals; select the contractor; define investor information requirements; develop the automated system that will obtain raw data and provide the required modified information; conduct international bidding for commodity requirements; market commercialization of the service; and effect delivery of the service to private and public sector users through an easily accessed system. This project element also will cover the cost of defining information requirements of the new system; developing the system and software; and acquiring the hardware.

Technical assistance in the form of short-term specialists will be required. The level of effort is estimated at a total of ten (10) person-months for the following categories:

Short-term specialists	Person-months
- Securities industry specialists (domestic, international)	4.0
- Capital market specialists (international)	4.0
- Automation specialists (domestic, international)	2.0

The "Seed Capital Challenge Grant" Fund, established under the cooperative agreement, has particular salience for this aspect of the project. A total of $1 million in capital will be provided through the cooperative agreement with FINEX to "challenge" other private sector investors to form a market operation system (MOS) service company -- e.g., through a consortium or joint venture instrument. The capital will be put up for an equity share in the service company in FINEX's name. This investment of capital -- which could be in-kind contribution, commodities, cash, or a combination of the three -- represents about 10 - 20 percent of the estimated cost of operating the investor information service, providing on-line, real-time access to users nationwide. "Challenge" capital will be released to the service company when the company:

(1) produces 80 - 90 percent of the capital required for MIS operations;

(2) uses proven technology for MIS; and

(3) demonstrates its capability to operate MIS -- i.e., with a six-month MIS operations track record.

The capacity to finance and operate a MIS service company already exists in the Philippines: i.e., in existing clearing banks; in the

Exchanges; among securities brokers-dealers; in financial sector associations; and, with other financial institutions and groups that understand and value the potential profit in the new MOS. The "challenge" capital is expected to encourage these potential partners to form the service company. Once the company is formed, FINEX can use the $750,000 mentioned previously to help develop and upgrade the MIS network. A proportionate share of revenues generated by the service company shall reflow to FINEX for use in sustaining capital market improvements during the project and after the project activity completion date (PACD). A revenue stream from the MIS will go to FINEX in perpetuity to support non-revenue portions of market operations -- e.g., policy advocacy.

3. Commodities

Commodities in the form of computer and data communication hardware and software will be required for:

- o project administration on the part of the NGO/Project Implementer, FINEX;
- o operationalizing the ANTCS system; and,
- o operationalizing the investor information system.

Technical assistance in the form of short-term specialists will be required. The level of effort is estimated at a total of three (3) person-months for the following categories:

Short-term specialists	Person-months
- Procurement Services Agents (domestic, international)	3.0

4. Training, Education, and Policy Research

FINEX will assist in professionalizing the operations, business standards, and market development practices of the capital market institutions. This activity includes the design, organization and implementation of short-term, fast-track training courses, workshops and seminars on capital markets development, and on-the-job training arrangements. FINEX will also be responsible for organizing support for a proposed Institute for Capital Markets Management, Research, and Policy to serve as a focal point for sector-wide programs for management education, training, policy dialogue, and research. The Institute, and other training, education and research activities, will be conducted on a fee-for-service basis and structured to sustain itself fully after the project's PACD.

Short-term, Fast-track Training. This training will be implemented on a cost-sharing basis with private sector participants on such topics as: automated trading systems; investment/trends analysis; portfolio management; new financial instruments; securities marketing, and other

technical areas over the life of the project. The project will provide funding up to $1 million to shoulder no more than 50 percent of the cost of the training to private sector participants. These will include stock brokers-securities dealers; financial analysts; and investors. FINEX will sub-contract for all the services required. Short-term training needs will be identified; implementation strategies and cost-sharing mechanisms will be developed;, and courses will be identified and implemented either in-country, in the U.S., or in a third country. Courses in-country will initially focus on assisting the users of the automated MOS in technology transfer and assimilation. Training courses will be implemented jointly, whenever possible, with public sector counterparts.

Policy Research and Curriculum Development. A separate allocation will be made available for capital markets research and for long-term curricula development. The project will provide grant funds through FINEX to conduct capital market research on issues for policy reform/dialogue; to identify new trends in capital markets; to examine training and education issues; and, to develop a one- or two-year curriculum with special emphasis on capital markets. FINEX will manage the allocation of $1 million, either through a sub-grant or contract to a highly respected business education institution with both a national and Asian regional audience and outreach.

FINEX will manage project funds to implement the various elements of the overall training-related program, including subcontracting for:

- various core professional education programs;
- periodic special focus workshop and seminars;
- fora and conferences for the business community;
- case and learning materials development;
- training development, consultation, and facilitation services (needs assessment, design, training of trainers, organizational development and systems change, human resource development, process facilitation);
- training materials development, packaging and marketing services to link users of training with providers of training or existing course materials;
- research to support policy analysis and dialogue;
- ongoing linkages and networking;
- shared experiential learning among Asian counterparts; and,
- infrastructure, support, and professional services for other organizations and groups (both private and public) that are

involved in capital market development.

In addition to various administrative support personnel, sub-contracted consultant inputs may be required to achieve this activity's objectives and output. Short-term technical assistance will also be required in a number of categories, including: needs and capacity assessment; program design and development; training packaging, marketing, promotion, delivery; organizational systems and development; human resource development; and capital market policy studies.

It is estimated that each of the five studies will cost $50,000, student costs will be nearly $16,000 per annum and annual administrative costs $105/student. FINEX will refine these estimates once a master training plan is developed for the life-of-project.

5. Institutional Support and Development

a) Project Implementing Organization

Funds will be provided to FINEX for procurement of equipment and staff development in support of its capacity enhancement. Capital outlays and expenses to be incurred by FINEX in the implementation of the Project will include, among others: outlays for office equipment, salaries of officers and staff hired for the Project, lease and rental of additional office space outside of Metro Manila, and other administrative expenses, such as utilities, office supplies, etc. FINEX will use these inputs to support nationwide outreach; and to strengthen its data communication linkages with regional offices.

b) Policy Reform and Advocacy

FINEX also will develop, and continue to conduct capability-building programs of its own, to address the needs of the investment community for professional education, policy development and advocacy for financial (private and public) sector reform. Funding is provided for activities which include: review and evaluation of existing regulations and practices in trading activities; meeting with key participants in the capital markets and other interested parties for identification of issues and areas for reform; policy analyses and evaluation; and, development of a policy agenda and action plans through private-public sector collaboration. Support will be provided by FINEX for meetings held by the CMDC in instituting policy reform.

C. PUBLIC SECTOR COMPONENT

1. Technical Assistance

This project component will require a mix of short- and long-term consultants who will work directly with the SEC in appropriate reforms based on other studies and recommendations funded under the study element of this component. The project will provide the following long-term expatriate specialists:

(1) Capital Markets Regulation Specialist, who will act as chief of party, to coordinate all project activities under the SEC component and assist in the area of identifying areas for reform, arranging for policy studies, and help to implement appropriate reforms.

(2) Organization Development and Training Specialist to assist with organizational procedures and training issues, as described above.

(3) Information Technology and Automation Advisor to develop and implement an overall automation strategy, provide direction for the SEC's automation efforts, and guide the development of overall capability. This would include providing directions for automation of both the SEC's internal systems and those that link with other external entities such as the exchange(s), the market information service, and other GOP agencies etc.

The long-term advisors will be assisted over the life of the project by short-term foreign and local specialists with expertise in appropriate areas of capital market development as it applies to the context of the Philippines.

a) Technical Studies to Enhance the Institutional Capability of the SEC in a Self-Regulated Securities Environment

Special studies under the public sector component will support the activities of the long-term technical assistance team and may be generated upon request by the SEC project management team and decisions emanating from the CMDC. The project-funded technical advisors may seek short-term specialists in completing studies. This activity intends to provide vital information to senior policy makers within the SEC so that they are better able to make sound decisions. The activity will fund studies on significant issues the SEC is now facing or expected to face in the near- and medium-term such as:

- The possible implementation of a strictly physical unification which merges antiquated and highly inefficient trading clearing and settlement methods;
- The integration of outside software procurement without first taking into account overall systems architecture;
- Considering partial automation options which may prove to be more costly and significantly less efficient than full automation; and,
- Misconceptions regarding the type of infrastructure and levels of financing required to effect an automated solution.

The examples listed highlight the need for objective information about how best to proceed with unification and automation, and point to an area of opportunity for the CMDP to make an impact.

The project will fund studies examining how a self-regulated market would most optimally work in the Philippine setting. A contractor will provide technical assistance to SEC management in further defining the SEC's role in the market-self-regulating environment; and in developing a strategy for implementing the findings.

Technical studies will be executed to identify critical areas of reform for the SEC.

b) Technical Support for Regulatory Reform

To improve the SEC's capacity to regulate the securities industry, improvements at the operational and administrative rule-making levels should be made. For example, there are a number of provisions in the Revised Securities Act and SEC rules that deal with "investment evaluations" as prepared by the SEC, such as: maximum commissions for public offerings; whether a security is a safe investment; whether the issuers' business is sound; clearance or approval of listed companies' news reports; and certification of financial statements, among others. The SEC assumes a large risk if, as a supposedly neutral public sector regulator, determinations and recommendations it prepares influence private sector investment decisions in such areas. The SEC may establish certain criteria as standards to be used, but investment risk and safety are evaluations that can best be made by private professionals, whose views often differ, and ultimately by the investors and prospective investors themselves.

Refraining from these types of evaluations is an important part of realizing self-regulation and permitting maximum private sector decision-making, which generally results in more appropriate economic decisions and eliminates any government responsibility for decisions taken by the private sector. The appropriateness of the SEC in engaging in these types of evaluations will be reviewed under this activity, and on the basis of that review, the project will work with the SEC in implementing mutually agreed upon changes to such administrative and regulatory rules.

A regulatory specialist will work with the SEC management to identify areas for reform. The CMDP will fund activities leading to such policy, administrative, and regulatory reforms. Technical studies will be undertaken to identify critical areas for reform, such as those listed, as well as major changes that can only be pinpointed after careful analysis. Three (3), long-term contracts with expatriate specialists (capital markets regulation specialist, training and organizational development expert, and an automation specialist) will provide technical support directly to SEC management in planning the proper courses of action and assist in the actual implementation of appropriate reforms. The goal of this task should result in a set of rationalized and updated rules (preferably in codified form), drafted with the SEC and issued by the SEC itself.

Funding will also be used to support policy dialogue efforts, including consensus building, among the major participants of the capital markets (e.g., SEC management, the Exchanges, FINEX, and other members of the CMDC). The long-term advisor could be expected to focus on the following categories of SEC rules and regulations:

- o Evaluations: Assist in reviewing the appropriateness of and possibly removing SEC rules that deal with investment evaluations by the SEC.

- o Streamlining: All rules related to or that deal with offering or trading of securities, by brokers, dealers and investment houses, should come under the jurisdiction of the Brokers and Exchanges Department (BED). Review of all rules should be executed with consideration of overlap and duplication. The advisor will coordinate closely with the Training and Organization Development Advisor in completing this task.

- o Automated Trading Clearing and Settlement: Assist in drafting rules pertaining to trading, clearing and settlement, particularly when the private sector securities industry institutions move toward the automation and integration of these functions.

- o Underwriting/Issuing: Assist in reviewing and recommending changes in rules and regulations to carry out the SEC's responsibilities and functions pertaining to underwriters and issuers (e.g., underwriter contracts, allotment, oversubscription, underwriting records and procedures, price stabilization, registration of offerings, registration of public companies, prospectus companies, prospectus definition, public company disclosure, insider disclosure, reporting requirements, underwriting results, suspension of offerings).

Short-term specialists will be required to assist the technical assistance team in such areas as:

- o Inspections: Assist in reviewing and recommending changes in rules and regulations pertaining to the SEC's inspection of securities market institutions (e.g., broker/dealers, securities exchanges, investment managers, etc.) to determine compliance with their responsibilities and any new rules and regulations that may be established in a new automated exchange system. Develop criteria for the stock Exchange(s) to fulfill their role as regulators of members and listed companies.

- o Legal and Administrative Appeal: Assist in reviewing standards and possibly drafting rules and regulations pertaining to administrative appeals (e.g., appeal procedures for the SEC to follow when a person believes that a sanction imposed either by the SEC or a self-regulatory organization is inappropriate).

- Enforcement: Assist in reviewing rules and regulations pertaining to structuring an administrative action by the SEC to establish the basis for limiting a person's license, canceling a person's license, barring a person, assisting in a legal action for the purpose of a fine, imprisonment and/or restitution of ill-gotten gains.

- Stock Exchange Operations: Assist in reviewing rules and regulations pertaining to stock exchange operations (e.g., listing/de-listing, rights offerings, trading and floor procedures, block trades, odd lot trades, floor trading procedures, floor trading personnel, commissions, member ethics and affairs, membership, member discipline, examinations, clearing and settlement).

- Clearing and Settlement: Assist in reviewing rules pertaining to clearing and settlement (e.g., inspection application, records, reports, license application, stop/resume clearing, disciplinary action, inspection procedures).

c) Organizational Development

In the area of securities market regulation, overlap and duplication of rules, regulations, and procedures are prevalent. For example, an overlap exists in the responsibility for registering, licensing, and regulating different types of securities companies and individuals. There is also significant overlap with respect to the registration of securities for public offerings and sales, and their listing on the stock exchanges for trading. Rationalization of the functions of each SEC department is in order to avoid such overlap and duplication on paper and in practice, so that the SEC adequately addresses the issues affecting the securities markets, such as stock exchange operations, governance of the exchanges, and the evaluation powers of the SEC.

A long-term consultant specializing in organizational development issues will work with the internal SEC team appointed to administer the public sector component to develop and recommend organizational and functional changes. The advisor will work directly with the Executive Director to review and draft changes, as well as with the Directors of all SEC departments that will be affected by organizational and functional changes. The scope of this activity will examine such areas as:

- Operational Strategy: Assist the SEC in reaching a consensus on a master strategy by (1) analyzing the operational goals of the SEC and providing comparative information on the structure of securities market supervisory agencies in other countries; and (2) assisting with the planning for the reorganization or restructuring of internal procedures.

- Procedures: Develop a procedures manual that specifies operating procedures for all SEC tasks listed in the master plan. This

procedural manual should form part of the SEC rule book and contain organizational charts, job descriptions, and operation flow diagrams.

- Records and Automation: Develop a records and automation plan which specifies SEC record keeping requirements and determines how they are to be stored and accessed. It would cover external as well as internal SEC documents. This plan would describe the SEC's needs for automation-current and future. These specifications and review would serve as the basis for further implementation.

d) Develop an Automated Capability within the SEC to Monitor the Market

There is a need to enhance the automation systems of the SEC to carry out its surveillance role. This component will assist the SEC in devising and executing its plan for the development of an information access facility linked with private sector investor information providers. The facility will be networked to regional offices and linked to the newly automated stock exchanges. Information generated will assist the SEC in its surveillance role and will be made available to all capital market participants and other users on a continuing fees-for-service, cost-sharing basis.

Technical assistance, studies, and commodities will be provided to the SEC to put this system into effect. A long-term consultant who specializes in automation systems will assist in drafting rules and procedures for the SEC in surveillance matters, assist in determining the computer systems networking requirements to carry out the surveillance function, and develop a procurement plan for needed commodities.

2. Commodities

Funding will be provided for upgrading the existing automation equipment, enhancing market surveillance information systems, expanding information and data communication networks to the existing and new SEC regional offices, and installing a MIS.

Funding will be provide also to assist the SEC's efforts to strengthen its outreach (through existing sub-offices located in Baguio, Cebu, Iliolo and Davao) by providing commodities in the form of computers and technical assistance to develop an in-house training program and integrated automation systems. Allocations will also be made for the provision of similar equipment and technical assistance for putting into operation three new SEC offices at Zamboanga, Legaspi and Cagayan de Oro.

3. Training

Training (as differentiated from technical assistance relating to

institutionalizing an in-house capability within the SEC) will be provided in such areas as:

- o operations of the new automated trading system, and the environment under which it will operate;
- o advanced security regulations, monitoring, surveillance, and other areas of capital markets regulation and development; and
- o securities market-related subjects (e.g., accounting, auditing, financial statement analysis, investment analysis, pricing of securities, etc.).

Training will be offered on a short-term basis within the Philippines, in the U.S., and perhaps third countries. The project may also fund study tours for senior SEC managers of newly automated exchanges operating in Asia, such as Indonesia and Thailand.

The SEC's mandate is broad and very technical in nature. However, it does not have access to the full range of resources needed to implement its mandate. Resources for training, staff planning, and team building have been severely reduced, leaving professionals and staff with little opportunity to develop or implement the mandate of the SEC. While many structural limitations are unlikely to change without major policy and political reform, the availability of good training is one way to provide some offsetting benefits. The objective of this activity is to strengthen the technical capital market skills of SEC staff, as required for their regulatory role.

Another issue is the SEC's ability to respond to private sector needs and demands on SEC's mandate. SEC staff may not have a clear or useful understanding of how they are perceived by their "marketplace." Certain kinds of training processes involving "market surveys" of SEC services and relationships with its "clients" could be very helpful. At the technical levels, the types of training required include:

- o Front line service: contact with "clients or customers";
- o Specific task/function/system oriented: emphasis on competencies, procedures and techniques;
- o Professional and analytical skills, prospectus review/ analysis, monitoring and enforcement; and
- o Team building.

At the management level (from mid-level to top), the types of training required include:

- o Management skills, analytical techniques, and development of group performance;

- Case-specific learning: project, problem, issue (exposure to counterparts and "pioneers" in other places and markets);

- Organization and institutional development: leadership, systems development, people development, strategic planning, among others; and

- Industry and sector development: vision, "marketplace" orientation, policy development and implementation, intergroup relations and consensus building (dialogue and consultative relationships with other capital market players).

Institutionally, the SEC needs the resources and training delivery capabilities necessary to address individual, functional and organizational needs, training for transition in systems, procedures, automation, records management, and reorganization of the exchanges, and training in values and services orientation.

In terms of staff training, human resource development and career management issues, specialized courses to prepare SEC staff in the technical areas that focus on capital markets operations, will be identified and implemented. A training plan will be prepared and will be focused on skills requirements for tasks identified under the organizational development plan. Training will be in areas similar to capability building programs to be conducted by the private sector such as: automated securities markets operations; portfolio management and securities analysis; investment and trend analysis; new financial instruments; monitoring, regulation and oversight, among others.

The long-term consultant tasked with organizational development will also assist the SEC in formulating the following:

- Human Resource Development Plan. The consultant will first make an organizational assessment that compares job requirements with existing and proposed staff skills. Using this information he will then develop a plan which determines how to "bridge" any gaps between requirements and existing skills in the short run, as well as recommends a long-term strategy for developing and maintaining the human resources that the SEC needs to operate effectively.

- Training Curricula and Career Development Plan. With assistance from the internal team at the SEC and local consultants, training plans and courses will be developed and implemented to enable SEC staff to achieve technical skills and competencies comparable to private sector counterparts in specific areas of capital markets operations, as well as in internal and managerial organizational skills. This plan would also specify the types of course to be funded under the project, including study tours, short-term, in-country training, U.S. short-term training, and perhaps third country training.

D. PROJECT BENEFICIARIES

CMDP is intended to promote a more open and efficient capital markets system that will allow businesses to have increased access to expansionary capital through equity and long-term debt rather than through high-cost, short-term debt financing. As confidence in the Philippine market grows, so will investments. As the capital market flourishes, long-term capital formation objectives are realized, thus building strong foundations for sustained economic development.

Under the private sector component, direct beneficiaries will be the Exchanges, and businesses that choose to go public and register with one or both of the Exchanges, as well as the investing public. With a properly operating automated exchange in a self-regulatory structure, all participants in the capital market become the primary beneficiaries of the project. Under the public sector component, the SEC will also benefit as its functional capabilities become more effective and efficient.

E. SUSTAINABILITY

Project activities under the **Private Sector Component** are designed to be self-sustaining by the end of the project. The capital costs for the purchase and implementation of an automated system, for example, will be shouldered, in large part, by private sector investors. USAID, through FINEX, will, however, provide initial "seed capital" on a cost-sharing basis for design costs and limited commodities. Essentially, USAID's approach for activities which predominantly benefit the private sector is structured to provide initial funding ("seed capital" and technical studies, for instance, under the automated exchange activity) that will consequently encourage additional investments from the capital markets participants. USAID's role thus becomes one of igniting private sector investment in viable activities that ultimately improve the operations of the Philippine capital markets. (See the Financial and Economic Analyses section 7, and the Annexes for a more detailed discussion of anticipated revenues to be generated by private sector participants in CMDP-initiated activities.)

Under the **Public Sector Component**, reforms within the SEC are aimed at promoting more efficient operations thus reducing administrative costs. Reforms refer to structural guidelines under which the Commission operates, as well as improved capacity of SEC personnel. The technical advisors under the SEC component will work with senior SEC management in forging a new mandate: one that considers the requirements of a regulatory agency in a changing environment, namely, an automated market system and a self-regulated market. Technical assistance advisors will work directly with staff, and training courses will be developed and offered that will enhance the institutional capacity of the SEC to carry out its new mandate after the expiration of the CMDP.

IV. IMPLEMENTATION PLAN

A. IMPLEMENTATION SCHEDULE

The project will be implemented over a five-year period with the project authorization and agreement, along with the first scheduled obligation of funds, to take place in September 1992. The PACD is September 30, 1997, however most activities under the private sector component are expected to be fully operational by mid-year 1995. A summary of major milestones and their planned dates for completion is listed below. The complete implementation schedule is provided in Annex L.

ACTION	DATE	AGENCY
1. Project Authorized and Agreements Signed	September 92	USAID/NEDA /SEC and FINEX
2. Meeting Conditions Precedent		
All Standard and Project Specific CPs Met	February 93	NEDA/SEC
3. Contracting		
All contracts actions complete and SEC General Contractor mobilized	September 93	AID/Contractor
4. Project Implementation	November 92 -July 97	AID/FINEX/SEC/ Contractor
5. Evaluation/Close Out		
a. Mid-Term Evaluation	January 95	AID/Contractor
b. Final Evaluation	August 97	AID/Contractor
c. PACD	September 97	AID/SEC/ Contractor

B. PROJECT MANAGEMENT

Four major entities will implement and administer the project elements under the CMDP, namely: FINEX, USAID (both working through the PIC) for the private sector component; and, the SEC with the technical assistance Contractor for the public sector component. (Refer to Figure IV-1 for a diagram of the organizational structure). A.I.D/W will monitor project progress through quarterly implementation reports as well as routine and special evaluations; and will assist Mission in executing selected components of CMDP. For instance, IRM will assist in the assessment of current data systems; and, in drafting the Request for Proposal (RFP) to design systems for the public and private

sectors. USAID will seek guidance from the Private Enterprise Bureau (PRE) on contract buy-ins and use of 8(a) firms in project activities.

Since other organizations not directly responsible for implementing this project perform key roles that would impact on the its success (such as ADB and the CMDC), it is incumbent on each of the project implementors to coordinate and communicate closely with each other and pertinent external groups. Given the inherent complexity of managing the project, with two distinct project components, one implemented through the public sector and the other through the private sector, the overall management structure must be such that communications are passed from key implementors on both sides of the project. The management structure chosen for the CMDP, though it places a burden on USAID for insuring this, is designed to further enhance communication and, as important, necessary follow-on action.

1. USAID

The Office Chief for the Private Enterprise Support Office (PESO) will serve as project officer for the CMDP. Day-to-day responsibilities will be carried out by a Foreign Service National (FSN) as Project Manager, who has specialized expertise in capital markets activities. Moreover, USAID adheres to the project team concept, which supports the implementing office (PESO) on problematic issues or areas within each member's control. Members of the project team, who have participated in this design process include representatives from: Development Resources Management (DRM); Office of Financial Management (OFM); Office of the Legal Advisor; Contract Services Office (CSO); Office of the Program Economist (OPE); and, the Office of Natural Resources, Agriculture, and Decentralization (ONRAD).

The USAID project officer and manager will administer the AID-direct contractor assigned to the SEC. Contract administration duties will include: ensuring that both the GOP and the contractor have a proper understanding of the services to be provided; ensuring compliance with AID rules and regulations; coordinating Mission approval processes for commodities, training, payments, and waivers; assisting in resolving logistics problems; and tracking contractor performance and initiating appropriate action when necessary. PESO will ensure that activities are carried out in accordance with the project implementation plan and that implementation proceeds as envisioned. USAID will also assist the SEC management and SEC project manager, where appropriate, in implementing their component of the project.

PESO will also monitor performance of FINEX and the extensive and complex activities to be implemented by them, as stipulated in the cooperative agreement. A PESO officer will serve as an *ex-officio non-voting* member of the FINEX Project Implementation Committee (Refer to IV-1). USAID was a driving force in conceptualizing and organizing

the CMDC (the "Council"). The Council, in existence since October 1991, has created an action plan for reform that all members of the Philippine capital market have agreed to implement. Much of the discussion and interaction between the private and public sectors will take place in this fora. USAID will continue to attend the meetings and monitor progress to ensure that the body continues to carry forward policy dialogue among all the major participants and that meaningful change is proposed and acted upon.

Given current and anticipated PESO workloads, it is envisioned at this time that the inclusion of CMDP into the PESO portfolio will not create an administrative burden requiring additional U.S. direct-hire or FSN workforce.

2. The Financial Executives Institute of the Philippines (FINEX)

FINEX, through a USAID cooperative grant, will administer all activities under the private sector component of the project. FINEX will hire project management and support staff who will have no additional responsibilities other than to implement the activities as specified in the USAID grant, including:

- contracting with local and international firms for technical studies, procuring commodities, establishing an automated trading, clearing and settlements corporation and investors' information service organization; and,

- awarding of sub-grants for technical assistance, training, research and long-term, formal education activities, among others, subject to USAID concurrence.

FINEX will create a PIC comprised of no more than five (5) senior persons from both the public and private sectors. The PIC is expected to include a representative from each of the following groups: USAID (in a non-voting capacity); FINEX; MSE; MKSE; the SEC, and the CMDC, or other private sector organizations involved in the local capital market. The PIC members will provide their services on a pro bono basis and hold meetings monthly or as required. The presence of at least 60 percent of the PIC members will constitute a quorum with majority rule for approvals.

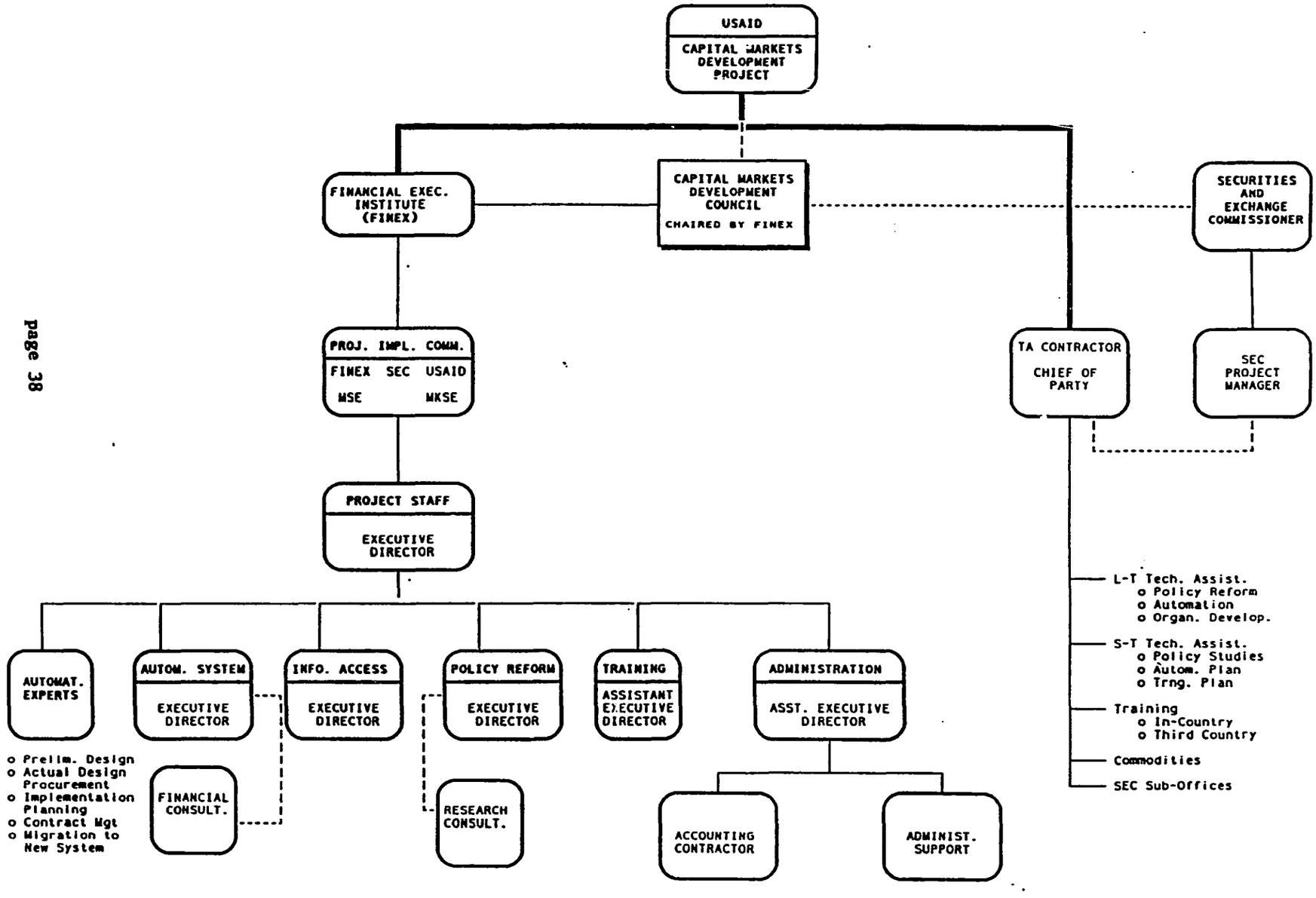
The PIC will initially establish operational and procedural guidelines. Once the FINEX project office has been staffed, the PIC will render decisions regarding: 1) overall direction of project activities; 2) policy conferences, workshops, or symposia; 3) training activities; 4) sub-grants for curriculum development and policy research; 5) review of contract proposals; and, 6) procurement of goods/services other than those related to project administration.

A proposed management structure of the FINEX project management office (PMO) has been discussed with FINEX and will be organized along the lines as depicted in Figure IV-1. The project implementation unit will

Figure IV-1

IMPLEMENTATION CHART

Capital Markets Development Project



be streamlined and appropriately staffed with fully qualified personnel. Given these parameters, a preliminary organizational structure will include a permanent Executive Director who will act as the chief operating officer to implement the Project. This person will be responsible for planning and managing the day-to-day operations of the Private Sector component of the Project. The Executive Director should possess familiarity with capital markets in general, and the long equity and securities markets in particular. In addition to general management responsibility over the Project, the Executive Director will be directly responsible for the organization of the corporate vehicle that is envisioned to own and operate the automated trading, clearing and settlements systems for the stock exchanges and for the Information Access and Policy Reform elements of the Project. In addition, this person will coordinate with local staff for the opening of FINEX offices in the cities of Cebu and Davao.

In view of the many activities constituting the Project, an Assistant Executive Director will be included in the Project Team. This person will be directly responsible for supervising the administrative unit of the project organization and generally will provide assistance to the Executive Director and directly oversee the Training, Education and Research elements of the Project.

An administrative unit, reporting to the Assistant Executive Director, will have two sections, namely, an Accounting Section, and an Administrative Support Section. The accounting services are envisioned to be contracted out. The accounting firm will be primarily responsible for the preparation of budgets, and establishment of appropriate accounting and internal control policies and procedures. They will also be responsible for the proper monitoring and reporting of project funds in accordance with USAID requirements. The Administrative Support Section will be responsible for providing secretarial, messenger and other administrative support to the Project Team and to the expatriate and local consultants engaged by the Project Team.

As the Project requires the engagement of technical consultants, contracting policies will be stipulated in the USAID-FINEX assistance agreement. Since FINEX as an organization has limited ability for contracting and consequently no prescribed contracting procedures, FINEX project management staff will be required to use contracting procedures in accordance with AID Handbook 13.

3. Securities and Exchange Commission

Although NEDA will be the signatory to the project and will sign on behalf of the GOP regarding any significant changes to the Project Agreement, SEC will implement the public-sector component through the direct assistance of the long-term contractor.

a. SEC Project Manager

The SEC Chairperson has appointed herself as project manager to the CMDP. It is expected that, as implementation begins, she will be replaced by a senior member of the Commission. The project manager will be responsible for: overall coordination of the activities carried out by the institutional support contractor; overall liaison with USAID counterpart and the contractor's chief of party (COP); be the SEC representative to the PIC for the FINEX activities; and, attend the monthly meetings of the CMDC. The Project Manager will also share responsibility with the SEC Chairperson in establishing the three (3) new regional sub-offices, which this project will support.

b. Office of the Executive Director

The Office of the SEC Executive Director executes the policies, rules, and regulations approved by the Commission and those imposed on the SEC through legislation or executive orders. This office will work directly with and support the contractor's COP, who will also act as the regulatory specialist.

c. Administrative and Finance Department

The Personnel Division comes directly under the supervision of the Administrative and Finance Department and holds responsibility for the institutional training element for the SEC component. The division will work with the Contractor's organizational specialist who will assist in developing the project's training plan, as well as a long-term training strategy, possibly developing an in-house training program that may possibly be implemented through a non-governmental organization (NGO), such as the Philippine Securities Institute. Based on further assessment of this alternative it is possible that a sub-grant for training inputs may be awarded to an NGO under this project.

d. Investments and Research Department

The Electronic Data Processing Group, administratively set up under the Investment Statistics Division, maintains charge of the SEC's automation systems. An automation specialist under the institutional contractor will work with the Group in improving its long-term automation plan and prioritizing those commodities required under the CMDP.

4. Technical Assistance Contractor

In view of the large number of activities to enhance the institutional capacity of the SEC, USAID will procure the services of one contractor to perform all appropriate tasks. This arrangement will minimize the coordinating functions of USAID and the GOP and place the burden for acceptable performance on one firm. As detailed in Section IIIC3, the contractor will carry out the following functions:

- provision of Technical Assistance (policy reform, organizational development, and automation);
- procurement of commodities (consortium arrangement or subcontract to a Gray Amendment firm);
- development of an automation plan;
- completion of a project and a long-term training plan;
- design and maintenance of a database relating to purpose-level, performance indicators;
- arranging for training of SEC employees;
- site preparation for three (3) new SEC regional offices; and,
- conduct of special studies.

C. CONTRACTING PLAN AND PROCUREMENT

1. Contracting Plan

Two major actions are envisioned under the CMDP: the first consists of a non-competitive assistance agreement with the Financial Executives Institute of the Philippines (FINEX), and the second is the provision of the Project's technical assistance (TA) contractor through the RFP process.

a. Cooperative Agreement with FINEX

USAID has reviewed FINEX's general capability to carry out the required activities and prepared appropriate recommendations for their selection as the implementer of CMDP. USAID will negotiate with, and award a cooperative agreement to FINEX for the implementation of the private sector component of the CMDP. Upon signing of the CMDP project agreement, FINEX will provide a formal plan on how it intends to implement the private sector component of the CMDP. The implementation plan will also demonstrate, to USAID's satisfaction, the financial, organizational, and management capabilities of FINEX to implement the proposed cooperative agreement. The cooperative agreement shall incorporate provisions for evaluation and audit.

b. Technical Assistance Contractor

USAID will directly contract for the services of a U.S. firm to provide the technical advisory and assistance services required for the enhancement of the institutional capabilities of the SEC. USAID, in consultation with the SEC Project Manager for the CMDP, shall be responsible for preparing the scope of work. Full and open competition will govern contractor selection and award. A notice of this proposed contracting action will be published in the U.S. Commerce Business Daily (CBD) within three months after the project agreement is signed. Offerors will be required to demonstrate their full understanding of the Project, and their ability to work and interface with the appropriate local institutions, both public and private. The technical assistance contractor shall also be required to coordinate and liaise with FINEX on issues concerning the private sector component.

2. Procurement of Commodities

USAID shall work with the SEC and the technical assistance contractor, to develop a commodity procurement plan that details the types, number, estimated cost, probable sources and origin, and intended users of commodities to be procured under the project. This information shall be the technical assistance contractor's basis for preparing the necessary solicitation document or Invitation-for-Bids. The procurement plan shall also take into account the authorized source and origin of goods and services for this Project.

3. Gray Amendment Arrangements and Use of Historically Black Colleges and Universities

Under the CMDP, USAID will procure the services of a technical assistance (TA) contractor to provide the SEC with highly specialized TA in addition to commodity procurement services and training assistance. Since diverse services will be delivered under the contract, the RFP will encourage interested firms to enter into a consortium arrangement. USAID will require the TA contractor, as part of its proposal, to present plans setting out how it intends to use the services and resources of qualified Gray Amendment entities, particularly small and disadvantaged firms.

In addition, the Contractor will be required to use the services of a qualified Gray Amendment firm to procure commodities as a Procurement Services Agent (PSA) either through a subcontract or as party to a consortium arrangement. The same will also hold true for the training portion of the contract. Regardless of the arrangement, open competition will be used to select the lead contractor, with the exception that Gray Amendment firms must be used as a PSA as well as for training and possibly some or all of the technical assistance. Also, USAID anticipates contracting with Gray Amendment firms for the conduct of the mid-term and final evaluations.

Certain short-term training sessions will be held in the U.S. USAID will require that the TA contractor for SEC examine the opportunities offered by historically black colleges and universities (HBCUs), where appropriate.

An illustrative estimate of the level of effort, both expatriate and domestic consultants, is provided as Figure V-1.

D. ENVIRONMENTAL CONCERNS

An Initial Environmental Examination (IEE) has authorized a Categorical Exclusion under A.I.D. Regulation 16, Section 216.2 (c) (2) (i), which allows for such an exclusion when there is no significant impact on the physical environment (see Annex K).

CMDP has the potential as a mechanism for encouraging environmentally-sound, corporate policies and operations. The market information service element of CMDP may connect provision of information about companies listed on the exchanges with the environmental practices and policies that add to (or detract from) their value. This could facilitate risk analysis by potential investors, enabling them to differentiate between companies with potential environmental clean-up liabilities and those that already have valuable, pollution-mitigating

policies and operations. Demonstrated investor confidence in companies that fall in the latter group should provide incentives for more companies to clean up their acts, environmentally. Information outputs from other USAID projects, such as the Industrial Environmental Project (IEMP) or the Natural Resources Management Project (NRMP) could be useful in providing the market information service with data from IEMP environmental risk assessment of the Philippine's industries, from pollution management appraisals of individual firms and by identifying to investors opportunities for investment in environmental technology transfer industries.

Figure V-1

ILLUSTRATIVE ESTIMATES OF LEVEL OF EFFORT (Expatriate and Local Consultants)

PRIVATE SECTOR COMPONENT

TECHNICAL STUDIES
Development/Implementation of
Automated Trading, Clearing
and Settlements System

Preliminary Systems Definition
Short-term specialists: 8 person-months
Expatriate/Local
-Securities industry/Capital market/
-Regulatory/Automation/Legal specialists

Consensus Building/Business Organization
Short-term specialists: 7 Person-months
Expatriate/Local
-Securities industry/Capital market/
Automation/Investment banking/finance/
Legal specialists

System Implementation/Installation
Short-term specialists: 14 Person-months
Expatriate/Local
-Securities industry/Procurement/
Automation specialists

Technology Transfer and Assimilation
Short-term specialists: 11 Person-months
Expatriate/Local
-Training assistance
-Securities industry/Capital market/
Automation specialists

TECHNICAL ASSISTANCE for Market and
Investor Information Services
Short-term specialists: 10 Person-months
Expatriate/Local
-Securities industry specialist
-Capital market specialists
-Automation specialists

COMMODITIES
Expatriate/Local
Short-term Procurement Services
Agents. 3 person months

TRAINING, RESEARCH & EDUCATION
-Local, US and Third country courses
To be conducted on a 50-50 cost sharing
arrangement with private sector
-Curriculum Development
To be contracted out on a 50-50 cost
sharing arrangement with private sector
(Estimated LOE: 36 person months)

PUBLIC SECTOR COMPONENT

3-EXPATRIATE LONG-TERM ADVISERS
(108 person-months total)
-Capital Markets Regulation
-Information Technology/Automation
-Organization Development/Training

TECHNICAL STUDIES
Short-term Expatriate/Local
Specialists

-Enhance SEC Institutional
Capability in Self-Regulated
Environment
Estimated LOE: 24 person months

-Regulatory Reform
o Inspections
o Legal/Administrative Appeal
o Enforcement
o Stock Exchange Operations
o Clearing and Settlements
Estimated LOE: 36 person months

COMMODITIES
Expatriate/Local
Short-term Procurement Services
Agents. 3 person months

TRAINING & EDUCATION
-Local, US and third country courses
To be conducted for SEC staff by
external contractors.
-Curriculum Development
To be contracted out
(Estimated LOE: 10 person months)

Figure V-1 (con'd)

PRIVATE SECTOR COMPONENT

FINEX-PROJECT MANAGEMENT ORGANIZATION

Project Implementation Committee (5-7 "pro bono" advisory members)	Project Team(LOCAL STAFF) (1) Executive Director (1) Asst. Executive Director (5) Project Staff Estimated LOE: 400 person months
EXPATRIATE AND LOCAL CONSULTANTS:	
TECHNICAL STUDIES: Development/Implementation of Automated Trading, Clearing and Settlements System	
Phase 1: Preliminary Systems Definition	Short-term consultants: 8 Person-months International/Expatriate/Local -Securities industry/Capital market/ -Regulatory/Automation/Legal specialists
Phase 2: Consensus Building and Business Organization	Short-term specialists: 7 Person-months International/Expatriate/Local -Securities industry/Capital market/ Automation/Investment banking/finance Legal specialists
PHASE 3-System Installation	Short-term specialists: 14 Person-months International/Expatriate/Local -Securities industry/Procurement/ Automation specialists
PHASE 4-Technology Transfer and Assimilation	Short-term specialists: 11 Person-months International/Expatriate/Local -Training assistance -Securities industry/Capital market/ Automation specialists
TECHNICAL ASSISTANCE for Market and Investor Information Services	Short-term specialists: 10 Person-months International/Expatriate/Local -Securities industry/Capital market/ Automation specialists
COMMODITIES	International/Expatriate/Local Short-term Procurement Services Agents. Total of 3 person months
TRAINING & EDUCATION -Local, US and third country courses	To be conducted on a 50-50 cost sharing arrangement with private sector participants
-Curriculum Development	To be contracted out on a 50-50 cost sharing arrangement with private sector (Estimated LOE: 36 person months)

Figure V-1 (con'd)

PUBLIC SECTOR COMPONENT

SEC-PROJECT MANAGEMENT ORGANIZATION (1) Project Manager (Full-Time) in coordination with Directors/Staff of -Office of the Executive Director -Administrative and Finance Department -Investments and Research Department	Estimated LOE: 400 person months
EXPATRIATE AND LOCAL CONSULTANTS:	
TECHNICAL ASSISTANCE	3-LONG TERM EXPATRIATE ADVISERS (Estimated LOE: 108 person-months total) -Capital Markets Regulation -Information Technology/Automation -Organization Development/Training
TECHNICAL STUDIES	Short-term International/Expatriate and Local Specialists
-Enhance SEC Institutional Capability in Self-Regulated Environment	Estimated LOE: 24 person months
-Regulatory Reform o Inspections o Legal/Administrative Appeal o Enforcement o Stock Exchange Operations o Clearing and Settlements	Estimated LOE: 36 person months
COMMODITIES	International/Expatriate/Local Short-term Procurement Services Agents. Total of 3 person months
TRAINING & EDUCATION -Local, US and third country courses	To be conducted for SEC staff by external contractors.
-Curriculum Development	To be contracted out Estimated LOE: 10 person months

V. MONITORING PLAN AND PROJECT EVALUATION

A. PROJECT IMPACT

Performance indicators established for the CMDP will allow for quantitative measurement of the project's progress toward meeting its purpose. The established indicators are realistic expectations given the activities envisioned. As part of its scope of work, the TA Contractor for the Public Sector Component will collect baseline data and maintain a database system, to be updated semiannually. Purpose-level indicators include:

- increase in the number of companies listed on the boards of the exchanges by 50 percent;
- increase in the volume of trade of securities issues by 100 percent;
- increase in the number of institutional investors engaged in the securities market and the volume of their trading by 50 percent; and
- increase in the amount of total capitalization of the securities market by 100 percent.

B. MONITORING PLAN

Implementation of the project through two distinct organizations requires that separate monitoring procedures be established for each implementor. USAID will take an active role in verifying the adequacy of the monitoring and implementation plans and will ensure that there is proper coordination between and among all implementors in this regard.

1. Private Sector Component/FINEX Activities

Although a cooperative agreement allows latitude on the part of the grantee, the nature of the activities FINEX will carry out demands a high degree of USAID monitoring. For the project as a whole, USAID will continue to attend the bi-monthly sessions of the Capital Markets Development Council to keep abreast of the reform issues confronting the government and the private sector. For FINEX activities, USAID will serve as a member to the PIC, albeit in a non-voting capacity, to assist in resolving potential conflicts and ensuring activities are implemented on schedule and in accordance with project objectives and AID regulations. Since overall project performance data will be collected by both the TA firm and the SEC, it will be required that FINEX provide reports specifically related to its activities which will include:

- a life-of-project work plan approved by USAID within six (6) months after the award of the grant;

- annual work plans;
- quarterly performance reports, tracking progress of each activity;
- minutes recorded after each meeting of the FINEX PIC, including issues identified, problems encountered, and decisions made;
- financial reports tracking USAID advances and FINEX disbursements as they relate to the project's objectives;
- detailed reports assessing the degree to which the CMDC has been instrumental in proposing and tracking reform in the capital markets;
- a detailed assessment identifying the studies (policy analyses, curriculum development) and their relevant impact;
- financial statements from the newly created Automated Exchange Corporation; and
- financial statements concerning all USAID-financed, money generating activities (i.e., training, challenge grant for an automated exchange, and the investors' information services), specifically the income earned and how those proceeds have been spent.

2. Public Sector Component (with the SEC)

For SEC activities, monitoring will be accomplished by the technical assistance contractor that will report directly to the USAID project officer. The contractor will provide information related to the project's progress toward meeting the performance indicators as specified in the section above. This includes collecting baseline data, creating a relevant data base, and updating the data base periodically (on a semi-annual basis). This data should reflect on the impact of the project as a whole with particular attention to the public sector component activities.

USAID will require the contractor to submit an initial work plan covering the life of the project, as well as annually updated work plans. At the end of each quarter, the contractor is expected to report implementation progress for that quarter including inputs required and outputs produced in narrative form or through the use of a GANTT chart.

USAID will manage contractor performance by holding periodic meetings with SEC management and the technical consultants assigned to the project and by making periodic site inspections at training facilities, SEC sub-offices, the SEC's Electronic Data Processing (EDP) office, and

other facilities where activities are taking place. USAID, in conjunction with the SEC, will review and provide approval for: all contractor implementation plans; the design of the data base tracking the performance indicators; all commodities to be procured as well as the procurement plan; SEC training participants and the related training plan; the automation plan; and the establishment of SEC sub-offices. Moreover, it is important to assess the impact of the technical assistance itself. The contractor will specifically report all policy studies carried out for SEC management, the recommendations recorded in each report, what actions the contractor and the SEC are taking to implement the reforms; and conclude to what degree the reform was made (partial, complete, or in stages) and the impact of the reform.

C. EVALUATION PLAN

Two project evaluations will be performed during the life of project, a mid-term and a final end-of project evaluation. The mid-term, evaluation is expected to take place in January 1995 and will coincide with the completion of a number of project activities, as follows:

Private Sector Component/FINEX Activities. By the mid-term of project, a majority of the project activities implemented through FINEX should be well on their way to completion and the Mission should be in a position to assess the initial indicators of financial viability and sustainability, specifically concerning the automated market operations system and the Market Information Services. The evaluation will assess the overall performance of FINEX (including the PIC under its aegis) and determine whether activities under the private sector component should be continued as planned, modified or curtailed. Specifically, the evaluation will:

- Assess the operations of FINEX in managing its component as well as the performance of the project implementation committee, and make appropriate recommendations;
- Analyze the actions taken by and the effectiveness of the Automated Market Operations and the Market Information Services organizations set up through FINEX;
- Evaluate the training sessions arranged and implemented by FINEX to assess their financial viability, as well as the impact and relevance of their technical content;
- Review the policy reform process as advocated by FINEX to determine the appropriateness of the forum used in getting all parties involved in policy dialogue;
- Recommend alternatives for policy dialogue activities, as appropriate;
- Utilize baseline data obtained from the TA contractor and the

SEC and gather current data on performance indicators to assess performance to date; consider the likelihood of the project's meeting its purpose, and recommend organizational changes to improve implementation during the remaining years of the project; and,

- Recommend revised project performance targets, as appropriate.

Public sector component activities implemented by the SEC through the USAID-direct contractor are expected to be in their early stages, by the mid-term of the project. However, most of the commodities envisioned under the project should be delivered and installed and the new SEC sub-offices should have been opened by the date of the mid-term evaluation. The evaluation will focus on:

- Making an interim assessment of the TA contractor's performance relating to policy studies, policy change, commodity procurement, local and third-country training, and the establishment of fully operational sub-offices;

- Assessing SEC's progress toward redefining and fulfilling its revised mandate;

- Assessing the impact of the agenda, as developed by the CMDC, on institutional change within the SEC;

- Preparing recommendations to improve implementation during the remaining 32 months of implementation, and

- Revalidating design assumptions and suggest potential improvements to the performance indicators, as appropriate.

The Final Evaluation, to be undertaken approximately two months before the PACD will examine the extent to which the project has achieved its purpose. The evaluation team will collect and examine data which allows for measurement of the project purpose indicators (see Section V.A). and determine the financial viability and general sustainability of the securities market operation system, the market information services, policy reform, and the training and research courses implemented through FINEX.

Women In Development

The project evaluations will explicitly review the relative impact of each component and sub-component activity on the role of women in the economic development of the Philippines. Issues to be included in both the mid-term and final evaluations' scopes of work are as follows:

1. How were the interests and role of women (compared to men) taken into account in each of the design, appraisal and implementation

stages of the project evaluated?

2. In what ways did women (compared to men) participate in these processes?

3. What were the effects, positive or negative of the project concerning women's (compared to men) access to income, education and training, and with respect to workloads, role in household and community, and health conditions?

4. How were the interests and roles of women (compared to men) taken into account in the evaluation stage?

5. How did women's integration in AID activities affect the sustainability of project outcomes and were outcomes more (or less) sustained when women were taken into account in AID activities?

6. Are the results achieved by the project equally sustainable between men and women beneficiaries?

VI. COST ESTIMATES AND FINANCIAL PLAN

A. PROJECT COSTS

The total cost of all activities under the proposed CMDP is approximately $27.75 million, $13.5 Million of which will be grant funded in SAI funds over the five-year life of the project, as detailed in Table 3. The GOP counterpart contribution will be $4.5 million (including cash and "in-kind"), or 25 percent, of total project costs. Private sector costs are expected to total $9.75 million (again, including cash and "in-kind").

With provisions made for contingencies and inflation, the distribution of USAID's project costs over the project life are: Public Sector Component - (59 percent); Private Sector component - (37 percent) and Monitoring, Evaluation and Audit - (4 percent). Planned obligations of USAID project funds are $10 million in FY 92, followed by $3.5 million in FY 93 (See Table 4).

USAID project funds will be used to finance the following: technical assistance in the form of technical studies, advisers and specialists; "Challenge" grant funds to FINEX for the ANTCS system; commodities for surveillance and automated linkages to regional SEC offices; investor information services and access systems; policy reform and advocacy; training, education and research; institution building for the Private Sector implementor; institutional support to the SEC; and funds for monitoring, evaluation and audit (see Table 5).

An estimated fifty-five (55) percent of the total USAID project funds ($7.45 million) will cover local costs, and the balance of 45 percent (or $6.05 million) will cover foreign exchange costs (see Table 1, Annex E). Table 2, Annex E, shows the projection of local and foreign exchange costs by project element over the five-year life of the project.

B. METHODS OF IMPLEMENTATION AND FINANCING

Table 5 summarizes the methods of implementation and financing for the Project. USAID will make funds available to FINEX through the Periodic Advance method. FINEX will be responsible for re-allocating and monitoring USAID grant funds to be made available for specific project activities.

For the Public Sector component, two methods of financing will be adopted. USAID's direct payment method will be adopted for off-shore procurement of commodities while a cost-reimbursement method will be adopted for all other expenditures of the US-Direct Contractor.

Table 3

Capital Markets Development Project
Illustrative Financial Plan (U.S. $000)

PROJECT ELEMENTS	AID GRANT			COUNTERPART CONTRIBUTION	
	FY 1992 OBLIGATION	FUTURE YEARS ANTICIPATED*	TOTAL	GOP	PRIVATE SECTOR
1. PUBLIC SECTOR COMPONENT	5,932	2,075	8,007	4,500	
Technical specialists/advisers	2,198	768	2,966	38	
Commodities	1,419	497	1,916	269	
Information access	652	228	880		
Policy reform	275	97	372	16	
Training and education	602	210	812	230	
Institutional support	786	275	1,061	3,947	
2. PRIVATE SECTOR COMPONENT	3,698	1,295	4,993		9,750
Technical studies	317	111	428		
Exchange Automation	741	259	1,000		9,000
Investor information services	643	226	869		
Policy reform	228	80	308		
Training, education, and research	1,245	436	1,681		750
Institution building	524	183	707		
3. MONITORING, EVALUATION & AUDIT	370	130	500	0	0
Total Planned Obligation	10,000	3,500	13,500	4,500	9,750

* Future obligations are subject to the availability of funds to A.I.D. for this purpose and mutual agreement of the Parties to proceed

** $1.00 = P _____

Table 4
Capital Markets Development Project
Planned Yearly Obligations & Expenditures
(US$000)

	FISCAL YEARS						GRAND TOTAL
	92	93	94	95	96	97	
1. USAID							
LOP FUNDING	13,500						13,500
PLANNED OBLIGATIONS	10,000	3,500					13,500
PLANNED EXPENDITURES	0	1,685	4,708	4,153	1,544	1,410	13,500
PROJECTED MORTGAGE (LOP–Planned Obligations)	3,500	0	0	0	0	0	
MORTGAGE/LOP	26%	0%	0%	0%	0%	0%	
PROJECTED PIPELINE (Cumulative Obligation– –Cumulative Expenditures)	10,000	11,815	7,107	2,954	1,410	0	
PIPELINE/OBLIGATION	100%	88%	53%	22%	10%	0%	
2. Counterpart Contribution							
In kind and cash outlays		1,101	4,581	4,369	4,049	150	14,250

Table 5
Capital Markets Development Project
Methods of Implementation and Financing
(US$000)

PROJECT ELEMENTS	METHOD OF IMPLEMENTATION	METHOD OF FINANCING	TOTAL COST (US$000)
1. PUBLIC SECTOR COMPONENT			
Technical specialists/advisers	AID – Direct Contract	Cost Reimbursement	2,966
Commodities	AID – Direct Contract	Direct Payment/ Letter of Commitment	1,916
-- PSA	Subcontract		
Information access	AID – Direct Contract	Cost Reimbursement	880
Policy reform	AID – Direct Contract	Cost Reimbursement	372
Training and education	AID – Direct Contract	Cost Reimbursement	812
Institutional support	AID – Direct Contract	Cost Reimbursement	1,061
2. PRIVATE SECTOR COMPONENT			
Technical studies	Cooperative Agreement	Direct Payment	428
Challenge grant	Cooperative Agreement	Direct Payment	1,000
Investor information services	Cooperative Agreement	Direct Payment	869
Policy reform	Cooperative Agreement	Direct Payment	308
Training, education, and research	Cooperative Agreement	Direct Payment	1,681
Institution building	Cooperative Agreement	Direct Payment	707
3. MONITORING, EVALUATION & AUDIT	AID – Direct Contract / IQC	Direct Payment	500
Total USAID Cost			13,500

Monitoring, Evaluation and Audit will be financed directly by USAID through AID-Direct payment. Fund disbursement methods and financial management systems for these contracts and agreements will follow USAID procedures.

C. FINANCIAL MONITORING

USAID will review the financial management systems, accounting records, and reports of the project. Through those reviews USAID will adequately be able to monitor financing activities of the project including required counterpart contribution. The Office of Financial Management (OFM)-USAID/Philippines, is responsible for monitoring project disbursements in order to ensure the propriety of transactions. If necessary, the services of independent Certified Public Accounting (CPA) firms may be contracted by OFM to carry out financial monitoring activities using project funds set aside for that purpose.

D. COUNTERPART CONTRIBUTION

The GOP, through the SEC, is expected to contribute the equivalent of 25 percent of the public sector component. This contribution represents the imputed cost of the following: office space; utilities; honorarium of resource speakers; and salaries of SEC department personnel directly or indirectly involved in the project. The Private Sector contribution will be phased over the LOP as indicated in Section IIIB, on private sector inputs and activities.

E. RECURRENT COSTS - SUSTAINABILITY

Recent studies conducted by a CPA firm for the design of this project determined that under the public sector component, sufficient funds will be made available by the GOP at the time when they are needed to cover necessary recurrent costs (e.g., salaries, utilities, office space, maintenance and repairs). GOP is expected to cover these costs during the life of the project and after A.I.D.'s contributions are terminated. The GOP also will ensure that appropriation and allotment is made through SEC to pay for taxes, duties and other expenses which cannot be paid out to the grant funds or charged to counterpart funding. To this end, the GOP will be asked to submit for legislative approval a request for budget allocation and allotment to cover continuation of activities started under the project. This request should be submitted for approval and appropriation upon execution of program agreement to ensure that funds will be available to support SEC reforms during and after the PACD.

As the SEC has traditionally provided certain information to the public, it will continue to do so under the project. It is reasonable to assume that the cost of providing that service will continue to receive budget support from the GOP.

Under the private sector component, the project will be generating

revenues under the "Seed Capital Challenge" grant and market information services and it is expected that these revenues will reduce needed external support.

F. AUDITS

The project provides funds for potential non-federal audits (NFA) and recipient contracted audits (RCA) of project activities following guidelines from the AID Office of the Inspector General. Primary responsibility for audits of AID-funded projects lies with the Regional Auditor's Office (RAO). However, RAO may contract non-federal auditors. Recipient-contracted, financial audit may be implemented under the Private Sector component of the project. Non-federal audits are carried out through contracts with independent auditors acceptable to the A.I.D. Inspector General to perform annual financial audits, and are financed through funds set aside within project activities.

VII. SUMMARY OF ANALYSES

A. TECHNICAL ANALYSIS

The Philippine capital market is characterized by a crisis of confidence. The Philippines finds itself falling further behind other Asian emerging markets. The long-term equity securities market is stagnant, dampening capital expansion. There is a fundamental lack of liquidity in the marketplace which is rooted in inefficient order execution and high transaction costs due to current trading practices based on antiquated processes and systems. This problem is seen as having both supply-side and demand-side implications.

On the supply side, over 170 companies are listed (as of March 1992) on the two stock Exchanges. However, only 70 of the top 1,000 corporations are listed; and, only the securities of some 20 listed companies are traded actively. This points to demand-side problems that are manifest in the number of direct individual investors.

Less than one percent of the population, as compared to ten percent in advanced economies, invest in securities. Demand has been seriously hampered by: the lack of adequate investor information and transparency of transactions; inadequate regulatory, monitoring and enforcement measures which provide protection against abuses; inadequate types and denominations of financial instruments to meet differing needs of savers and investors; the institutional weakness of securities market institutions in the provision of professional client-services and information; and, the lack of interest on the part of major institutional investors, such as insurance companies and pension funds, to participate actively in the equities market.

The most feasible approach to dealing with these constraints, and bolstering investor confidence, in the Philippine capital market environment is to modernize equity and debt securities market operations systems. There are serious misconceptions on the part of the exchanges and the regulatory agencies regarding such an automated system: i.e., focus on the need for substantial investments in real estate, an exchange trading floor, and computer hardware and software; and, on the value of physically merging the current organizations and systems of the two Exchanges.

Despite these concerns, the Exchanges and the SEC have defined similar objectives and development goals as discussed in Annex H. Due in large part to the lack of state of the art information, progress in working towards these objectives has been slow. The CMD Council, a private sector-public sector policy dialogue and reform forum, has been instrumental in bringing about consensus on the need to automate and integrate market operations systems.

During the past five years, numerous studies have been conducted by USAID, the ADB, and the World Bank, in order to analyze and prepare

recommendations for improving various segments of the capital markets. A few of these recommendations have been implemented leading to some minor improvements, as can be observed in the market's 1992 activities. Full implementation of these recommendations requires: commitment on the part of the market's private and public sector participants; development and enhancement of the expertise and professionalism in both public and private sector securities market institutions; training in order to take advantage of advances in technology; acquisition of capital equipment and information-technology software; and the education of the general public through provision of investor information services.

The approach of the project is to work primarily with the private financial sector, through FINEX and, secondarily with public sector regulator agencies (through the SEC) in implementing specific project activities. The private sector component will be operationalized through a cooperative grant agreement with FINEX, which will administer and make available project assistance to groups in the business community through sub-grants on a cost-sharing basis. The objectives of FINEX, as described in its charter, are quite compatible with the objectives of the Project.

Given the tangible benefits to be derived from the project, the private sector can readily contribute financial expertise and resources to project activities. The specific cost-sharing and/or leveraging mechanisms for funding of project activities have been developed and tested in previous private enterprise projects in the Philippines, demonstrating the private sector's willingness to commit and pool resources, focused on achieving mutually beneficial sectoral improvements. The provision of automated securities trading, clearing and settlements, investor information, and training and education services all with national outreach, directly benefits private sector users, which would be willing to shoulder a greater part of the costs required for success. This leveraging strategy assures cost-effectiveness and sustainability of the project's outputs.

B. FINANCIAL ANALYSIS

In performing financial analyses, three potential revenue producing areas were initially analyzed: the FINEX/Automated Trading, Clearing and Settlements System; the FINEX/Investor Information System; and the SEC/Information Access System. Annex E presents the results of these analyses.

On the private sector side, FINEX will be responsible for administering "seed capital" amounting to a $1 million to challenge other potential investors to establish a private-sector-owned and operated ANTCS system. In determining the Financial Internal Rate of Return (FIRR) for this "seed capital", the following scenarios were evaluated:

- **Alternative A:** the total cost would be comparable to that of a customized "built from scratch" system development activity

presently being started up with the MSE by a local vendor company;

- **Alternative B**: the total cost would be based on the purchase of an existing market operations (trading, clearing and settlements) system and its adaptation to the Philippine business environment.

  Alternative B-1: 100 percent of the commodities for the system will be purchased in the U.S. with 100 percent equity contribution;

  Alternative B-2: the system will be purchased in the U.S. with 30 percent funding from long-term debt and the balance from equity contribution. Such a system will be more advanced and sophisticated than Alternative A and most likely will not be financed by long-term debt, for purposes of this narrative, only Alternative B-1 will be discussed.

In determining the FIRR for Alternative B-1, the cost of acquisition of the hardware and software was estimated at $7,662,000 consisting of the $1 million "seed capital" and the balance from investors' contributions. Potential revenues or fees were projected based on rental of the terminals to brokers-dealers; and the lease of communication lines to other users to gain access to investor information from the ANTCS system.

The following sensitivity analysis shows that the FIRR ranges from 17.41 percent to 45 percent, depending on the number of terminals rented each month and the rental fee charged for each terminal:

Automated Trading, Clearing and Settlements System
Internal Rate of Return

# of terminals	P15,000/month	P20,000/month
250	17.41 percent	25.69 percent
300	22.40 "	32.20 "
350	24.61 "	38.63 "
400	32.20 "	45.00 "

To be financially viable, these scenarios must "hurdle" the 23 percent (estimated) interest rate on debt-financing. Although the cost of equity financing has not been determined, this cost will most likely reflect a lower hurdle rate, given the high cost of domestic debt. For purposes of establishing financial viability, a feasibility study need not be performed at this time since viability can be determined from available information. At a later date, a more in-depth analysis will be made to determine exact service fees.

The table shows the break-even point for the new system. At least 350 terminals would-have to be rented out at P15,000 a month or 250 terminals at P20,000 a month. The rental fee of P20,000 a month is realistic since the MSE charges P15,000 a month for its terminals; The

new automated system will be more advanced and sophisticated and a higher rental rate can be commanded. The rental of 350 terminals is not an insurmountable quantity since a sufficient number of users are expected to take advantage of these services, perhaps renting two terminals each. Furthermore, when the new automated trading, clearing, and settlements system is operational, linked directly to it will be an Investor Information Services system. On the basis of its estimated capital outlay and incremental revenues and costs, the incremental FIRR was calculated at 24.23 percent. In conclusion, this investment would be attractive to potential investors since these revenue projections are reasonable and conservative, making the potential for higher fees achievable.

C. ECONOMIC ANALYSIS

With limited access to the stock market, many savers could not get better returns for their financial investments while firms are starved for badly needed long term funds. However, the depth and breadth of the market recently has been increasing. Medium-term prospects appear to be right. The previous administration implemented significant sector reforms and more are expected to be implemented soon. Additional reforms also have to be considered in the areas of macroeconomic stability, the demand and the supply sides of the equity market, and the debt securities market. CMDP addresses major current concerns in the capital markets which should contribute to their rapid development.

CMDP's approach appears appropriate and cost effective. Giving the private sector the lead role provides for better introduction of innovations and ensures flexibility in implementation. The private sector is expected to contribute its talents and resources to the project. The choice of the private sector implementing organization is appropriate given this institution's membership, demonstrated experience and apparent motivation. The choice of SEC for the public sector component is appropriate given its mandate for more effective promotion and supervision of market activities.

Using the Automated and Investor Information Systems' projected revenues as benefits, a quantitative economic appraisal of the private sector component is conducted corresponding to two alternative automated systems. A separate economic appraisal of the private sector component appears valid because the public sector component is expected to enhance rather than reduce benefits generated by the former.

Alternative A is a customized "built from scratch" system development activity presently being started up with the MSE by a local vendor company; Alternative B is based on an existing system to be acquired from the U.S., and adapted to the Philippine environment. The calculated economic internal rate of return (EIRR) is 27.5 percent for A and 22.5 percent for B. The EIRRs cannot be used in choosing between the two alternatives because they are not directly comparable. The sensitivity analyses suggest that the EIRR is more sensitive to changes

in revenues than to changes in residual investment values. Using a minimum benefits approach for the entire project, the calculated required annual benefits over five years appear achievable in terms of such indicators as increased income from financial savings and additional foreign portfolio investment inflow.

Risks to project viability can be contained through expected favorable effects of initial CMDP implementation on the performance of the two exchanges of their expected roles in the project; consideration of alternative local training arrangements for overseas training to be funded by the private sector; and conduct of full feasibility studies on the automated systems. Improved macroeconomic stability, particularly containing the national government's fiscal deficit, and improved infrastructure, particularly in power and telecommunications, will also reduce project risks.

D. SOCIAL SOUNDNESS ANALYSIS

The proposed project aims to transform the equity and debt securities markets into a more viable mechanism for raising capital funds for private enterprises. Through a more effective market mechanism, the private sector will develop more confidence in the system, and thus stimulate increased investment activities. As the capital market develops, long-term capital formation objectives will be realized, thus building the foundations for sustained economic development. This process will be accompanied by significant changes in socio-cultural relations in business institutions which, if properly directed, should be mutually reinforcing and supportive of further advancements in economic welfare.

All existing participants in the capital market (i.e., the initial project population) are the primary beneficiaries of the project. By specializing in its primary function of overseeing the proper operations of the capital market where market forces are allowed to operate freely, government structures become more effective and efficient. The primary benefits of a properly operating self-regulatory market structure are: that it makes maximum use of the expertise of private sector participants; results in enhanced compliance with established domestic and international standards; minimizes GOP interference with market processes; and, minimizes public sector expense while permitting the GOP to assure that specific investor protection and market standards are maintained. Meanwhile, gains from market participation will tend to be distributed more equitably as more transparent information becomes available in the system. Innovations and improvements in trading systems in the stock exchanges will allow more information to be disseminated. As individuals become more informed, the price system likewise becomes more informative and transparent. As this develops, income disparities become narrower as market participation increases and broadens. Although the very poor cannot be identified, at this stage as direct or indirect beneficiaries, they are not be left out in the course of social changes and economic growth stimulated by inputs from the

project. As the entire economy benefits from sustained growth influenced significantly by an active capital market, social structures, values, and institutions will undergo changes.

Notwithstanding the scope of planned activities, the project is not expected to cause radical changes in behavior and attitudes. Instead, foundations for arriving at better and more intelligent business decisions will be provided. Values and business ethics may likely be slow to change, and may furnish resistance to innovation in subtle ways. Nevertheless, some values change, and traditions may evolve, become adopted to objective changes in social conditions, and even decline. Thus, for instance, the project cannot be expected to diminish desire for control of companies, or lead companies to broaden their equity base, but with changes in the environment, businessmen will make appropriate decisions. Such decisions will be enhanced by demonstrations that the capital market can function better and be more responsive to private sector capital requirements. It is likewise important to note, that market participants can readily identify with the project since it addresses their conscious and practical needs. Some of the groundwork for needed changes have actually already been started by the major market interests themselves, albeit at varying degrees of emphasis and progress. These positive attitudes, if continuously stimulated, will provide sustainability for the project. In addition, the involvement of an institution which has been, and continues to be committed to reforms in the capital market, will ensure success for the project.

E. INSTITUTIONAL AND ADMINISTRATIVE ASSESSMENT

The Public Sector component will be implemented by an AID-Direct Contractor wherein the SEC will be the recipient of technical assistance and studies for the improvement of the public sector part of the Philippine capital market system. Organizational limitations within the SEC may constrain the effective implementation of the Project if the SEC itself were tasked to implement it. Moreover, the present SEC has inadequate experience in the implementation of large-scale donor funded projects such as the CMDP.

An administrative assessment study performed by an outside, independent CPA firm has examined organizational limitations within the SEC and confirms the rationale for selecting a USAID-direct Contractor to implement the Public Sector component of the Project. This TA Contractor will provide the expatriate specialists that are needed for the Project and will hire the required local consultants. In its administration of the Project, in addition to the designation of a Chief of Party, the Contractor will have to organize an Administrative Unit to be headed by a Project Administration Officer and which will include a procurement service agent, an Accounting Section to be contracted from a professional firm, and an Administrative Support Section. A Project Committee should also be organized within the SEC to coordinate the work of the various specialists and consultants. It

is expected that such a committee will enhance the acceptability of the recommendations of the specialists and consultants and help ensure the subsequent implementation of the recommended changes. It is suggested that the Project Committee be composed of the Commission en banc for more effectiveness.

In the implementation of the Private Sector component of the Project, it is recommended that a separate Project Team be organized within FINEX because of its present organizational limitations. As the Board of Directors of FINEX does not have permanent tenure, it is recommended that a FINEX Project Implementation Committee, consisting of as many as seven members, be organized to oversee the work of the Project Team. To provide a reasonable degree of permanence, it is further suggested that at least two of the three members coming from FINEX be made permanent members during the entire life of the Project. To provide a broader focus on the implementation of the Project, three of the seven members should come from the MSE, MKSE and one alternating member from the Bankers Association of the Philippines and Investment Houses Association of the Philippines. The other member should be the SEC project manager for the public sector component, who will provide the needed coordination between the project activities between the Public and Private Sector components.

VIII. CONDITIONS AND COVENANTS

A. CONDITIONS PRECEDENT TO DISBURSEMENTS

Disbursement for commodities. Prior to disbursement under the Grant, or to the issuance of commitment documents for automation equipment for the SEC, the Grantee will, except as the Parties may otherwise agree in writing, furnish to A.I.D., in form and substance satisfactory to A.I.D., evidence of the establishment of a separate EDP division in the SEC.

B. COVENANTS

Training Plan. The Grantee will provide an annual training plan, at the beginning of each Project year, with the names and positions of SEC employees who are proposed for training, and the type of training desired.

Budget Support. The Grantee will provide regular budget support to the SEC that is adequate to carry out the Project, including adequate budget to strengthen the SEC's training and EDP divisions.

ANNEX A

GOP REQUEST FOR ASSISTANCE

REPUBLIC OF THE PHILIPPINES
NATIONAL ECONOMIC AND DEVELOPMENT AUTHORITY
NEDA sa Pasig, Amber Avenue, Pasig, Metro Manila

SEP 29 1 45 PM '92

MR. RICHARD JOHNSON
Acting Director
U.S. Agency for International Development
Ramon Magsaysay Center
Roxas Boulevard, Manila

92061
USAID/G&R

Cable Address: NEDAPHIL
P.O. Box 419, Greenhills
Tels. 631-09-45 to 64

SEP 28 1992

Dear Acting Director Johnson:

We wish to convey the Philippine Government's request for grant assistance to finance the Capital Markets Development Project (CMDP). The requested grant assistance amounts to US$ 13.5 million. The Philippine Government, through the Securities and Exchange Commission (SEC), envisions to provide US$ 2.088 million "in-kind" contributions as counterpart funding for the project. The FINEX will provide $0.75 million.

The project consists of two components, namely the (1) Public Sector Component; and (2) Private Sector Component. The Public Sector Component will extend assistance to SEC, focusing on administrative and regulatory reforms and improvements in operational efficiency, technical staff capabilities, training and organizational development of the Commission. On the other hand, the Private Sector Component, the assistance for which will be extended to the Financial Executives Institute of the Philippines (FINEX), will focus on the (a) conduct of capability-building programs in policy design development and advocacy for the financial sector, (b) implementation of an Automated Securities Trading, Clearing and Settlements System that will link up both Makati and Manila Stock Exchanges, (c) development and operationalization of an investor information providers, and d) design and implementation of short-term fast-track training courses, workshops and seminars on capital markets development.

The Investment Coordination Committee approved the project on its meeting of 16 September 1992 subject to the establishment of a coordinating committee for both public sector and private sector components, to be chaired by SEC, that, among other things, will coordinate the implementation of the two components.

We shall highly appreciate USAID's full support to the proposed project.

Thank you for your continued interest in the pursuit of our national development goals.

ACTION TAKEN

Very truly yours,

DANTE B. CANLAS
Deputy Director-General and
Office-In-Charge

cc: Chairman Rosario Lopez, SEC
Mr. Eduardo Alvarez, FINEX
Secretary Salvador Enriquez, DBM

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ANNEX B

LOGICAL FRAMEWORK

PROJECT DESIGN SUMMARY
LOGICAL FRAMEWORK

Total U.S. Funding [illegible]
Date Prepared: July 15, [illegible]

Project Title and Number: Capital Markets Development Project (492-0447)

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
(A-1) Program or Sector Goal: The broader objective to which this project contributes: To enhance the operational capacity of the capital markets so that an increase in the number and types of equity and debt securities becomes available to investors, thereby attracting additional investments and contributing to overall economic growth.	**(A-2) Measures of Goal Achievement:** -Increase in private sector employment. -Increase in the number of new business starts financed with equity instruments. -Increase in the number of existing businesses expanding through equity instruments. -Increase in the number of types and volume of the financial instruments traded in the securities market	(A-3) GOP records Impact evaluation	**(A-4) Assumptions for achieving goal targets:** Potential investors react positively to the [illegible] and improvements, and consequently look for [illegible] equity investments over short term high interest [illegible] accounts.
(B-1) Project Purpose: To assist in the enhancement of the efficiency of the securities market in the Philippines by improving the quality and transparency of investor information available to investors, the public, and other capital market participants.	**(B-2) Conditions that will indicate purpose has been achieved: End-of-Project Status.** -Increase in the number of companies listed on the boards of the exchanges by * percent -Increase in the volume of trade of securities issues by * percent. -Increase in the number of institutional investors engaged in the securities market and the volume of their trading by * percent. -Increase in the amount of total capitalization of the securities market by * percent.	(B-3) SEC Records GOP Statistics Project Monitoring	**(B-4) Assumptions for achieving purpose:** -Automation will lead to greater efficiency [illegible] confidence in the market, and thereby [illegible] increase in the number of firms willing to [illegible] -Automation, transparency of information, and their efficiency in operations will attract [illegible]
(C-1) Project Outputs: -Creation of self-sustained SEC sub-offices. -Full automation of stock market operations in the fields of trading, clearing, settlements, and investor information. -Enhancement of the SEC's ability to monitor regulation. -Strengthening of the private sector's capabilities to self-regulate. -Creation of a self-sustained - through a fee-for-services mechanism - training program to develop the professional services of capital market participants. -Strengthening of the CEC's capabilities to carry out a better defined mandate. -Strengthening of the private and public sectors' capabilities to conduct meaningful policy dialogue with each other. -Creation of an investors' information service.	**(C-2) Magnitude of outputs:** -SEC sub-offices operating in Cebu, Cagayan de Oro, and Davao become self-sustaining through provision of investment information on a fee-for-use basis. -Stock Market automated in areas of trading, clearing, settlements, and investor information. -TA to SEC will assist in assessing automation needs, management restructuring, and prioritization of objectives. -The Capital Markets Development Council becomes institutionalized and provides verifiable input into policy reform.	(C-3) TA reports Site verification	**(C-4) Assumptions for achieving output:** -SEC-rendered information services prove [illegible] and fees generated from these services offset operation costs. -SEC heeds TA advice regarding automation, professionalization, and internal reforms -Challenge grant leverages sufficient capital for an automated exchange.
(D-1) AID Project Inputs: 1. Technical Assistance 2. Commodities 3. Institutional Support 4. Technical Studies 5. Training 6. Cooperative Agreement	**(D-2) Implementation Target (Type and Quantity):** (1000) SEC / PRIVATE SECTOR TA: 3,338 / - Commodities: 2,798 / - Grant: - / 4,993 Inst. Sup.: 1,061 / - Training: 812 / - Mon/Eval: 750 / 750 Totals: 8,757 / 5,243	(D-3) -Cooperative Agreement in place with NGO -TA contract -Financial reports	**(D-4) Assumptions for providing inputs:** -Availability of incremental funding -Availability of GOP counterpart funds -Agreement on terms of project

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ANNEX C

STATUTORY CHECKLIST

5C(2) - ASSISTANCE CHECKLIST

Listed below are statutory criteria applicable to the assistance resources themselves, rather than to the eligibility of a country to receive assistance. This section is divided into three parts. Part A includes criteria applicable to both Development Assistance and Economic Support Fund resources. Part B includes criteria applicable only to Development Assistance resources. Part C includes criteria applicable only to Economic Support Funds.

CROSS REFERENCE: IS COUNTRY CHECKLIST UP TO DATE

A. CRITERIA APPLICABLE TO BOTH DEVELOPMENT ASSISTANCE AND ECONOMIC SUPPORT FUNDS	Yes.
1. **Host Country Development Efforts** (FAA Sec. 601(a)): Information and conclusions on whether assistance will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; (c) encourage development and use of cooperatives, credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture, and commerce; and (f) strengthen free labor unions.	a. The project intends to make the Philippines a more attractive place for investment in the capital markets. b. Project will increase private sector competition for equity investments. c. N/A d. Project will assist in effecting a more transparent market, thereby reducing instances of insider trading. e. N/A. f. N/A
2. **U.S. Private Trade and Investment** (FAA Sec. 601(b)): Information and conclusions on how assistance will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).	U.S. firms will be solicited to implement the project. A more open and competitive environment should encourage further U.S. investment.

3. Congressional Notification

a. **General requirement** (FY 1991 Appropriations Act Secs. 52 and 591; FAA Sec. 634A): If money is to be obligated for an activity not previously justified to Congress, or for an amount in excess of amount previously justified to Congress, has Congress been properly notified (unless the notification requirement has been waived because of substantial risk to human health or welfare)?	Congress cleared notification on 7/15/92.
b. **Notice of new account obligation** (FY 1991 Appropriations Act Sec. 514): If funds are being obligated under an appropriation account to which they were not appropriated, has the President consulted with and provided a written justification to the House and Senate Appropriations Committees and has such obligation been subject to regular notification procedures?	N/A
c. **Cash transfers and nonproject sector assistance** (FY 1991 Appropriations Act Sec. 575(b)(3)): If funds are to be made available in the form of cash transfer or nonproject sector assistance, has the Congressional notice included a detailed description of how the funds will be used, with a discussion of U.S. interests to be served and a description of any economic policy reforms to be promoted?	N/A
4. **Engineering and Financial Plans** (FAA Sec. 611(a)): Prior to an obligation in excess of $500,000, will there be: (a) engineering, financial or other plans necessary to carry out the assistance; and (b) a reasonably firm estimate of the cost to the U.S. of the assistance?	A. Yes B. Yes

5. **Legislative Action** (FAA Sec. 611(a)(2)): If legislative action is required within a recipient country with respect to an obligation in excess of $500,000, what is the basis for a reasonable expectation that such action will be completed in time to permit orderly accomplishment of the purpose of the assistance?	N/A
6. **Water Resources** (FAA Sec. 611 (b); FY 1991 Appropriations Act Sec. 501): If project is for water or water-related land resource construction, have benefits and costs been computed to the extent practicable in accordance with the principles, standards, and procedures established pursuant to the Water Resources Planning Act (42 U.S.C. 1962, et seq.)? (See A.I.D. Handbook 3 for guidelines.)	N/A
7. **Cash Transfer and Sector Assistance** (FY 1991 Appropriations Act Sec. 575(b)): Will cash transfer or nonproject sector assistance be maintained in a separate account and not commingled with other funds (unless such requirements are waived by Congressional notice for nonproject sector assistance)?	N/A
8. **Capital Assistance** (FAA Sec. 611(e)): If project is capital assistance (e.g., construction), and total U.S. assistance for it will exceed $1 million, has the Mission Director certified and Regional Assistant Administrator taken into consideration the country's capability to maintain and utilize the project effectively?	N/A
9. **Multiple Country Objectives** (FAA Sec. 601(a)): Information and conclusions on whether projects will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; (c) encourage	See A.1.(a)-(f) above.

development and use of cooperatives, credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture and commerce; and (f) strengthen free labor unions.

10. **U.S. Private Trade** (FAA Sec. 601(b)): Information and conclusions on how project will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).

See A.2, above.

11. **Local Currencies**

a. **Recipient Contributions** (FAA Secs. 612(b), 636(h)): Describe steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and other services, and foreign currencies owned by the U.S. are utilized in lieu of dollars.

The GOP will finance in kind or in cash a minimum of 25% of project costs in the form of: additional personnel to staff satellite SEC offices; new facilities; commodities; and manpower to carry out the project.

b. **U.S. -Owned Currency** (FAA Sec. 612(d)): Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release?

N/A

c. **Separate Account** (FY 1991 Appropriations Act Sec. 575). If assistance is furnished to a foreign government under arrangements which result in the generation of local currencies:

N/A

(1) Has A.I.D. (a) required that local currencies be deposited in a separate account established by the recipient government, (b) entered into an agreement with that government providing the amount of local currencies to be generated and the

terms a .d conditions under which the currencies so deposited may be utilized, and (c) established by agreement the responsibilities of A.I.D. and that government to monitor and account for deposits into and disbursements from the separate account?

(2) Will such local currencies, or an equivalent amount of local currencies, be used only to car y out the purposes of the DA or ESF chapters of the FAA (depending on which chapter is the source of the assistance) or for the administrative requirements of the United States Government?

(3) Has A.I.D. taken all appropriate steps to ensure that the equivalent of local currencies disbursed from the separate account are used for the agreed purposes?

(4) If assistance is terminated to a country, will any unencumbered balances of funds remaining in a separate account be disposed of for purposes agreed to by the recipient government and the United States Government?

12. Trade Restrictions

a. Surplus Commodities (FY 1991 Appropriations Act Sec. 521(a)): If assistance is for the production of any commodity for export, is the commodity likely to be in surplus on world markets at the time the resulting productive capacity becomes operative, and is such assistance likely to cause substantial injury to U.S. producers of the same, similar or competing commodity? — No.

b. Textiles (Lautenberg Amendment) (FY 1991 Appropriations Act Sec. 521(c)): Will the assistance (except for programs in Caribbean Basin Initiative countries — N/A

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under U.S. Tariff Schedule (Section 807," which allows reduced tariffs on articles assembled abroad from U.S.-made components) be used directly to procure feasibility studies, prefeasibility studies, or project profiles of potential investment in, or to assist the establishment of facilities specifically designed for, the manufacture for export to the United States or to third country markets- in direct competition with U.S. exports, of textiles, apparel, footwear, handbags, flat goods (such as wallets or coin purses worn on the person), work gloves or leather wearing apparel?

13. **Tropical Forests** (FY 1991 Appropriations Act Sec. 533(c) (3)): Will funds be used for any program, project or activity which would (a) result in any significant loss of tropical forests, or (b) involve industrial timber extraction in primary tropical forest areas? N/A

14. **Sahel Accounting** (FAA Sec. 121(d)): If a Sahel project, has a determination been made that the host government has an adequate system for accounting for and controlling receipt and expenditure of project funds (either dollars or local currency generated therefrom)? N/A

15. **PVO Assistance**

a. **Auditing and registration** (FY 1991 Appropriations Act Sec. 537): If assistance is being made available to a PVO, has that organization provided upon timely request any document, file, or record necessary to the auditing requirements of A.I.D., and is the PVO registered with A.I.D.? Yes

b. **Funding sources** (FY 1991 Appropriations Act, Title II, under heading "Private and Voluntary Organizations"): If assistance is to be made to a United States PVO N/A

cooperative development (other than a cooperative organization), does it obtain at least 20% of its total annual funding for international activities from sources other than the United States Government?	
16. **Project Agreement Documentation** State Authorization Sec. 139 (as interpreted by conference report) Has confirmation of the date of signing of the project agreement, including the amount involved, been cabled to State L/T and A.I.D. LEG within 60 days of the agreement's entry into force with respect to the United States, and has the full text of the agreement been pouched to those same offices? (See Handbook 3, Appendix 6G for agreements covered by this provision).	Yes, it will be.
17. **Metric System** (Omnibus Trade and Competitiveness Act of 1988 Sec. 5164, as interpreted by conference report, amending Metric Conversion Act of 1975 Sec. 2, and as implemented through A.I.D. policy): Does the assistance activity use the metric system of measurement in its procurements, grants, and other business-related activities, except to the extent that such use is impractical or is likely to cause significant inefficiencies or loss of markets to Untied States firms? Are bulk purchases usually to be made in metric, and are components, subassemblies, and semi-fabricated materials to be specified in metric units when economically available and technically adequate? Will A.I.D. specifications use metric units of measure from the earliest programmatic stages, and from the earliest documentation of the assistance processes (for example, project papers) involving quantifiable measurements (length, area, volume, capacity, mass and weight), through the implementation stage?	N/A

18. **Women in Development** (FY 1991 Appropriations Act, Title II, under heading "Women in Development"): Will assistance be designed so that the percentage of women participants will be demonstrably increased?	Project will benefit both men and women equally.
19. **Regional and Multilateral Assistance** (FAA Sec. 209): Is assistance more efficiently and effectively provided through regional or multilateral organizations? If so, why is assistance not so provided? Information and conclusions on whether assistance will encourage developing countries to cooperate in regional development programs.	N/A
20. **Abortions** (FY 1991 Appropriations Act, Title II, under heading "Population, DA," and Sec. 525):	N/A
a. Will assistance be made available to any organization or program which, as determined by the President, supports or participates in the management of a program of coercive abortion or involuntary sterilization?	No.
b. Will any funds be used to lobby for abortion?	No.
21. **Cooperatives** (FAA Sec. 111): Will assistance help develop cooperatives, especially by technical assistance, to assist rural and urban poor to help themselves toward a better life?	N/A
22. **U.S.-Owned Foreign Currencies**	
a. **Use of currencies** (FAA Secs. 612(b), 636(h); FY 1991 Appropriations Act Secs. 507, 509): Describe steps taken to assure that, to the maximum extent possible, foreign currencies owned by the U.S. are utilized in lieu of dollars to to meet the cost of contractual and other services.	N/A

b. **Release of currencies** (FAA Sec. 612(d): 612(d)): Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release?	N/A
23. **Procurement**	
a. **Small business** (FAA Sec. 602(a)): Are there arrangements to permit U.S. small business to participate equitably in the furnishing of commodities and services financed?	Yes, it is expected that a Gray Amendment firm specializing as a Procurement Services Agent will be contracted.
b. **U.S. procurement (FAA Sec. 604(a)**: Will all procurement be from the U.S. except as otherwise determined by the President or determined under delegation from him?	All commodities envisaged under the project are expected to be purchased from U.S. sources. If there are exceptions justification will be documented in a waiver.
c. **Marine insurance (FAA Sec. 604(d)**: If the cooperating country discriminates against marine insurance companies authorized to do business in the U.S., will commodities be insured in the United States against marine risk with such a company?	N/A
d. **Non-U.S. agricultural** procurement (FAA Sec. 604(e): If non-U.S. procurement of agricultural commodity or product thereof is to be financed, is there provision against such procurement when the domestic price of such commodity is less than parity? (Exception where commodity financed could not reasonably be procured in U.S.)	N/A
e. **Construction of engineering services** (FAA Sec. 604(g) : Will construction or engineering services be procured from firms of advanced developing countries which are otherwise eligible under Code 941 and which have attained a competitive capability in international markets	No.

such contract for the convenience United States?	
j. **Consulting services** (FY 1991 Appropriations Act Sec. 524): If assistance is for consulting service through procurement contract pursuant to 5 U.S.C. 3109, are contract expenditures a matter of public record and available for public inspection (unless otherwise provided by law or Executive Order?)	Yes.
K. **Metric conversion** (Omnibus Trade and Competitiveness Act of 1988, as interpreted by conference report, amending Metric Conversion Act of 1975 Sec. 2, and as implemented through A.I.D. policy): Does the assistance program use the metric system of measurement in its procurements, grants, and in its procurements, grants and other business-related activities, except to the extent that such use is impractical or it likely to cause significant inefficiencies or loss of markets to United States firms? Are bulk purchases usually to be made in metric, and are components, subassemblies, and semi-fabricated materials to be specified in metric units when economically available and technically adequate? Will A.I.D. specifications use metric units of measures from the earliest programmatic stages, and from the earliest documentation of the assistance processes (for example, project papers) involving quantifiable measurements (length, area, volume, capacity, mass and weight), through the implementation stage?	See Section A.17 above.
l. **Competitive Selection Procedures** (FAA Sec. 601(e): Will the assistance utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise?	Yes.

in one of these areas? (Exception is for those countries that receive direct economic assistance under the FAA and permit United States firms to compete for construction or engineering services financed from assistance programs of these countries.)	
f. **Cargo preference shipping** FAA Sec.03): Is the shipping excluded from compliance with the requirement in section 901(b) of the Merchant Marine Act of 1936, as amended, that at least 50 percent of the gross tonnage of commodities (computed separately from dry bulk carriers, dry cargo liners, and tankers) financed shall be transported on privately owned U.S. flag commercial vessels to the extent such vessels are available at fair and reasonable rates?	No.
g. **Technical assistance** (FAA Sec. 621 (a)): If technical assistance is financed, will such assistance be furnished by private enterprise on a contract basis to the fullest extent practicable?	Yes.
Will the facilities and resources of other Federal agencies be utilized, when they are particularly suitable, not competitive with private enterprise, and made available without undue interference with domestic programs?	Yes.
h. **U.S. air carriers** (International Air Transportation Fair Competitive Practices Act, 1974): If air transportation of persons or property is financed on grant basis, will U.S. carriers be used to the extent such service is available?	Yes.
i. **Termination for convenience of U.S. Government** (FY 1991 Appropriations Act Sec/ 504): If the U.S. Government is a party to a contract for procurement, does the contract contain a provision authorizing termination of	Yes, it will.

24. Construction

a. **Capital project** (FAA Sec. 601(d)): If capital (e.g., construction) project, will U.S. engineering and professional services be used?	N/A
b. **Construction contract** (FAA Sec. 611(c)): If contracts for construction are to be financed, will they be lent on a competitive basis to maximum extent practicable?	N/A
c. **Large projects, Congressional approval** (FAA Sec. 620(k)): If for construction of productive enterprise, will aggregate value of assistance to be furnished by the U.S. not exceed $100 million (except for productive enterprise in Egypt that were described in the Congressional Presentation), or does assistance have the express approval of Congress?	N/A
25. **U.S. Audit Rights** (FAA Sec. 301(d)): If fund is established solely by U.S. contributions and administered by an international organization, does Comptroller General have audit rights? organization, does Comptroller General have audit rights?	Yes.
26. **Communist Assistance** (FAA Sec. 620(h): Do arrangements exist to insure that United States foreign aid is not used in a manner which, contrary to the best interests of the United States, promotes or assists the foreign aid projects or activities of the Communist-block countries?	Yes.
27. **Narcotics**	
a. **Cash reimbursements** (FAA Sec. 483): Will arrangements preclude use of financing to make	Yes.

payments, to persons whose illicit drug crops are eradicated?

b. **Assistance to narcotics traffickers** (FAA Sec. 487): Will arrangements take "all reasonable steps" to preclude use of financing to or through individuals or entities which we know or have reason to believe have either: (1) been convicted of a violation of any law or regulation of the United States or a foreign country relating to narcotics (or other controlled substances); or (2) been an illicit trafficker in, or otherwise involved in the illicit trafficking, of any such controlled substance? Yes.

28. **Expropriation and Land Reform** (FAA Sec. 620(g): Will assistance preclude use of financing to compensate owners for expropriated or nationalized property, except to compensate foreign nationals in accordance with a land reform program certified by the President? Yes.

29. **Police and Prisons** (FAA Sec. 660): Will assistance preclude use of financing to provide training, advice, or any financial support for police, prisons, or other law enforcement forces, except for narcotics programs? Yes.

30. **CIA Activities** (FAA Sec. 662): Will assistance preclude use of financing for CIA activities? Yes.

31. **Motor Vehicles** (FAA Sec. 636(i): Will assistance preclude use of financing for purchase, sale, long-term lease, exchange or guaranty of the sale of motor vehicle manufactured outside U.S., unless a waiver is obtained? Yes.

32. **Military Personnel** (FY 1991 Appropriations Act Sec. 503): Will assistance preclude use of financing to pay pensions, Yes.

annuities, retirement pay, or adjusted service compensation for prior or current military personnel?	
33. **Payment of U.N. Assessments** (FY 1991 Appropriations Act Sec. 505): Will assistance preclude use of financing to pay U.N. assessments, arrearages or dues?	Yes.
34. **Multilateral Organization Lending** (FY 1991 Appropriations Act Sec. 506): Will assistance preclude use of financing to carry out provisions of FAA section 209(d) (transfer of FAA funds to multilateral organizations for lending)?	Yes.
35. **Export of Nuclear Resources** (FY 1991 Appropriations Act Sec. 510): Will assistance preclude use of financing to finance the export of nuclear equipment, fuel, or technology?	Yes.
36. **Repression of Population** (FY 1991 Appropriations Act Sec. 511): Will assistance preclude use of financing for the purpose of aiding the efforts of the government of such country to repress the legitimate rights of the population of such country contrary to the Universal Declaration of Human Rights?	Yes.
37. **Publicity or Propaganda** (FY 1991 Appropriations Act Sec. 516): Will assistance be used for publicity or propaganda purposes designed to support or defeat legislation pending before Congress, to influence in any way the outcome of a political election in the United States, or for any publicity or propaganda purposes not authorized by Congress?	No.
38. **Marine Insurance** (FY 1991 Appropriations Act Sec. 563): Will any A.I.D. contract and solicitation, and subcontract entered into under such contract,	Yes.

include a clause requiring that U.S. marine have a fair opportunity to bid for marine insurance when such insurance is necessary or appropriate?

39. **Exchange for Prohibited Act** (FY 1991 Appropriations Act Sec. 569): Will any assistance be provided to any foreign government (including any instrumentality or agency thereof), foreign person, or United States person on exchange for that foreign government or person undertaking any action which is, if carried out by the United States Government, a United States official or employee, expressly prohibited by a provision of United States law?

No.

ANNEX D

NAD APPROVAL CABLE

UNCLASSIFIED STATE 144294

ACTION: AID-5 INFO: AMB DCM AA RA ECON/8

VZCZCMLO334
PP RUEHML
DE RUEHC #4294 1280432
ZNR UUUUU ZZH
P 070424Z MAY 92
FM SECSTATE WASHDC
TO AMEMBASSY MANILA PRIORITY 9417
BT
UNCLAS STATE 144294

07-MAY-92 TOR: 04:37
CHRG: AID
DIST: AID

USAID/C&R

AIDAC

E.O. 12356: N/A
TAGS:
SUBJECT: NEW ACTIVITY DESCRIPTION FOR CAPITAL MARKETS DEVELOPMENT PROJECT (492,0447)

1. AA/ASIA APPROVES THE NEW ACTIVITY DESCRIPTION (NAD) FOR THE CAPITAL MARKETS DEVELOPMENT PROJECT (CMDP). THE MISSION DIRECTOR, USAID/PHILIPPINES, HAS AUTHORITY TO APPROVE SUBSEQUENT DOCUMENTS FOR THIS ACTIVITY.

2. WE APPLAUD THE MISSION'S INNOVATIVE APPROACH TO ENGAGING PLAYERS WITH DIVERSE INTERESTS IN ACTIVITIES TO INCREASE INVESTOR CONFIDENCE IN PHILIPPINES CAPITAL MARKETS.

3. ON THE BASIS OF THE BUREAU REVIEW OF THE NAD, WE RECOMMEND THAT YOU CONSIDER THE FOLLOWING IN FINAL PROJECT DESIGN.

A. LINKING CMDP AND MACROECONOMIC POLICY REFORM

-- PROGRESS OF THE GOVERNMENT OF PHILIPPINES (GOP) IN THE AREA OF MACROECONOMIC POLICY REFORMS, PARTICULARLY IN THE FINANCIAL MARKETS SECTOR, WILL IMPACT UPON THE SUCCESS OF CMDP. THE PROJECT PAPER SHOULD CAPTURE THE

ELATIONSHIP BETWEEN MACROECONOMIC POLICY ACTIVITIES
'SAID'S AND OTHER DONORS') AND CAPITAL MARKETS
VELOPMENT. DOCUMENTATION OF LESSSONS LEARNED FROM THIS
JECT ABOUT THE LINKAGE BETWEEN POLICY CHANGE AND
ITAL MARKETS DEVELOPMENT CAN INFORM FUTURE DESIGN OF
LAR PROJECTS ELSEWHERE IN A.I.D.

PRIVATE SECTOR COMPONENT

UPPORT THE PLANNED, FOURYEAR PROJECT LIFE
OF THE USUAL FIVE-PLUS YEARS. WE RECOMMEND THAT
'ATE SECTOR COMPONENT BE GIVEN ONLY ONE OR TWO
RIAL AND THEN DROPPED IF UNPRODUCTIVE. EITHER THE
ECTOR WILL HAVE PICKED UP THE BALL IN THIS TIME,
ING IS WRONG. THIS PROJECT APPROACH SHOULD ALSO
TED IN THE PROJECT PAPER.

THAT MISSION FORWARD THE INITIAL ENVIRONMENTAL

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Response to NAD Approval Cable

1. Linking CMDP and Macroeconomic Policy Reform - PP should incorporate the relationship between macroeconomic policy activities (USAID's as well as other donors) and capital markets development.

Mission Response: Capital markets development is dependent on a favorable macroeconomic environment and cannot thus be treated in isolation. Any attempt to improve the capital market while operating in generally hostile financial and macroeconomic climates would prove futile. The economic analysis (Annex G) refers to a larger economic study conducted for this project but not included in the PP. This study covers in detail the relationship between capital markets development and the macroeconomic situation in the Philippine context.

The capital market contributes to a rising standard of living because of its close connection to the saving-investment process, which is vital for economic growth. Sound policies are needed, however, to encourage the development of the capital markets. For instance, an unsound credit policy allowing for subsidies encourages corporations to raise capital through borrowing rather than raising funds through the capital markets, causing an inefficiency in the use of financial resources.

The study concludes that reforms in the Philippine financial sector have been substantial since 1980. In the area of stabilization measures, the deficit was trimmed down in 1991 to 2.8 percent of GNP, well below the program target of 3.7 percent. The inflation rate declined below 10 percent and the Treasury bill rate hovered around 17 percent. The GOP also greatly exceeded the programed international reserve amount of $ 3 billion. This was largely obtained by decreasing public spending rather than raising revenues, however.

Over the past decade USAID and the World Bank have been deeply committed to structural reforms in the economy. The average nominal tariff rate has been reduced from 50 percent to 20 percent. The recent implementation of the Foreign Investment Act is a welcome development that liberalizes entry of foreign investors in the Philippines. In general there are no restrictions on the extent of foreign ownership of export-oriented enterprises, whereas firms engaged in business for the domestic market may be owned up to 100 percent ownership by foreigners, unless participation is prohibited or restricted by law.

In other areas of deregulation, the government has been backing out of commercial banking. The foreign exchange market has recently undergone deregulation. Exporters may now retain 40 percent of their export proceeds. Privatization of government controlled assets, after initially moving slowly, has generally proved successful.

The study demonstrates that although more is needed in the way of policy reform, a favorable economic policy environment now exists in the Philippines that will improve the chances of success in reforming the capital markets.

2. Private Sector Component - Recommend the private sector component be given only one or two years' trial and then dropped if unproductive.

Mission's Response: The Mission agrees with adopting a trial period for the private sector component. However, we feel that a three-year period is more realistic given the complex nature of certain project elements (for example, the automated exchange and setting up an investors' information service) and the time required to implement these activities fully. On page 13 of the PP, we have incorporated the Bureau's advice by including a provision for a trial period (years two through four) at the end of which not only will the operation of the activities be examined but also the sustainability. Those elements that prove unproductive will be dropped from further USAID support.

Annex E

FINANCIAL ANALYSIS AND SUMMARY BUDGETS

ANALYSES

A. FINANCIAL ANALYSIS

Financial viability studies were prepared by a Contractor for each project element expected to generate revenue in order to determine their sustainability after the life of the Project. These project elements are the Information Access System at the Securities and Exchange Commission under the Public Sector component and the Automated Trading, Clearing and Settlements Systems for the stock exchanges and the Market Information Services both to be implemented by FINEX under the Private Sector Component. In the analysis of the viability of each of the .project elements, the following general approach and procedures were taken:

1. Conceptualization of the overall framework of the services being offered under each project element.

2. Preparation of cash flow projections for five years.

3. In preparing the cash flow projections, assumptions were formulated based on:
   - o Capital outlays required to set up the system
   - o Operating revenues
   - o Operating expenses

4. Computed the internal rate of return (IRR) based on the annual cash flows, using the following model :

   Annual Cash Flows (CF) = Funds Generated from Operations Less Debt Service Requirements

Funds generated from operations were computed by deducting operating expenses from gross revenues. Debt service requirements refer to the annual payments of principal and interest. In addition to the annual cash flows, the cash flow model also takes into account the residual value of the assets at the end of the projection period, as applicable. After determining the cash flows, the Internal Rate of Return(IRR) is computed by obtaining the rate at which the present value of annual cash flows will equal the amount of investment. This is expressed in the following formula:

$$IRR = \frac{CF_1}{(1+IRR)^1} + \frac{CF_2}{(1+IRR)^2} + \ldots \frac{CF_n}{(1+IRR)_n} - I_0 = 0$$

where:

CF = Cash Flow
I = Investment

The essential elements in computing the IRR are investments and cash flows. Investments in this context refer to the equity contribution of the stockholders. The viability analysis and related detailed assumptions made and procedures adopted for each relevant activity are discussed in the succeeding sections.

COMPONENT 1: PRIVATE SECTOR COMPONENT

A. **Automated Trading, Clearing and Settlements System.**

In determining the IRR for the automated trading, clearing and settlements systems, two alternative assumptions on the cost of the system (software and hardware) and corresponding levels of revenue were adopted. Alternative A uses cost estimates of hardware and software based on the cost of an automated system presently being considered by the Manila Stock Exchange. Under this alternative, revenues are based on the planned billing rate of MSE for the use of terminals linked to the system. The total capital outlay is assumed to be funded entirely from equity contribution. Alternative B uses the median of the lower and higher range of the cost of software and the upper range for hardware cost provided by a U.S. consulting firm. A higher billing rate was assumed for the computation of revenue as this higher-priced system, it is assumed, will be more advanced and sophisticated than the MSE system. Under this alternative, two sets of computations of the IRR were made based on assumed sources of capital funding, as follows:

Alternative B-1	assumes funding of capital outlays entirely from equity contribution.
Alternative B-2	assumes 30% funding from long-term debt and the balance from equity contribution.

Discussed below are various detailed assumptions relating to capital outlays, revenues and expenses. Unless otherwise specified, these assumptions equally apply to both alternatives.

A.1 COST OF HARDWARE AND SOFTWARE

As mentioned earlier, two alternative cost estimates were obtained.

A.1.1. Alternative A (system being developed for MSE) Total cost of hardware and software is estimated at US$3.46 million (P90 million), consisting of:

a.	Automated trading, price inquiry, and information system	US$	2,308,000
b.	Automated clearing and settlements system		1,154,000
	Total	US$	3,460,000

These costs are based on the actual cost of development of the trading system for MSE by Equicom Computer Center and the contracted package cost for a clearing and settlements system to be developed by a Japanese software company.

A.1.2 Alternative B (system to be acquired from the U.S.)

The cost of acquiring of software (licensed) from the United States for the automated trading, clearing and settlements systems would range from US$ 2.7 million to $ 6.5 million and the cost of the hardware would range from US$ 1.65 million to US$ 2.05 million based on cost estimates provided by Phoenix Associates, Inc. Under this alternative, the median for software cost and the upper range for the hardware cost are used in evaluating the viability of the Project.

A.2 Equity Contribution and Debt Financing

Equity contribution for Alternatives A and B-1 was computed at 100 percent while that of Alternative B-2 was computed at 70 percent of total investment cost. The balance of the investment cost of 30 percent for Alternative B-2 is assumed to be funded by debt. Total investment cost includes capital outlay for other fixed assets and working capital requirements in addition to the cost of hardware and software.

A.2.1 Capital Outlay for Other Fixed Assets

Cost of equipment, furniture, and fixtures necessary for the operation, management, and maintenance of the fully automated system were estimated based on current prices and assumptions on the type of fixed assets required for the system. Total cost is estimated at US$ 273,000 (P7,105,000).

A.2.2 Working Capital Requirement

This is based on the total amount of operating expenses incurred annually and is estimated at US$739,000 based on the estimated total operating expenses for Year 1.

A.2.3 Long-Term Debt

As mentioned previously, 30 percent of the total capital outlay under alternative B-2 will be financed through long-term debt. This is estimated at US$ 2,298,620. Interest payments on the loan is computed at 23 percent over a 5-year repayment period.

A.3 POTENTIAL REVENUES OF THE AUTOMATED SYSTEMS - Revenues were projected based on the following assumptions:

A.3.1 Rental of the terminals

Inquiry with the Manila Stock Exchange indicated that it would be charging its brokers P15,000 per terminal per month. This billing rate was adopted under Alternative A. For Alternative B, however, a rate of P20,000 per terminal per month was assumed based on the assumption that the automated systems to be developed under the Project will be more advanced and sophisticated than the MSE System. Using these billing rates as the basis, and considering that there are presently about 200 brokers from the two stock exchanges and assuming that two terminals will be used by each broker, the fully automated systems could generate P72 million or US$2.77 million annually under Alternative A and P96 million annually or US$3.69 million for Alternative B.

A.3.2 Lease of communication lines

Communication lines can be linked to non-brokers (like Reuters) to gain access to the automated systems. Again, using the Manila Stock Exchange planned rate as basis, the charge for this link is assumed to be $ 500 (P13,000) per month or about P156,000 annually per non-broker client. Conservatively, it is assumed that there will be an average of 100 non-broker clients for the duration of the projection period. These may include Reuters, CIBI, Central Bank, BAP Information Credit, banks and other financial institutions, news agencies, and financial analysts. Thus, this source of revenue may generate for the company an average of P15,600,000 annually or US$600,000.

A.3.3 Clearing and settlements fee

Inquiries from banks reveal that they are charging P.90 per transaction a day as clearing and settlements fee. Using this rate and assuming 2,000 transactions per day in Year 1 and 22 banking days per month, total revenue generated for Year 1 would be P475,200 or US$18,000. Assuming further that transactions would increase by 1,000 annually, estimated revenue would be as follows:

Year	No. of Transactions		Amount US$
2	3,000	US$	28,000
3	4,000		37,000
4	5,000		46,000
5	6,000		55,000

The revenues from clearing and settlements fee may appear to be on the low side considering that the automated systems will

be much quicker and efficient than existing systems. For purposes of this study, however, this rate was used for lack of a more objective basis at the present time.

A.4 PROJECTED OPERATING EXPENSES OF AUTOMATED SYSTEMS

The operating expenses of the automated systems are projected based on the following assumptions:

A.4.1 General and Administrative Expenses

a. Corporate Executives Salaries

It is assumed that the new corporate vehicle will have the following set of officers with the corresponding annual salaries (amounts in thousands):

	In Pesos	In Dollars
President/General Manager	P 1,500	$ 58
Treasurer	1,040	40
Controller/Finance Off.	845	33
EDP Manager/Operations	845	33
	P 4,230	$ 164

b. Salaries of Rank and File Personnel

The annual personnel salary cost is estimated as follows:

	In Pesos	In Dollars
Administrative Off.	P 240,000	$ 9,300
Accounting Manager	240,000	9,300
2 Technical assist.	240,000	9,300
3 Secretaries	270,000	10,400
2 Bookkeepers	144,000	5,600
Messenger/Driver	60,000	2,300
	P 1,194,000	$ 46,200

c. In addition to the salaries of company personnel, the new corporate vehicle will also hire the services of technical specialists for the operation of the systems. The applicable costs are estimated as follows:

	In Pesos	In Dollars
Expatriate	11P,232,000	$ 432,000
Local	1,296,000	49,800
	12P,528,000	$ 481,800

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The expatriate technical specialist will only be needed for the first two years of the estimated five-year life of the system. Thus, the cost of the expatriate specialist will be incurred in Years 1 and 2 only.

A.4.2 Other operating costs are estimated as follows:

	In Pesos
Office supplies and materials	P 250,000
Office rent	200,000
Water/Power/Communication	300,000
Maintenance of the hardware	150,000
Janitorial services	60,000
Security services	100,000
Representation and travelling	90,000
Maintenance of office equipment	30,000
Maintenance of motor vehicle	50,000
Registration of motor vehicle	20,000
	P.250,000
Equivalent in US Dollars	$ 47,000

A.5 RESIDUAL VALUE

Residual values represent the realizable value of the automated systems at the end of the projection period. This is computed at 50% of the original cost of software and hardware plus the initial working capital of $739,000, which is assumed to remain intact at the end of Year 5. At the end of Year 5, the automated trading, clearing and settlements systems will have a residual value amounting to US$ 2,469,000 under Alternative A and $4,064,000 under Alternative B.

A.6 RESULTS OF IRR ANALYSIS

On the basis of the foregoing assumptions on capital outlays, revenues and expenses, the IRR under each alternative will range from 45 percent to 60 percent, as summarized below (amounts in thousand US$). Supplement to this annex explores additional scenarios based on a sensitivity analysis.

	Alternative		
	A	B-1	B-2
Equity contribution	($4,472)	($7,662)	($5,363)
Annual Cash Flows			
Year 1	2,648	3,571	2,751
2	2,658	3,581	2,761
3	3,099	4,022	3,202
4	3,108	4,031	3,211
5	5,586	8,104	7,284
IRR (%)	59.77%	45.00%	52.58%

A.7 CONCLUSIONS ON THE AUTOMATED MARKET OPERATIONS SYSTEM

As shown above, the IRR for the Project would be attractive to potential investors considering that the rate of return exceeds the cost of debt which is estimated at 23 percent. The IRR will range from 45 percent to 60 percent. The lowest rate represents the return to investors using the cost estimates from the US and assuming 100 percent equity funding. The middle rate uses the same US cost estimates but assumes a debt mix of 30 percent. The highest rate represents the return using the MSE cost estimates and 100 percent equity capital contribution. It should be noted that the system costs and annual cashflows as explained above are based on broad estimates. To provide a more conclusive indication of viability of the proposed automated system, the preparation of a detailed feasibility study either should be required prior to the completion of the final design of the Project or as part of the project element relating to the conduct of technical studies for the design and installation of the automated systems. Another important issue to consider which may impact on the project design is the automation of the Manila Stock Exchange (MSE) by August 1992. It may be necessary to establish whether the automated systems as envisioned in the Project would merely provide improvement over the system currently being installed at MSE or would replace it.

B. MARKET INFORMATION SERVICE

As originally envisioned by in the project, FINEX will contract the services of an information bureau which will set up the system for a fee. However, as explained in the Financial Plan, it is assumed, for purposes of the viability analysis, that:

1. Funding will be given to FINEX in the form of a grant for additional equity investment in the new corporate vehicle which will own the automated trading, clearing and settlements systems.

2. The Market Information System will be linked to the automated trading, clearing and settlements systems.

3. Only incremental costs and revenues will be considered in determining the IRR, as it may not be practicable to identify and divide the common costs between the two activities. In any case, the incremental cost/revenue basis may reasonably provide an indication of the viability of this activity.

On the basis of the estimated capital outlay and incremental revenues and costs, the IRR over five years for the system is computed at 24.23 percent, as shown below:

	Amount
Capital Outlay	US$766,000
Annual Net Cash Inflow	
Year 1	281,000
2	281,000
3	281,000
4	281,000
5	281,000
Internal Rate of Return	24.23%

The assumptions relating to the computation of the capital outlays and annual cash flows are discussed in the next section.

B.1 CAPITAL OUTLAY

This consists of the cost of acquiring the required computer configuration, as follows:

Description	In Pesos	In Dollars
1 communication server	P 500,000	US$ 19,230
2 mini-computers	4,000,000	153,850
Communication software	1,000,000	38,460
5 printers	100,000	3,850
50 communication lines	150,000	5,770
50 PC with modems	8,500,000	326,900
10 PC on a LAN	850,000	32,700
1 imaging system	1,820,000	70,000
1 disk subsystem	650,000	25,000
1 tape subsystem	650,000	25,000
Consumables (tapes, disks)	1,040,000	40,000
	P8,220,000	US$700,760

The total capital outlay was estimated based on the assumption that there will be 50 regular subscribers of information and 10 regular providers of raw data for manipulation. Included in the 50 regular subscribers are banks, investment houses, news agencies, the Central Bank, BIR and the Department of Finance. On the other hand, included in the 10 regular providers of raw data are the SEC, the Automated Stock Market System, Central Bank, BIR, CIBI, NSO, and other statistical information providers.

B.2 ADDITIONAL OPERATING COSTS FOR THE MARKET INFORMATION SYSTEM

Annual incremental costs for the operation of the system are estimated as follows:

	In Pesos
Maintenance of the hardware	P 100,000
Power and communication	200,000
Supplies and materials	200,000
	P 500,000

The cost of obtaining market information is estimated at P10,000 per month for every information-source entity. For purposes of this study, it is assumed that there would be 10 providers for which a total annual cost of P1,200,000 would be incurred.

No provision for salaries of personnel was provided, on the assumption that the personnel of the new corporate vehicle handling the automated stocks exchange system will also handle the operation of the investor information system.

B.3 PROJECTED REVENUE OF THE MARKET INFORMATION SYSTEM

Revenue is estimated at P15,000-a-month per subscriber to the investor information system. This is based on the monthly fee that Manila Stock Exchange would be charging its brokers for the use of the terminals in its new system. Thus, based on the initial estimate of 50 regular subscribers, an annual gross revenue of P9,000,000 is projected.

It is anticipated that potential revenues could be derived from users of information who are not linked to the system as subscribers. These are individuals or individual companies which may directly obtain information from the system on an infrequent basis for research and other uses. For purposes of this study, the revenue derived from such sources has not been considered as it may not be practicable to do so within the scope of this Study.

B.4 CONCLUSIONS ON THE MARKET INFORMATION SERVICE

Overall, the IRR for the investor information system would be high and attractive to any potential investor. This is computed at 24 percent. This rate could possibly be higher considering that potential revenues from individual users not linked to the system have not been considered. However, it should be emphasized that this rate was derived based on incremental revenues and expenses only. If this were a new venture altogether and not linked with the automated system, additional costs, particularly personnel costs, would be incurred, reducing the resulting cashflows.

COMPONENT 2: PUBLIC SECTOR COMPONENT

A. Information Access System

The IRR for the information access system for the SEC, and consequently its viability, was not determined for the following reasons:

1. Under current SEC regulations, information on companies listed in the stock exchanges such as audited financial statements are made available to the public at a minimal fee (cost of reproduction). Information on unlisted companies, when made available to the public, is also charged with the same minimal fee.

2. Under the concept of an automated investor information system (for the Private Sector), the SEC information access system will be linked to the former as a source of information. The SEC information access system may possibly derive revenues from information provided to the latter system, but such revenues may be minimal considering the present SEC practice in this regard. Also, there may be in effect a duplication of services being offered by both the SEC and the private investor information system if SEC also offers the same information to the general public.

3. As the SEC has traditionally provided certain information to the public, it will continue to do so under an automated system. It is reasonable to assume that the cost of providing that service will continue to receive budget support from the GOP.

4. In all likelihood, the cost of maintaining public access to the new system will be in excess of the revenue that may be received from the public.

Thus, in view of the foregoing reasons, the viability of this project element is not an issue, as it will continue to be supported by the GOP.

A.1 RECURRENT COST ANALYSIS

The Information Access System consists of the SEC's data base relating to the registration and licensing of shares of stock, registration and issuance of commercial papers, investment statistics and other relevant data which may be required by prospective investors and the general public in setting up businesses or evaluating investment opportunities. As mentioned above, revenues that may be derived from such a system have not been quantified, as information is provided to the public at a minimal fee that covers the cost of reproduction. In lieu of the IRR which calls for the determination of revenues, the

recurrent costs were determined for this project element. Annual recurrent costs are estimated at US$51,500. These consist of costs directly associated with the system operation and upkeep of related facilities which are estimated as follows:

	Amount
Salaries of EDP Personnel	US$26,000
Imputed Cost of Space Utilized by the System	5,500
Cost of Utilities	8,000
Cost of Supplies	8,000
Repairs and Maintenance of Computer Hardware	4,000
Total	US$51,500

A.1.1 Salaries of EDP Personnel

It is estimated that the SEC will maintain a complement of 10 personnel with corresponding monthly salaries as follows:

	No. of Personnel	Amount
System Analyst	1	P 10,000
Programmer	2	14,000
Data Controller	3	12,000
Data Entry Operator	3	12,000
Clerk	1	4,000
Total	10	P 52,000

The above monthly salary costs are based on current salary rates contained in the SEC Budget. On an annual basis, these costs amount to US$26,000 (P676,000).

A.1.2 Imputed Cost of Office Space

The total area allotted for the EDP Center is assumed at 80 sq. m. at a rental cost of P150/sq. m. monthly. Thus, the total cost is estimated at P12,000 monthly or P144,000 annually (equivalent to about US$5,500).

A.1.3 Utilities, Supplies and Repairs and Maintenance

These are estimated based on SEC's budgeted costs for the EDP unit as follows:

	Monthly	Annual	Rounded Off To
Utilities	US$ 642	US$7,704	US$ 8,000
Supplies	142	7,704	8,000
Repairs and Maintenance	319	3,828	4,000
Totals	US$ 1,603	US$9,230	US$20,000

Capital Markets Development Project
Automated Trading, Clearing and Settlements System
Internal Rate of Return (IRR)
(Sensitivity Analysis)

Rent per month = P15,000

	No. of Terminals	A	B–1	B–2
1.	250	35.88%	17.41%	15.60%
2.	300	43.91%	22.40%	22.20%
3.	350	48.81%	24.61%	25.17%
4.	400	59.78%	32.20%	35.29%

Rent per month = P20,000

	No. of Terminals	A	B–1	B–2
5.	250	49.22%	25.69%	26.57%
6	300	59.78%	32.20%	35.29%
7.	350	70.25%	38.63%	43.96%
8.	400	78.91%	45.00%	52.59%

Capital Markets Development Project
Automated Trading, Clearing and Settlements System
Internal Rate of Return (IRR)

Sensitivity Analysis 1 – 250 terminals at P15,000/mo/terminal

Alternative A

	Investment	Net Cash Flow	IRR
	(4,472,000)	0	(4,472,000)
YR1		1,609,769	1,609,769
YR2		1,619,769	1,619,769
YR3		2,060,769	2,060,769
YR4		2,069,769	2,069,769
YR5		4,547,769	4,547,769
		IRR	35.88%

Alternative B–1

	Investment	Net Cash Flow	IRR
	(7,662,000)	0	(7,662,000)
YR1		1,609,769	1,609,769
YR2		1,619,769	1,619,769
YR3		2,060,769	2,060,769
YR4		2,069,769	2,069,769
YR5		6,142,769	6,142,769
		IRR	17.41%

Alternative B–2

	Investment	Net Cash Flow	IRR
	(5,363,000)	0	(5,363,000)
YR1		789,769	789,769
YR2		799,769	799,769
YR3		1,240,769	1,240,769
YR4		1,249,769	1,249,769
YR5		5,322,769	5,322,769
		IRR	15.60%

	YR1	YR2	YR3	YR4	YR5
Terminal Rental	1,730,769	1,730,769	1,730,769	1,730,769	1,730,769
Other Revenues	618,000	628,000	637,000	646,000	655,000
Total Revenues	2,348,769	2,358,769	2,367,769	2,376,769	2,385,769
Expenses	739,000	739,000	307,000	307,000	307,000
Net cashflow	1,609,769	1,619,769	2,060,769	2,069,769	2,078,769

	YR1	YR2	YR3	YR4	YR5
Terminal Rental	1,730,769	1,730,769	1,730,769	1,730,769	1,730,769
Other Revenues	618,000	628,000	637,000	646,000	655,000
Total Revenues	2,348,769	2,358,769	2,367,769	2,376,769	2,385,769
Expenses	739,000	739,000	307,000	307,000	307,000
Net cashflow	1,609,769	1,619,769	2,060,769	2,069,769	2,078,769

	YR1	YR2	YR3	YR4	YR5
Terminal Rental	1,730,769	1,730,769	1,730,769	1,730,769	1,730,769
Other Revenue	618,000	628,000	637,000	646,000	655,000
Total Revenues	2,348,769	2,358,769	2,367,769	2,376,769	2,385,769
Expenses	739,000	739,000	307,000	307,000	307,000
	1,609,769	1,619,769	2,060,769	2,069,769	2,078,769
debt service	–820000	–820000	–820000	–820000	–820000
net cashflow	789,769	799,769	1,240,769	1,249,769	1,258,769

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Capital Markets Development Project
Automated Trading, Clearing and Settlements System
Internal Rate of Return (IRR)

Sensitivity Analysis 2 – 300 terminals at P15,000/mo/terminal

Alternative A

	Investment	Net Cash Flow	IRR
	(4,472,000)	0	(4,472,000)
YR1		1,955,923	1,955,923
YR2		1,965,923	1,965,923
YR3		2,406,923	2,406,923
YR4		2,415,923	2,415,923
YR5		4,893,923	4,893,923
		IRR	43.91%

	YR1	YR2	YR3	YR4	YR5
Terminal Rental	2,076,923	2,076,923	2,076,923	2,076,923	2,076,923
Other Revenues	618,000	628,000	637,000	646,000	655,000
Total Revenues	2,694,923	2,704,923	2,713,923	2,722,923	2,731,923
Expenses	739,000	739,000	307,000	307,000	307,000
Net cashflow	1,955,923	1,965,923	2,406,923	2,415,923	2,424,923

Alternative B–1

	Investment	Net Cash Flow	IRR
	(7,662,000)	0	(7,662,000)
YR1		1,955,923	1,955,923
YR2		1,965,923	1,965,923
YR3		2,406,923	2,406,923
YR4		2,415,923	2,415,923
YR5		6,488,923	6,488,923
		IRR	22.40%

	YR1	YR2	YR3	YR4	YR5
Terminal Rental	2,076,923	2,076,923	2,076,923	2,076,923	2,076,923
Other Revenues	618,000	628,000	637,000	646,000	655,000
Total Revenues	2,694,923	2,704,923	2,713,923	2,722,923	2,731,923
Expenses	739,000	739,000	307,000	307,000	307,000
Net cashflow	1,955,923	1,965,923	2,406,923	2,415,923	2,424,923

Alternative B–2

	Investment	Net Cash Flow	IRR
	(5,363,000)	0	(5,363,000)
YR1		1,135,923	1,135,923
YR2		1,145,923	1,145,923
YR3		1,586,923	1,586,923
YR4		1,595,923	1,595,923
YR5		5,668,923	5,668,923
		IRR	22.20%

	YR1	YR2	YR3	YR4	YR5
Terminal Rental	2,076,923	2,076,923	2,076,923	2,076,923	2,076,923
Other Revenue	618,000	628,000	637,000	646,000	655,000
Total Revenues	2,694,923	2,704,923	2,713,923	2,722,923	2,731,923
Expenses	739,000	739,000	307,000	307,000	307,000
	1,955,923	1,965,923	2,406,923	2,415,923	2,424,923
debt service	(820,000)	(820,000)	(820,000)	(820,000)	(820,000)
net cashflow	1,135,923	1,145,923	1,586,923	1,595,923	1,604,923

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Capital Markets Development Project
Automated Trading, Clearing and Settlements System
Internal Rate of Return (IRR)

Sensitivity Analysis 3 – 350 terminals at P15,000/mo/terminal

Alternative A

	Investment	Net Cash Flow	IRR
	(4,472,000)	0	(4,472,000)
YR1		2,302,077	2,302,077
YR2		2,312,077	2,312,077
YR3		2,753,077	2,753,077
YR4		2,069,769	2,069,769
YR5		4,547,769	4,547,769
		IRR	48.81%

	YR1	YR2	YR3	YR4	YR5
Terminal Rental	2,423,077	2,423,077	2,423,077	1,730,769	1,730,769
Other Revenues	618,000	628,000	637,000	646,000	655,000
Total Revenues	3,041,077	3,051,077	3,060,077	2,376,769	2,385,769
Expenses	739,000	739,000	307,000	307,000	307,000
Net cashflow	2,302,077	2,312,077	2,753,077	2,069,769	2,078,769

Alternative B–1

	Investment	Net Cash Flow	IRR
	(7,662,000)	0	(7,662,000)
YR1		2,302,077	2,302,077
YR2		2,312,077	2,312,077
YR3		2,753,077	2,753,077
YR4		2,069,769	2,069,769
YR5		6,142,769	6,142,769
		IRR	24.61%

	YR1	YR2	YR3	YR4	YR5
Terminal Rental	2,423,077	2,423,077	2,423,077	1,730,769	1,730,769
Other Revenues	618,000	628,000	637,000	646,000	655,000
Total Revenues	3,041,077	3,051,077	3,060,077	2,376,769	2,385,769
Expenses	739,000	739,000	307,000	307,000	307,000
Net cashflow	2,302,077	2,312,077	2,753,077	2,069,769	2,078,769

Alternative B–2

	Investment	Net Cash Flow	IRR
	(5,363,000)	0	(5,363,000)
YR1		1,482,077	1,482,077
YR2		1,492,077	1,492,077
YR3		1,933,077	1,933,077
YR4		1,249,769	1,249,769
YR5		5,322,769	5,322,769
		IRR	25.17%

	YR1	YR2	YR3	YR4	YR5
Terminal Rental	2,423,077	2,423,077	2,423,077	1,730,769	1,730,769
Other Revenue	618,000	628,000	637,000	646,000	655,000
Total Revenues	3,041,077	3,051,077	3,060,077	2,376,769	2,385,769
Expenses	739,000	739,000	307,000	307,000	307,000
	2,302,077	2,312,077	2,753,077	2,069,769	2,078,769
debt service	(820,000)	(820,000)	(820,000)	(820,000)	(820,000)
net cashflow	1,482,077	1,492,077	1,933,077	1,249,769	1,258,769

Capital Markets Development Project
Automated Trading, Clearing and Settlements System
Internal Rate of Return (IRR)

Sensitivity Analysis 4 – 400 terminals at P15,000/mo/terminal

Alternative A

	Investment	Net Cash Flow	IRR
	(4,472,000)	0	(4,472,000)
YR1		2,648,231	2,648,231
YR2		2,658,231	2,658,231
YR3		3,099,231	3,099,231
YR4		3,108,231	3,108,231
YR5		5,586,231	5,586,231
		IRR	59.78%

	YR1	YR2	YR3	YR4	YR5
Terminal Rental	2,769,231	2,769,231	2,769,231	2,769,231	2,769,231
Other Revenues	618,000	628,000	637,000	646,000	655,000
Total Revenues	3,387,231	3,397,231	3,406,231	3,415,231	3,424,231
Expenses	739,000	739,000	307,000	307,000	307,000
Net cashflow	2,648,231	2,658,231	3,099,231	3,108,231	3,117,231

Alternative B–1

	Investment	Net Cash Flow	IRR
	(7,662,000)	0	(7,662,000)
YR1		2,648,231	2,648,231
YR2		2,658,231	2,658,231
YR3		3,099,231	3,099,231
YR4		3,108,231	3,108,231
YR5		7,181,231	7,181,231
		IRR	32.20%

	YR1	YR2	YR3	YR4	YR5
Terminal Rental	2,769,231	2,769,231	2,769,231	2,769,231	2,769,231
Other Revenues	618,000	628,000	637,000	646,000	655,000
Total Revenues	3,387,231	3,397,231	3,406,231	3,415,231	3,424,231
Expenses	739,000	739,000	307,000	307,000	307,000
Net cashflow	2,648,231	2,658,231	3,099,231	3,108,231	3,117,231

Alternative B–2

	Investment	Net Cash Flow	IRR
	(5,363,000)	0	(5,363,000)
YR1		1,828,231	1,828,231
YR2		1,838,231	1,838,231
YR3		2,279,231	2,279,231
YR4		2,288,231	2,288,231
YR5		6,361,231	6,361,231
		IRR	35.29%

	YR1	YR2	YR3	YR4	YR5
Terminal Rental	2,769,231	2,769,231	2,769,231	2,769,231	2,769,231
Other Revenue	618,000	628,000	637,000	646,000	655,000
Total Revenues	3,387,231	3,397,231	3,406,231	3,415,231	3,424,231
Expenses	739,000	739,000	307,000	307,000	307,000
	2,648,231	2,658,231	3,099,231	3,108,231	3,117,231
debt service	(820,000)	(820,000)	(820,000)	(820,000)	(820,000)
net cashflow	1,828,231	1,838,231	2,279,231	2,288,231	2,297,231

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B. PRIVATE SECTOR COMPONENT

1. IMPLEMENTATION VEHICLE

In selecting a Project Implementor for the Private Sector component of the Project, the Financial Executives Institute of the Philippines (FINEX) was preferred over other financial organizations which had also been considered by USAID, such as the Bankers Association of the Philippines (BAP), and the Investment Houses Association of the Philippines (IHAP). This preference is based on the consideration that the membership of FINEX extends to the entire financial community and not just confined to specialized activities like commercial banking or investment houses. Moreover, FINEX chairs the Capital Markets Development Council.

A review of the organization and financial system of FINEX is presented in Appendix B to this report. (Appendix B is not included in this annex but a copy is maintained in the official project file.)

The Study Team assessed that FINEX possessed several advantages as the potential implementing agency. Foremost of these advantages is that this non-government organization has a membership roster of over 500 individuals, representing for the most part the chief financial officers of leading corporations in the Philippines and ranking officers of major financial institutions. FINEX is a highly respected institution in the country and possesses a high level of credibility in the business community. Of equal importance, FINEX has spearheaded in recent years the movement toward the development of capital markets in the country. FINEX, in 1991, formed a Capital Markets Development Committee which was the catalyst in the later establishment (in November 1991) of the Capital Markets Development Council, a forum consisting of very senior executives in both the public and private sectors involved in developing the Philippine Capital Markets.

FINEX, however, is not without its disadvantages as the Private Sector component's implementing agency. The Institute is a professional association of financial executives and, as such, it is a volunteer organization. Its set of officers generally changes every year, and therefore the Institute does not have permanent personnel. Its primary source of revenue is dues collected from its members, and its major disbursements are for salaries of its secretariat, and cost of membership programs, meetings and fellowships. As an organization, the experience of FINEX in big-scale undertakings is limited.

In its present form, the FINEX organization is not capable of administering a project of the magnitude of CMDP. However, with proper design and staffing by qualified personnel, the creation of a separate Project Team to act as the administrative vehicle for the Private Sector component would overcome current deficiencies in the FINEX organization to implement the Project. Similarly, the existing contracting capability and disbursement capability of

FINEX were assessed to be limited in terms of implementing a project of this nature. Specific recommendations for strengthening these capabilities are presented in later sections of this Report.

2. FINEX OR FINEX FOUNDATION

The issue of selecting between FINEX and the FINEX Foundation as the implementing agency was also evaluated. The FINEX Foundation serves as the research arm of FINEX and is involved in providing grants for scientific research and development work. The Foundation's funds are provided by FINEX. Also, the Foundation's members are selected from the members of the FINEX organization.

Based on the Study Team's review, there were no significant differences between FINEX and the FINEX Foundation that would favor the selection of the Foundation as the proposed Project's implementing agency. On the contrary, the following disadvantages were identified:

- FINEX has a larger membership body than the Foundation.
- The FINEX Board meets more regularly than does the Foundation Board; and,
- FINEX has an established source of revenue (membership dues, etc.) in contrast to the Foundation which obtains its funds from FINEX itself.

With these disadvantages, it is preferable to use FINEX itself as the implementing agency rather than the FINEX Foundation.

A first step in the use of FINEX as the Project's implementing agency is the registration of FINEX as a Private Voluntary Organization (PVO) with USAID. At present, FINEX is not a registered PVO with USAID, and it is necessary that it register in order for it to qualify for project funding as PVO.

3. IMPLEMENTATION ORGANIZATIONAL STRUCTURE

As explained earlier, FINEX itself does not have the organizational machinery to implement a project of the magnitude of the Project. It is therefore necessary to create a suitable organization for this purpose. The important features of this organizational structure are discussed in the succeeding subsections.

a. FINEX Project Implementation Committee

As mentioned earlier, it is recommended that a separate Project Team be created to administer and manage the implementation of the Project's Private Sector component. In the organization of the Project Team, the non-permanent nature of the tenure of the FINEX Board of Directors should be given consideration.

Capital Markets Development Project
Automated Trading, Clearing and Settlements System
Internal Rate of Return (IRR)

Sensitivity Analysis 5 – 250 terminals at P20,000/mo/terminal

Alternative A

	Investment	Net Cash Flow	IRR
	(4,472,000)	0	(4,472,000)
YR1		2,186,692	2,186,692
YR2		2,196,692	2,196,692
YR3		2,637,692	2,637,692
YR4		2,646,692	2,646,692
YR5		5,124,692	5,124,692
		IRR	49.22%

	YR1	YR2	YR3	YR4	YR5
Terminal Rental	2,307,692	2,307,692	2,307,692	2,307,692	2,307,692
Other Revenues	618,000	628,000	637,000	646,000	655,000
Total Revenues	2,925,692	2,935,692	2,944,692	2,953,692	2,962,692
Expenses	739,000	739,000	307,000	307,000	307,000
Net cashflow	2,186,692	2,196,692	2,637,692	2,646,692	2,655,692

Alternative B–1

	Investment	Net Cash Flow	IRR
	(7,662,000)	0	(7,662,000)
YR1		2,186,692	2,186,692
YR2		2,196,692	2,196,692
YR3		2,637,692	2,637,692
YR4		2,646,692	2,646,692
YR5		6,719,692	6,719,692
		IRR	25.69%

	YR1	YR2	YR3	YR4	YR5
Terminal Rental	2,307,692	2,307,692	2,307,692	2,307,692	2,307,692
Other Revenues	618,000	628,000	637,000	646,000	655,000
Total Revenues	2,925,692	2,935,692	2,944,692	2,953,692	2,962,692
Expenses	739,000	739,000	307,000	307,000	307,000
Net cashflow	2,186,692	2,196,692	2,637,692	2,646,692	2,655,692

Alternative B–2

	Investment	Net Cash Flow	IRR
	(5,363,000)	0	(5,363,000)
YR1		1,366,692	1,366,692
YR2		1,376,692	1,376,692
YR3		1,817,692	1,817,692
YR4		1,826,692	1,826,692
YR5		5,899,692	5,899,692
		IRR	26.57%

	YR1	YR2	YR3	YR4	YR5
Terminal Rental	2,307,692	2,307,692	2,307,692	2,307,692	2,307,692
Other Revenue	618,000	628,000	637,000	646,000	655,000
Total Revenues	2,925,692	2,935,692	2,944,692	2,953,692	2,962,692
Expenses	739,000	739,000	307,000	307,000	307,000
	2,186,692	2,196,692	2,637,692	2,646,692	2,655,692
debt service	–820000	–820000	–820000	–820000	–820000
net cashflow	1,366,692	1,376,692	1,817,692	1,826,692	1,835,692

Capital Markets Development Project
Automated Trading, Clearing and Settlements System
Internal Rate of Return (IRR)

Sensitivity Analysis 6 – 300 terminals at P20,000/mo/terminal

Alternative A

	Investment	Net Cash Flow	IRR
	(4,472,000)	0	(4,472,000)
YR1		2,648,231	2,648,231
YR2		2,658,231	2,658,231
YR3		3,099,231	3,099,231
YR4		3,108,231	3,108,231
YR5		5,586,231	5,586,231
		IRR	59.78%

	YR1	YR2	YR3	YR4	YR5
Terminal Rental	2,769,231	2,769,231	2,769,231	2,769,231	2,769,231
Other Revenues	618,000	628,000	637,000	646,000	655,000
Total Revenues	3,387,231	3,397,231	3,406,231	3,415,231	3,424,231
Expenses	739,000	739,000	307,000	307,000	307,000
Net cashflow	2,648,231	2,658,231	3,099,231	3,108,231	3,117,231

Alternative B–1

	Investment	Net Cash Flow	IRR
	(7,662,000)	0	(7,662,000)
YR1		2,648,231	2,648,231
YR2		2,658,231	2,658,231
YR3		3,099,231	3,099,231
YR4		3,108,231	3,108,231
YR5		7,181,231	7,181,231
		IRR	32.20%

	YR1	YR2	YR3	YR4	YR5
Terminal Rental	2,769,231	2,769,231	2,769,231	2,769,231	2,769,231
Other Revenues	618,000	628,000	637,000	646,000	655,000
Total Revenues	3,387,231	3,397,231	3,406,231	3,415,231	3,424,231
Expenses	739,000	739,000	307,000	307,000	307,000
Net cashflow	2,648,231	2,658,231	3,099,231	3,108,231	3,117,231

Alternative B–2

	Investment	Net Cash Flow	IRR
	(5,363,000)	0	(5,363,000)
YR1		1,828,231	1,828,231
YR2		1,838,231	1,838,231
YR3		2,279,231	2,279,231
YR4		2,288,231	2,288,231
YR5		6,361,231	6,361,231
		IRR	35.29%

	YR1	YR2	YR3	YR4	YR5
Terminal Rental	2,769,231	2,769,231	2,769,231	2,769,231	2,769,231
Other Revenue	618,000	628,000	637,000	646,000	655,000
Total Revenues	3,387,231	3,397,231	3,406,231	3,415,231	3,424,231
Expenses	739,000	739,000	307,000	307,000	307,000
	2,648,231	2,658,231	3,099,231	3,108,231	3,117,231
debt service	(820,000)	(820,000)	(820,000)	(820,000)	(820,000)
net cashflow	1,828,231	1,838,231	2,279,231	2,288,231	2,297,231

Capital Markets Development Project
Automated Trading, Clearing and Settlements System
Internal Rate of Return (IRR)

Sensitivity Analysis 7 – 350 terminals at P20,000/mo/terminal

Alternative A

	Investment	Net Cash Flow	IRR
	(4,472,000)	0	(4,472,000)
YR1		3,109,769	3,109,769
YR2		3,119,769	3,119,769
YR3		3,560,769	3,560,769
YR4		3,569,769	3,569,769
YR5		6,047,769	6,047,769
		IRR	70.25%

	YR1	YR2	YR3	YR4	YR5
Terminal Rental	3,230,769	3,230,769	3,230,769	3,230,769	3,230,769
Other Revenues	618,000	628,000	637,000	646,000	655,000
Total Revenues	3,848,769	3,858,769	3,867,769	3,876,769	3,885,769
Expenses	739,000	739,000	307,000	307,000	307,000
Net cashflow	3,109,769	3,119,769	3,560,769	3,569,769	3,578,769

Alternative B–1

	Investment	Net Cash Flow	IRR
	(7,662,000)	0	(7,662,000)
YR1		3,109,769	3,109,769
YR2		3,119,769	3,119,769
YR3		3,560,769	3,560,769
YR4		3,569,769	3,569,769
YR5		7,642,769	7,642,769
		IRR	38.63%

	YR1	YR2	YR3	YR4	YR5
Terminal Rental	3,230,769	3,230,769	3,230,769	3,230,769	3,230,769
Other Revenues	618,000	628,000	637,000	646,000	655,000
Total Revenues	3,848,769	3,858,769	3,867,769	3,876,769	3,885,769
Expenses	739,000	739,000	307,000	307,000	307,000
Net cashflow	3,109,769	3,119,769	3,560,769	3,569,769	3,578,769

Alternative B–2

	Investment	Net Cash Flow	IRR
	(5,363,000)	0	(5,363,000)
YR1		2,289,769	2,289,769
YR2		2,299,769	2,299,769
YR3		2,740,769	2,740,769
YR4		2,749,769	2,749,769
YR5		6,822,769	6,822,769
		IRR	43.96%

	YR1	YR2	YR3	YR4	YR5
Terminal Rental	3,230,769	3,230,769	3,230,769	3,230,769	3,230,769
Other Revenue	618,000	628,000	637,000	646,000	655,000
Total Revenues	3,848,769	3,858,769	3,867,769	3,876,769	3,885,769
Expenses	739,000	739,000	307,000	307,000	307,000
	3,109,769	3,119,769	3,560,769	3,569,769	3,578,769
debt service	(820,000)	(820,000)	(820,000)	(820,000)	(820,000)
net cashflow	2,289,769	2,299,769	2,740,769	2,749,769	2,758,769

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Capital Markets Development Project
Automated Trading, Clearing and Settlements System
Internal Rate of Return (IRR)

Sensitivity Analysis 8 – 400 terminals at P20,000/mo/terminal

Alternative A

	Investment	Net Cash Flow	IRR
	(4,472,000)	0	(4,472,000)
YR1		3,571,308	3,571,308
YR2		3,581,308	3,581,308
YR3		4,022,308	4,022,308
YR4		4,031,308	4,031,308
YR5		6,509,308	6,509,308
		IRR	78.91%

	YR1	YR2	YR3	YR4	YR5
Terminal Rental	3,692,308	3,692,308	3,692,308	3,692,308	3,692,308
Other Revenues	618,000	628,000	637,000	646,000	655,000
Total Revenues	4,310,308	4,320,308	4,329,308	4,338,308	4,347,308
Expenses	739,000	739,000	307,000	307,000	307,000
Net cashflow	3,571,308	3,581,308	4,022,308	4,031,308	4,040,308

Alternative B–1

	Investment	Net Cash Flow	IRR
	(7,662,000)	0	(7,662,000)
YR1		3,571,308	3,571,308
YR2		3,581,308	3,581,308
YR3		4,022,308	4,022,308
YR4		4,031,308	4,031,308
YR5		8,104,308	8,104,308
		IRR	45.00%

	YR1	YR2	YR3	YR4	YR5
Terminal Rental	3,692,308	3,692,308	3,692,308	3,692,308	3,692,308
Other Revenues	618,000	628,000	637,000	646,000	655,000
Total Revenues	4,310,308	4,320,308	4,329,308	4,338,308	4,347,308
Expenses	739,000	739,000	307,000	307,000	307,000
Net cashflow	3,571,308	3,581,308	4,022,308	4,031,308	4,040,308

Alternative B–2

	Investment	Net Cash Flow	IRR
	(5,363,000)	0	(5,363,000)
YR1		2,751,308	2,751,308
YR2		2,761,308	2,761,308
YR3		3,202,308	3,202,308
YR4		3,211,308	3,211,308
YR5		7,284,308	7,284,308
		IRR	52.59%

	YR1	YR2	YR3	YR4	YR5
Terminal Rental	3,692,308	3,692,308	3,692,308	3,692,308	3,692,308
Other Revenue	618,000	628,000	637,000	646,000	655,000
Total Revenues	4,310,308	4,320,308	4,329,308	4,338,308	4,347,308
Expenses	739,000	739,000	307,000	307,000	307,000
	3,571,308	3,581,308	4,022,308	4,031,308	4,040,308
debt service	(820,000)	(820,000)	(820,000)	(820,000)	(820,000)
net cashflow	2,751,308	2,761,308	3,202,308	3,211,308	3,220,308

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Table 1, Annex E

Capital Markets Development Project
Summary Cost Estimates and Financial Plan
(US$000)

PROJECT ELEMENTS	USAID GRANT		TOTAL USAID	TOTAL GOP FINEX	TOTAL L O P COSTS
	LC	FX			
1. PUBLIC SECTOR COMPONENT	3,157	4,850	8,007	4,500	12,507
Technical specialists/advisers	790	2,176	2,966	38	
Commodities	437	1,479	1,916	269	
Information access	0	880	880		
Policy reform	372	0	372	16	
Training and education	497	315	812	230	
Institutional support	1,061	0	1,061	3,947	
2. PRIVATE SECTOR COMPONENT	4,093	900	4,993	9,750	14,743
Technical studies	8	420	428		
Challenge grant	1,000	0	1,000	9,000	
Investor information services	869	0	869		
Policy reform	308	0	308		
Training, education, and research	1,201	480	1,681	750	
Institution building	707	0	707		
3. MONITORING, EVALUATION & AUDIT	200	300	500	0	500
Total	7,450	6,050	13,500	14,250	27,750

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Table 2, Annex E

Capital Markets Development Project
Projection of Expenditures
By Fiscal Year and by Project Element
(US$000)

PROJECT ELEMENTS	FY93		FY94		FY95		FY96		FY97		USAID GRANT		TOTAL USAID	TOTAL GOP	TOTAL L O P COSTS
	LC	FX	LC	FX	LC	FX	LC	FX	LC	FX	LC	FX			
1. PUBLIC SECTOR COMPONENT	284	383	1,219	1,113	693	2,271	524	543	437	540	3,157	4,850	8,007	4,500	12,507
Technical specialists/advisers	47	195	129	537	128	544	185	400	231	500	790	2,176	2,966	38	
Commodities	0	0	437	58	0	1,421	0	0	0	0	437	1,479	1,916	269	
Information access	0	176	0	484	0	220	0	0	0	0	0	880	880		
Policy reform	5	0	15	0	93	0	115	0	144	0	372	0	372	16	
Training and education	20	12	55	34	137	86	223	143	62	40	497	315	812	230	
Institutional support	212	0	583	0	265	0	1	0	0	0	1,061	0	1,061	3,947	
2. PRIVATE SECTOR COMPONENT	565	453	2,104	172	932	107	281	96	211	72	4,093	900	4,993	9,750	5,403
Technical studies	2	333	6	76	0	12	0	0	0	0	8	420	428		
Challenge grant	0	0	1,000	0	0	0	0	0	0	0	1,000	0	1,000	9,000	
Investor information services	0	0	218	0	651	0	0	0	0	0	869	0	869		
Policy reform	77	0	61	0	62	0	62	0	46	0	308	0	308		
Training, education, and research	263	120	690	96	90	96	90	96	68	72	1,201	480	1,681	750	
Institution building	223	0	129	0	129	0	129	0	97	0	707	0	707		
3. MONITORING, EVALUATION and AUDIT	0	0	100	0	0	150	100	0	0	150	200	300	500	0	500
Total	849	836	3,423	1,285	1,625	2,528	905	639	648	762	7,450	6,050	13,500	14,250	18,410

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ANNEX F

SOCIAL SOUNDNESS ANALYSIS

D. SOCIAL SOUNDNESS ANALYSIS

Background

The Philippine capital market, although fairly well established, has not been an effective and efficient mechanism for raising corporate funds. The securities market segment lacks both depth and breadth and suffers from liquidity problems, thus, constraining its growth and efficiency. Though stock market activity has increased significantly over the past years, trading breadth is still lacking with heavy concentration of trading in a relatively few issues. The limited supply of equity issues on the other hand, results from several critical factors including cheaper alternative fund sources, reluctance of family-owned corporations to dilute ownership and control, along with the associated aversion to disclose company information. Demand for securities remains limited because of the lack of investor confidence in the system. The public appears generally uninformed about securities investments and appears wary of past episodes of speculation and abuses due to insider trading. Moreover, there is a perceived dearth of professional money managers who can attract funds for management and investment in equities. At the operational level the primary problem faced by the stock exchanges is the lack of liquidity. Volumes traded remain low because of inefficiencies in order execution, excessive turn-around time, high transactions costs, lack of safe and efficiently managed securities accounts available with brokers and the public's distrust in brokers' behavior.

The proposed project attempts to respond to the need to develop the securities markets into a more viable mechanism for raising capital funds for private enterprise. At a more specific level, the project aims to improve the quality and transparency of information available to the investing public and other capital market participants in order to instill renewed investor confidence in the business environment. Expected project activities include: advocacy program for financial policy reform through a non-governmen organization (NGO), technical studies leading to automation of stock market trading, clearing, settlements and investor information system, enhancement of professional, in-house training and automation capability within the Securities and Exchange Commission (SEC), administrative reforms in SEC's rules and administrative mechanisms in relation to its regulatory functions, and provision of training, education and investor information services. These activities involve various degrees of organizational and financial innovations which have important sociocultural implications with respect to implementation as well as eventual success of the project.

The Social Context

In order to have an understanding of the socio-cultural environment within which the project elements will operate, the major stakeholders in the development of the capital market must first be identified.

Structurally, the securities segment of the Philippine capital market is compri ed of the following:

1) A regulatory agency which is empowered by law to oversee the securities industry and to protect the investor;
2) A professional securities industry which includes brokers, securities affiliates of commercial banks, universal banks and investment houses (institutional investors);
3) Stock exchanges;
4) Clearing and registration facilities; and
5) Professional industry associations.

In addition to these groups, the investing public who may not be formally affiliated with institutional investors should be included. Each of these entities or groups has its own interests or agenda which may parallel or conflict with one another, and which may be affected by innovations in the system. The focal point in the system are the two operating exchanges, the Makati and the Manila Exchanges. The two exchanges are independent of each other but trade and list the same securities. The Manila Exchange is the larger and more active of the two. Each stock exchange has membership seats which are owned and held by members, with each member, whether individual or corporate, entitled to one seat.

Market regulatory functions are performed by the SEC. Under its legal mandate, the SEC monitors the operation of the stock exchanges, the over-the-counter market and all firms and individuals engaged in the securities industry to insure compliance with the securities law. The SEC is also primarily responsible for preventing exploitation of the public by unscrupulous traders. The SEC has likewise been given quasi-judicial powers, enabling it to mediate corporate disputes. In addition to these functions, the Commission also acts as the registrar of companies to enforce the companies law and keep public records of all company information.

There are about seventy(70) brokers/dealers, although the bulk of the trading volume is accounted for by fewer than 25 brokers. Securities brokers/dealers are in general small enterprises, with many of them operating as individual proprietorships. Meanwhile, all stockbroker/members of the exchanges are also licensed dealers. The brokers/dealers are organized into the Philippine Association of Securities Brokers and Dealers, Inc. (PASBDI). The association represents the brokerage industry in matters affecting members' interests.

Clearing of securities transactions is done through two different banks: the Equitable Bank Corporation for the Manila exchange and the Rizal Commercial Bank Corporation for the Makati exchange. There are a number of firms, including accounting firms and banks, which act as transfer agents for issuance of certificates to new owners and cancellation of certificates sold. Since the clearing and settlement system is not fully automated, the system is subject to overload and delay during periods of heavy volume of transactions.

Characteristics of Groups and their Attitudes toward Change and Innovation

A. The Stock Exchanges

The exchanges have previously been operated more like "clubs" than as independent professionally-managed businesses. The predominant mode of operations and learning has been through handing down of "understandings" and traditional patterns of work from person to person and generation to generation. This has created the perception of a "closed" system that has remained impervious to change. Also, the prevalence of ethnic networks and family firms has slowed the emergence of systematic professional development and training initiatives. Apparently, the system still serves the interests of "club" members so that it is normal for them to favor existing arrangements over new approaches or major system changes.

The distribution of power among the market players has likewise tended to inhibit reforms. Leadership roles are concentrated among a small number of dominant groups on one hand, whereas minority power is distributed among many smaller groups, on the other. These groups seem to have an informal agreement that leaders can follow their own plans as long as smaller groups are not threatened by them.

These characteristics can be serious potential obstacles to introduction of improvements and innovations into the system. However, earlier reviews indicate that the exchanges are in fact open to reforms. The major forces behind the exchanges have been considering serious changes that will improve the efficiency of the exchanges. Among the changes envisioned by these sectors include automation, unification/integration of the exchanges, linkages with SEC information systems, revision of listing rules and more productive contact with the government and the investing public. In line with these planned changes, the exchanges appear to be already in various stages of studying and acting on the various components of the change process.

However, the two exchanges have expressed disinclination to merge, particularly if the merger were to be decreed by the SEC. But both exchanges, as well as the SEC, agree on the need for automation and modernization, and that some integration between the two exchanges is necessary.

In May 1992, the preliminary legal documents for the establishment of a Philippine Stock Exchange (PSE) were finalized and signed by the Presidents of both the Makati and Manila Stock Exchanges agreeing to an eventual merger in cooperation with the SEC. Although the agreement to merge and even collapse operations into the new Philippine Stock Exchange exists, a significant amount of study on operationalizing such an activity still has to be carried out. The SEC has taken on the responsibility for conducting this study.

It may be noted that the Manila exchange has already installed a computerized Real-Time Reporting System which provides its members and subscribers information on movements in the trading floor and

ready access to other market information. Although the system is still limited, this is a concrete indication of their readiness to adopt modern automated systems.

B. Brokers/Dealers

The brokerage group is regarded with some prejudice by the investing public, mainly because of past scandals and losses caused by undue speculation. In addition, few brokerage firms have research capabilities such that their market opinions are less professionally developed than in more advanced markets. The lack of research induces the small circle syndrome which often leads to insider trading.

The brokers/dealers group are among the primary beneficiaries, even if they only provide critical support. The brokers/dealers stand as primary beneficiaries of the investors' information system which will be developed with project funds. Fortunately, there appears to be no significant negative reactions toward proposed project activities from the individual brokers/dealers themselves. Their support is critical in building a stronger foundation for public sector-private sector cooperation and interaction in the capital markets system.

C. Family Businesses

The prevalence of family owned companies in the Philippines, especially among the Chinese business community has been associated with difficulties in reforming the capital market. Drawing from a 1966 study of Filipino entrepreneurs prepared by John Carroll, the family firm, as found in the Philippines, is basically characterized by the premium placed on control of the firm. Carroll observed that control of the major decisions of the enterprise is desired by practically all entrepreneurs in order to protect their investments, and probably also as one of the psychological rewards of entrepreneurship itself. Majority of entrepreneurs attempt to control policy by means of majority ownership in the enterprise, either in their own names or as representatives of unified groups.

From the perspective of owners, there are obvious disadvantages when one loses control of a family firm. Examples abound in the histories of Philippine corporations which tend to validate this perception. There are also examples of family firms that have lost their businesses because of maintaining absolute control. A popular case was that of the Palanca family which controlled the La Tondena, Inc., a firm engaged in production and distribution of local and imported liquor. In this case, loss of control of the firm resulted from executive irresponsibility which led to inadequate checks on management decisions.

Related to the problem of control is the issue of disclosure. Studies show that one of the many reasons why owners of family firms prefer not to open ownership to the public is the requirement to disclose substantial information on the company's operational and financial procedures. By going public, the company would be

opening itself to a variety of perceived disadvantages.

There are also other major reasons why businessmen resist disclosing information about their activities. In general Philippine businessmen lack trust in government and its agencies. For instance, the government does not provide the necessary support and stimulus for the growth of industry and is perceived as primarily interested in getting what it can from the private sector without adequate compensation. The private sector also probably doubts the capacity of government to apply consistent rules and policies toward business. These perceptions appear to have been developed and reinforced by experiences under the Marcos regime. These attitudes may have changed to a limited degree during the Aquino administration but positive action will still depend on concrete measures by the new government in terms of private sector support.

D. The Securities and Exchange Commission (SEC)

The SEC has encountered many problems in the implementation of its numerous responsibilities. The SEC's mandate is broad and very technical in nature. Unfortunately, however, it does not have full access to all the resources needed to implement its mandate. The Commission is undermanned, owing mainly to civil service restrictions which pose serious disincentives to attracting and retaining talented personnel. Resources for training, staff planning, and team building have been seriously reduced, leaving professionals and staff with little opportunity to develop or fulfill the Commission's mandate. In addition, other activities of the SEC such as making evaluations about the soundness of investments, the suitability and pricing of new issues and listing and delisting of stocks seem inappropriate.

The objectives of the present SEC management toward developing the capital markets generally coincide with those in the exchanges and other securities industry participants. However, the SEC is constrained by the lack of resources for manpower development, as well as up-to-date information about automation options, system capabilities and associated costs. The SEC also has inadequate information on the type of infrastructure and levels of financing appropriate for achieving its computerization requirements, although based on expert evaluation, the SEC's technology environment is fairly advanced and in line with current trends. Therefore, aside from cost considerations, it is important that project inputs build on existing capabilities in order to minimize changes in organizational structures as well as the need for technology assimilation and acculturation to the new system.

Spread of Project Benefits and Diffusion of Innovation

The primary benefits of a properly operating self-regulatory structure are that it makes maximum use of the expertise of private sector participants, results in enhanced compliance with established standards, minimizes government interference with market processes, and minimizes government expense while permitting the government to ensure that certain investor protection and market operati[illegible] standards are maintained. Thus, with a properly operating self-regulatory structure, all existing participants in the capital market (i.e. the initial project population) obviously become the primary beneficiaries of the project. Government structures will become more effective and efficient by specializing in its primary function of overseeing the proper operations of the capital markets. The private sector will develop more confidence in the system, thus stimulating more investment activities. As the capital market flourishes, long-term capital formation objectives are realized, thus building strong foundations for sustained economic development. This process is normally accompanied by significant changes in the social and cultural relations and institutions which should be mutually reinforcing and supportive of further advancements in economic welfare.

At the other end of the social and economic spectrum are the very poor which cannot be realistically identified as direct or indirect beneficiaries of this type of project. It is recognized that the impact of many projects has tended to benefit the well off disproportionately. This is particularly true for the proposed project inasmuch as the major actors are those who hold capital or have access to sources of investible funds. Unless the very poor become employed by industries which directly benefit from an expanded and a better functioning capital market through equity capital infusion, it seems hard to predict the extent of participation or the degree to which the benefits from the project reach the very poor. Again, given the nature of the project, the very poor will not have the desire or capacity to participate. However, this should not imply that the very poor will be totally left out in the course of social and economic changes stimulated by inputs from the project. As the entire economy benefits from sustained growth influenced significantly by an active capital market, social structures, values and institutions will undergo substantial changes.

Beyond the initial project population, the spread of the technical and institutional innovations will be limited only by the reluctance of some existing as well as prospective market participants to assimilate the values and practices encouraged by the innovations. Thus, persuasive communication programs should support project implementation in order to stimulate awareness, interest and adoption. The acceptance and adoption of the individual comprising the defined social system results from the favorable effect of persuasive communication on such individuals with given attitude sets or predisposition states.

It is recognized that traditionally-oriented businessmen will continue to resist changes unless their own business concerns undergo drastic changes in philosophy, perhaps brought about by

transfer of control to another generation of more broad-minded entrepreneurs, even if they still have the same family affiliations. Yoshihara (1985) observed posited that younger and better educated entrepreneurs are gradually taking over enterprises of elder blood relatives, particularly among the Chinese businesses. Though a significant number of first generation Chinese wer u: able to attend pursue higher education, second and third generation Chinese are now much better educated. This is a positive trend inasmuch as higher education gives new ideas and contributes to social integration.

The spread of project benefits can also be analyzed formally in terms of market processes which generate, develop, and disseminate information. Individual participants invest on obtaining information, thus creating two types of participants - the informed participant who have access to information, and the uninformed ones who only observe the prices of commodities or stocks. Some of the information held by the informed participants may be revealed through the market decisions of the former. However, not all information will be publicly relayed to the uninformed traders because information-efficient markets are difficult, if not impossible, to achieve in the real world. Thus, uninformed participants purchase/sell stocks solely on the basis of observed prices whereas the informedparticipants include both their information set and the observed prices in their purchasing/selling decisions.

Generally, the informedparticipants should gain more from trading than the uninformed. However, gains from market participation will tend to be distributed relatively more fairly as the price system becomes more informative. More information is observed and disseminated since variations in the information content of prices of issues will be reflected on the pattern of demand. As this develops, income disparities become narrower as market participation becomes broader.

Improvements in the quality of information held by informed participants will change their demand patterns, making prices vary more according to the amount of information. This likewise makes the price system more informative. However, the proportion of uninformed relative to informed participants may either increase or decrease since although the value of being informed increases due to the increased quality of the information set, the value of being uninformed also increases as the price system becomes more informative. If the information is noisy or erroneous, meaning less transparent information, the uninformed participants will be clearly disadvantaged.

Sustainability

While the proposed elements of the public sector component are expected to improve the capability of the SEC to enforce its regulatory mandate, SEC's long term commitment to the project is still a potential issue for consideration. Although the present political environment within and around the SEC is favorable to project activities, there could be a possible lack of implementation continuity. Changes in SEC management according to

the changes in the political leadership have the potential to jeopardize activities over the longer term. However, changes in leadership should not be considered merely as constraints but should also be viewed as dynamic, infusing new ideas and thrusts which could be supportive of project goals. What should be required to ensure continuity of project activities after the life of project is a dynamic organization committed to capital market development that plays a strong advocacy role.

The involvement of an institution committed to the improvement in the capital markets will provide the impetus for sustaining the activities begun under this project. The Capital Markets Development Council (CMDC) is an institution which has been on the forefront of inducing much needed reforms in the capital markets. Based on the design of the project, the CMDC will provide coordination between the public sector and private sector components of the project. The CMDC has a vantage position in terms of coordination because of the high-level representation of major entities involved in capital markets development from both government and private sectors. As envisioned under this project, the CMDC would be a forum for policy reviews, studies and recommendations pertaining to the development of the capital markets.

A program of consensus building regarding the advantages of automation and modern exchange practices should be an integral part of the project to insure its continued support and success. With the CMDC providing the lead, this process should emphasize the importance of making the market participants realize that they are implementing their own project, and that the project meets their conscious needs. Thus, the consensus building process should also provide broker-dealers with a picture of modern financial marketing techniques and business practices, showing how the proposed system will help them increase their business and profits.

Gender Issues

Although Filipino women share essentially the same burden of women all over the world, particularly with respect to differential access to opportunities and services among men and women, there have been positive indications of an improving situation for women in the country. In the recent past, women have figured prominently in political, social, and economic affairs and gradually, they have been entering new fields. Government and nongovernment organizations have taken significant efforts to accelerate women's development.

Recently, improvements in legal conditions have underscored the role of women as full and equal partners of men in development and nation building. In particular, Republic Act 7192 ("Women in Development and Nation Building Act") ensures the fundamental equality of men and women before the law. This act is of particular relevance to this project since it requires all government agencies to ensure that women benefit equally and participate directly in development programs and projects, especially those funded through official development assistance (ODA). This act also requires that a substantial portion of ODA

received from foreign governments and multilateral agencies be set aside and utilized for programs and activities for women.

Although men still dominate employment in financing, insurance, real estate and business services, employment of women in these sectors has been increasing over the recent years. Women have likewise assumed important positions with major decision making responsibilities in corporate organizations (A basic example of this is the present Chairperson of the SEC, who is a woman, who is recognized internationally as championing capital markets development in the Philippines). In view of such inroads into employment and management opportunities in the financial sector, access of women to opportunities offered by the project should not be a major concern. Innovations due to the project, such as automation, are considered to be gender neutral such that, women will be able to compete effectively with their male counterparts for job opportunities offered as a result of the new technology. Thus, the project can become a genuine contribution to efforts at removing perceived as well as actual biases against women in the workplace.

To further enhance equal access to the positive aspects of the new technology, information campaigns, for instance, should stress past experiences wherein women have been effective users and agents of changes in technology. The public advocacy program should document evidence of successful entry and participation of women into the trading and brokerage business and disseminating such information to the entire financial sector. In addition, the advocacy program should be accompanied by a vigorous campaign against cultural biases which continue to limit access to resources for women and hinder their full participation in national development.

Feasibility of Planned Change and Social Desirability of the Project

Analyses of various social organizations and social processes often place great emphasis on the integrative function of values. This emphasis is valid if it is on the functional importance of ultimate explanations and justifications for specific beliefs, rules and patterns of action. However, the emphasis is less valid if such values are regarded as immutable, and therefore as permanent sources of differences in social systems or at least as tremendous barriers to the acceptance of any such social novelty. Precisely because of their pervasive, integrative function, values are likely to be slow to change, and to furnish resistance to innovation in subtle ways. Nevertheless, some values change, and "traditions" may evolve, become adopted to objective changes in social conditions and even decline.

Tradition per se is not regarded as a factor inimical to change or economic innovations although it may be argued that traditionalism is always adverse to change and innovation. If a traditionalist ideology is prevalent, traditional norms will enhance the reactionary tendencies prevailing and will constitute an additional obstacle to growth. But if modernization is the prevailing ideology, traditionally held norms may provide stability in a

situation of constant and rapid change. They may tend to carve out areas of social action in which known and well-understood behavior patterns prevail, and they may in this way provide a feeling of security in a situation where there are strong negative forces.

The "club" mentality among members of the exchanges is a tradition that could prove difficult to change especially if the system serves their interest. On the other hand, these individuals are aware of their needs and the practical benefits to be derived from the project. Knowledge of the practical benefits is an important motivation for the acceptance of change. If such benefits are not immediately apparent to market participants, change is still possible when other agents, particularly the small minority groups in the exchanges, emulate the dominant groups which tend to support change and innovation. Meanwhile, the emphasis on family control of companies as a major obstacle to developing the capital markets in the Philippines is an inaccurate and static view of the individual goals of entrepreneurs. This view does not allow for the changing demands on firms as economies grow and social systems modernize. Business enterprises exist to make profits, or conversely, to minimize losses. The successful entrepreneur must therefore possess the necessary inputs, including information in order to make appropriate decisions. Given the available information, if they perceive that conditions are appropriate for expansion, then a decision to expand will be made. This appears to be the area wherein the project will be of greatest benefit. By laying the foundations for a functioning capital market, the project provides entrepreneurs with additional resources to make better decisions. The project will not cause radical changes in behavior and attitudes, it will not diminish desire for control of companies, but it will provide foundations for arriving at more intelligent decisions. In the process, entrepreneurs discover that to increase profits, expansion of business and the concomitant dilution of control is timely and necessary, then, appropriate decisions will be made.

ANNEX G

ECONOMIC ANALYSIS

ECONOMIC ANALYSIS

This economic analysis uses in large part the results of a more extensive analysis prepared by Dr. Mario Lamberte for USAID. It includes a literature survey; a brief assessment of the current Philippine capital markets situation; the status of reform in the sector and a reform agenda for the new administration; the economic rationale of the CMDP; a cost-effectiveness analysis; a quantitative benefit-cost analysis of CMDP; and recommendations to contain identified risks to project economic viability.

Literature Survey

Capital markets development cannot be treated in isolation of the broader issues in economic development, in general, and financial markets development, in particular. Reforms in the financial sector have been substantial since 1980. These included, among others, the liberalization of interest rates, reduction of credit subsidies to priority sectors, privatization of government-owned banks, and relaxation of foreign exchange regulations.

The literature on Philippine capital markets is mostly descriptive, very few studies are analytical. It has been observed that the equity market is highly sensitive to political and economic developments in the country. It shrank during periods of political and economic instability and expanded during relative political and economic stability. The very high means, variances and the systematic risk of each security in the stock market reflect the highly volatile Philippine market.

Among financial instruments examined during the period November 1986 to March 1992, common stocks obtained the highest after-tax real rates of return (21.5 percent), distantly followed by Treasury bills (4.1 percent), time deposits (2.0 percent), and savings deposits (-5.6 percent). Indeed, limited access to the stock market means that many savers have high opportunity cost for their financial investments, while firms are starved of badly needed long term funds. Also, in the absence of a democratic system of stocks allocation, opportunities for good deals go first to those few with market power.

Capital Markets Situation and Prospects

There has been a noticeable change in the character of the equity market in the most recent past. First, there is an improvement in the quality of new listings as more issues come from the commercial group. Investors subscribe to these issues not for speculative purposes. Second, there is now more representation from sectors not traditionally listed. And third, the peso value of the recent issues has been very large, thereby increasing the depth and breadth of the market.

The overall medium term prospects of the market seem to be bright, and could even be brighter if the necessary policy and regulatory

reforms are in place and if efficient systems are installed. The economy is expected to pick up toward the second half of 1992 and, with proper macroeconomic management, the growth momentum can be sustained. With large corporations expected to expand their operations and given that many of them are approaching their debt-to-equity ceilings as well as the single borrower's limit with banks, they will soon be forced to look for alternative sources of funds for their expansion projects. The oversubscription of the latest issues further boosts the capital market and improves access of small investors to the market. The very recent entry of foreign brokers can bring in more foreign investment into the local securities market. Lastly, the formation in late 1991 of the Capital Market Development Council (CMDC) augurs well for the development of the capital markets.

Sector Reform Status and Agenda

There were three major policy reforms during the previous administration that have a direct bearing on capital markets development. First, the double taxation of dividend income was eliminated through the abolition of the tax on intercorporate dividends and gradual phase out of the tax on shareholder's dividend income. Second, the Securities and Exchange Commission (SEC) formally signed on October 31, 1989 the rules and regulations governing investment companies signaling the revival of mutual funds. Third, rules and regulations covering foreign investments in CB-approved securities have been relaxed, substantially reducing the period for the settlement of transactions related to foreign investment in CB-approved securities to three to four days from four to six months. The rules and regulations covering "warrants" and "asset-backed" securities recently issued by SEC could further boost the development of the capital markets.

More reforms are expected to be implemented in the near term. The member agencies and institutions of the CMDC signed in May 1992 an agreement to implement the recommendations of the various sub-committees of the Council that are within the powers of the concerned agencies and institutions. The private sector also has done its share by agreeing to revise some of the procedures and practices that breed inefficiency at the expense of the investing public.

Among the reforms recommended to expand the size and enhance the efficiency of the capital markets, a number has not yet been incorporated into the recent agreement among member-institutions of the CMDC. The macroeconomic environment must be conducive to the development of capital markets. Macroeconomic policies must be fine-tuned to achieve economic stability in the shortest time possible and to allow resources to move from inefficient to efficient sectors. There are areas where reforms need to be reviewed in light of the recent developments in neighboring countries such as in tariff and foreign exchange reform. There also are areas where reforms are needed to improve resource mobilization by the National Government. There is a need to

strengthen and harmonize the SEC's regulatory and promotional function.

For the supply side of the equity market, the following reforms may be considered: a privatization program a la PNB i.e., through public offering, for other government-owned corporations; mandating public offering of at least 30 percent of total outstanding shares after five years of operation of industries providing important services to the general public, such as banks and the media; and tax incentives for corporations that go public.

For the demand side of the equity market, the following reforms are suggested: channeling the large pool of savings deposits held by small depositors to the equity market through a fair distribution system; and changing policy to encourage the contractual savings of the national security system, the private pension system and the insurance system to shift from investments in short term securities to the equity market.

With regard to the debt securities market, the following changes are recommended: revision of the documentary stamp tax (DST) to remove its discriminatory effect against long-term debt securities; strengthening of the Credit Information Bureau to provide a credible rating system for long term debt securities to prospective investors on a regular basis and at lower cost; and policy changes to encourage contractual savings institutions to also invest in long term debt securities.

Economic Rationale of the CMDP

The current optimism after a generally orderly transition is well reflected in the stock market and oversubscription of newly listed shares. However, the structural weaknesses of the securities market may soon be felt and constrain further growth of the market. In the first place, the system for collecting, processing, and quickly disseminating information needed by investors and other market participants still leaves much to be desired. The same is true with trading, clearing, and settlement system. The lack of better systems in these areas does not only engender inefficiency but also makes the confidence in the market now being shown very fragile. The current systems are open to abuse, and any rumor about misdeed by one market participant could drive investors away from the securities market.

The SEC recently agreed to implement the recommendation of the CMDC that it will focus its "oversight" function and encourage self-regulation by private sector capital market institutions. SEC, however, requires substantial improvement in its monitoring capability, which would include restructuring its organization, reallocating its resources, upgrading staff skills, and acquiring appropriate information systems and data processing equipment.

The reforms initiated by the GOP in some areas of the economy, such as trade, foreign investment, foreign exchange market and the

banking system, facilitate reforms in other areas including the capital market. This opportunity should be exploited by encouraging the GOP to come up with its vision and program for the development of the capital market. A program of activities leading to this end is certainly desirable since the development of the capital markets contributes to growth and stability of the economy. The SEC could take a lead role in this area.

In capital markets development, the private sector plays a greater role. Having been in the market for a long time, the private sector knows better what policies, rules and regulations and government administrative arrangements have distortionary impacts on or constrain the growth of the capital markets. The sector can therefore be an articulate and effective pressure group for policy reforms. Under a more liberal environment, its role as a pressure group for reforms is even greater. This is because as the private sector operates under this new environment, it begins to identify new policies and regulations that can further promote capital markets development. Its constant pressure on policy makers and regulators will put the latter more in step with market development.

Once restrictive policies and regulations are removed, microeconomic inefficiency becomes more glaring. This is one big challenge to private sector market participants. For instance, current trading, clearing and settlement systems are antiquated. Also, investors' confidence in the securities market is low, which is due partly to absence of quality information needed to make investment decisions, and partly due to the lack of transparency of the operations of the securities market institutions. Their inefficiency will become more acute once trading volume further increases and becomes a drag to the growth of the capital markets.

The private sector, particularly securities market institutions, must constantly adjust to the changing demands and must adopt new but appropriate technology to enhance the working of the capital markets. Some of their activities could be coordinated to effect smooth functioning of the market without necessarily undermining competition, or could be jointly done to achieve economies of scale. For example, a center may be set up to provide research and statistical information to the general public. The private sector also may conduct training programs to upgrade skills of market participants. A central stock depository system is another case in point. These can be done by the private sector on a self-sustaining basis.

The major elements of the CMDP address the concerns listed above. The primary focus on the private sector fits well into the recent developments in the capital markets. The private sector-led CMDC is now taking the initiative in reforming the capital markets, and the needs the Council has identified for the rapid development of the capital markets match well with the major components of the CMDP.

Cost Effectiveness Analysis

The CMDP approach is to work primarily with the private financial sector and secondarily with public sector regulatory agencies (through the SEC) in improving the quality and transparency of investor information available to the public and other capital market participants.

The approach appears to be appropriate and cost effective for a number of reasons. First, it recognizes the fact that capital market development is primarily a concern of the private sector and having the private sector take the lead in introducing innovations in the sector increases the chances for project success. It is superior to an approach that put primary focus on the government sector because the private sector is less constrained by bureaucracy. Flexibility is badly needed by the executing agency given that innovations take place rapidly in the financial markets.

Second, the selection of the implementation vehicle, i.e., FINEX, gives CMDP a broader appeal to the financial community whose support is badly needed for the success of the project. FINEX membership includes leading financial executives and practically all financial institutions in the country. Other possible private institutions, such as the Bankers' Association of the Philippines and the Investment Houses' Association of the Philippines, do not have this important feature. Also, FINEX has shown a keen interest in the development of the capital markets when it formed the Capital Markets Development Committee, the predecessor of the CMDC. Given the many fora FINEX has conducted in the past, it is very familiar with the policy, regulatory and institutional issues related to capital markets development. It can therefore be said to have already incurred sunk costs on this project. FINEX needs little additional cost in achieving its objectives through the project compared with other possible private institutions.

Third, given the tangible benefits it can derive from the project, the private sector will readily contribute their talents and money to CMDP. The automation of the trading, clearing and settlements system directly benefits from the private sector, and therefore, it will be willing to shoulder a greater part, if not all, of the cost. This in itself ensures cost-effectiveness of the project.

Finally, the selection of SEC as the public sector recipient of the CMDP assistance is most fitting. Its leadership has already recognized the improved role SEC can play in the development of the capital markets. SEC has already initiated a program for Philippine capital markets development including automation of many of its activities that can transform it into a more effective promotional and supervisory body.

Quantitative Benefit-Cost Analysis

The economic benefits of the CMDP are diffuse. Capital markets development will result in an increased proportion of long term

capital financing relative to the current predominance of short-term loan-financed investment. This will result also in an expansion of the securities market as well as reduced financial leverage, and therefore, reduced financial risks for firms that take advantage of equity financing. At the same time, there will be added savings incentives and increased financing for risky and long-term investments through increased diversity of available instruments in the financial market. Firms as well as financial intermediaries would be better able to match their investment and financing alternatives. The end result would be increased incomes to society through higher levels of and more efficient investment.

An analysis tracing these expected results, however, does not lend easily to quantification. For purposes of demonstrating the economic desirability of CMDP, the economic appraisal consists of (a) standard benefit-cost analysis of the private sector component using as benefits projected revenues from the financial analysis for the Automated Trading, Clearing and Settlements System (or Automation System for short), and the Investor Information System; and (b) an alternative economic rate of return analysis using the minimum benefits approach for the entire project.

Economic Appraisal of Private Sector Component

This economic appraisal takes off from the financial analysis of the Automation System and the Investor Information System. The various elements of the Private Sector Component are going to be funded out of the USAID grant and contribution of the private sector. Although foreign currencies mainly come from the USAID grant, some would have to come from the private sector to finance some activities that need foreign exchange. In adjusting financial values to economic values, the foreign exchange component of each project element was converted into local currency using the shadow exchange rate, which carries a 20 percent premium over the prevailing exchange rate, as prescribed by NEDA. The people to be employed directly by the project mostly will be highly skilled, and therefore, it is assumed that they will be paid competitive wages. Thus, there is no need to make adjustments for the shadow wage rate. The monitoring, evaluation and audit costs were distributed across the project elements on a pro-rata basis.

The economic benefits of the project are expressed in terms of the revenues from the Automation System and the Investor Information System. For the Automation System, benefits in the form of revenues consist of rental of terminals, lease of communication lines, and clearing and settlements fees. For the investor information services, additional benefits may be expected in terms of the revenues from fees of subscribers of the system. It can be assumed that all these charges reflect the economic values of these services; hence there is no need to make price adjustments.

A separate economic appraisal of the Private Sector Component is a valid approach. Implementation of the Public Sector Component will enhance rather than reduce the benefits generated by the Private

Sector Component. The economic appraisal must be applied to the entire Private Sector Component because each element contributes directly and indirectly to the costs and benefits of the component. For instance, the technical studies by themselves do not generate direct benefits, but they are considered crucial in determining the final design, business organization plan and implementation plan for an automated system, all of which are necessary for the success of the automation element. Without the other elements, the actual revenues from the revenue-generating elements could be substantially lower than what were provided in the financial projections. Taking together all the project elements of the Private Sector Component, economic internal rates of return (EIRR) were calculated corresponding to the two alternative automation systems. Alternative A will use a system being developed for the Manila Stock Exchange; and Alternative B will use a system to be acquired from the U.S.

The results are as follows:

Year	Alternative A Net Inflow (Outflow) (in thousand 1992 US$)	Alternative B Net Inflow (Outflow) (in thousand 1992 US$)
0	(5908)	(10196)
1	1666	2589
2	935	1858
3	2588	3511
4	2689	3612
5	6001	9068
Economic Internal Rate of Return (percent)	27.5	22.5

As in the financial analysis, Alternative B gives a lower EIRR than Alternative A. This is due to two factors: one is that it involves higher investment cost, and the other is that the software and hardware for the Automation System are all imported. Without a full feasibility study, the technical details of the two alternative systems are limited. What is certain is that the system in Alternative B is more advanced and sophisticated than that under Alternative A. This may imply that the system under Alternative A becomes obsolete much faster than the system under Alternative B, and hence, the former becomes more costly than the latter if a longer time horizon were considered. Given the available information, it seems that the two alternative systems are not directly comparable. Therefore, the calculated EIRRS could not be used in determining which alternative to choose. In the sensitivity analysis, four cases are considered. Case 1 assumes that the residual value of the project at the end of the five-year projection period is only 40 percent (instead of 50 percent) of fixed assets and 50 percent (instead of 100 percent) of the working capital of the automated system. Case 2 assumes that the residual value is 20 percent of fixed assets and 50 percent of the working

capital of the automation element. Case 3 assumes that the revenues (i.e., total benefits) of the automation element is 10 percent lower than the base case. Finally, Case 4 assumes that the revenues of the automated system is 20 percent lower than the base case.

Under Alternative A, the calculated EIRR drops by 1.5 percentage points in Case 1 and by 3 percentage points in Case 2. Case 3 shows that a 10 percent decline in revenues reduces the calculated EIRR by 4.3 percentage points. In Case 4, a 20 percent reduction in revenues leads to a decline of the EIRR to 16 percent, which is only 1 percentage point above the 15 percent social discount rate prescribed by NEDA. Under Alternative B, Case 1 gives a 2 percentage-point reduction in the EIRR, while Case 2 yields a 4.2 percentage point reduction. The calculated EIRR for Case 3 drops by 4.7 percentage points. In Case 4, the EIRR declines to 13.3 percent, which already falls below NEDA's 15 percent social discount rate.

These results generally suggest that the EIRR is more sensitive to the revenues of the Automated System than to the assumed residual values of the investment at the end of the five year projection period. Therefore, greater effort should be exerted in ensuring that the projected revenues will be realized by the Private Sector Component.

Alternative Economic Rate of Return Analysis of CMDP

The economic viability of the entire CMDP (all components) was assessed using the required minimum benefits approach. The total economic cost of CMDP amounts to $26.8 million under Alternative A, and $31.1 million under Alternative B. Given the NEDA-prescribed social discount rate of 15 percent, CMDP must achieve an annual economic return valued at $8 million pesos under Alternative A and $9.3 million under Alternative B for five years. The likelihood of attaining the minimum benefits is demonstrated in terms of two indicators: (1) increased income from financial savings since the rate of return on stocks is found to be the highest among financial assets; and (2) additional foreign portfolio investment inflow. The results show that the required annual benefits of CMDP represent only 33-38 percent, depending on the alternative Automated System used, of the increase in income of savers arising from reallocating one percent of their total savings and time deposits to stocks in 1992. In other words, a much smaller amount of reallocation of savings is necessary to justify the economic cost of CMDP. In 1991, portfolio investment inflow amounted to U.S.$227 million. Assuming an incremental capital output ratio of 4.6, the additional generated income from this foreign investment inflow is calculated at $49.3 million. The required minimum annual benefits represent only 16.2 percent under Alternative A and 18.8 percent under Alternative B of increased income from the 1991 portfolio investment inflow. Thus, only a small increase in portfolio investment is required to justify the economic cost of the project. This is not impossible given an efficient stock

market system.

Containing Project Risks

The formation of a corporate vehicle is crucial to the viability of the CMDP since it will be responsible for putting up a bigger share of the capital outlay and will own and operate the Automation System and the Investor Information System. Many are looking forward to the participation of the two exchanges, However, this may not come too easily considering the existing rivalry of the two exchanges. The mechanism for their participation must therefore be given primary consideration at this early stage. The results of the first few activities of the CMDP and those of the current technical assistance provided by ADB would hopefully provide sufficient motivation to the two exchanges to come to work together for the project.

Another risk to the project is the commitment of the private sector to shoulder part of the cost of training, especially those that have to be conducted in the U.S. or third countries. The amount of contribution to be shared by the private sector is quite substantial. Perhaps, some of those out-of-country training programs could be done in the Philippines without losing much of the training content. This alternative will be examined more seriously during CMDP implementation.

The results of the sensitivity analysis show that the economic viability of the CMDP crucially depends on the projected revenues of the Automated System. However, conduct of a market study is not possible at this time. The full feasibility studies during the CMDP implementation should pay special attention to the market aspects of the project to validate the projected revenues.

There are other factors that increase the project risk. One is the currently large fiscal deficit. Without effective fiscal discipline, interest rates will remain high and volatile, and crowding out the private sector continues to occur. All these undermine the development of the capital markets. This problem can be partly addressed by improving the government's tax collection system and through better pricing policies for the goods and services provided by government-owned corporations.

A related issue has to do with the infrastructure bottlenecks faced by the economy. Business expansion and entry of new firms will be deterred by inadequate infrastructure facilities, particularly power and telecommunications. Innovative schemes in the financing of key infrastructure projects, such the build-operate-transfer (BOT) scheme, should be given emphasis considering the expected uncomfortable financial position of the government in the next few years.

ANNEX H

TECHNICAL ANALYSIS

B. TECHNICAL ANALYSIS

1. Capital Markets Business Environment

The development of Philippine capital market has been the subject of renewed interest by the Government of the Philippines(GOP), as well as by the USAID, the Asian Development Bank and the World Bank. Continued development of the Philippines' capital market is considered of extreme importance in view of the market's vital role and impact on capital formation, continued economic growth, domestic resource mobilization, attraction of foreign investments, and improvement in the levels of national employment, incomes and standard of living. The globalization of capital markets, the liberalization of financial sectors in many countries, and the competition for capital funds have made it difficult to attract domestic and foreign investment, unless a stable and competitive business environment is offered.

The stagnation of the Philippine long term securities market in recent years stands in sharp contrast to the strong growth of emerging markets in the Asia-Pacific region and worldwide. In the IFC publication, Emerging Markets Factbook 1991, the Philippine capital markets ranked second-to-last in market performance in the world, though some improvement in the capital market activities is underway in 1992.

In the 1980s, the GOP's investment financing policies of selective credit allocation of subsidized medium-to-long term investment credit, the promotion of short-term oriented macro-economic fiscal management policies, and the Central Bank's utilization of short term debt-financing as an investment alternative, encouraged the corporate sector to become highly dependent on debt financing and less inclined to undertake equity financing. These have retarded growth in the securities markets for long term equity and debt instruments as a means to finance capital expansion. Although businesses can use short-term debt successfully to generate returns after financial charges, over reliance on bank debt also leads to disproportionate capital structures, high debt-to-equity ratios which constrain further expansion, and increased vulnerability to economic downturns, and political or social instability. These financial policies fostered the growth and expansion of the banking system but hampered development of the securities (stocks and bonds) market. Businesses with term financing needs not operating in GOP priority sectors and without the appropriate political affiliations had to resort to short-term commercial debt to finance growth.

The GOP now estimates that $7.5 billion will have to invested annually in the economy in order to achieve its full objective of full employment by 1997. To meet this goal, it will be necessary to raise investment rates from 15% of GDP to 22-25% of GDP, which requires substantial increases in domestic savings, as well as foreign capital inflows.

A developed capital market to mobilize domestic resources and foreign savings is important in encouraging domestic savings mobilization by offering investors a variety of investment opportunities and to assure that the flows of net savings are directed to more efficient enterprises. The project's objective is to improve the regulatory and institutional environment for capital markets in order to mobilize the development of long term capital more effectively and encourage an increase in the supply of equity securities and debt offerings, create a more transparent, accurate and efficiently functioning securities trading, clearing settlements and investor information system. This is expected to result in: increased mobilization of savings due to the expected diversification of financial instruments and reduction of investment risk; reduced vulnerability of business enterprises through a reduction in financial leverage or risk to economic downturns; and, the expansion of business activity and increased corporate incomes as a result of increased financial resources flowing into the business sector.

The lack of a clear policy for capital markets development and the legislative/statutory, regulating, procedural and operational impediments and deficiencies have also directly stunted the growth in the supply and demand for long term securities. Insufficient investment in human capital, technical enhancements, organizational capabilities exists within capital market institutions, basically due to the underdevelopment of a responsive and transparent capital market environment which can take advantage of new products and skills. As such, a significant number of highly skilled financial managers and technicians in the Philippine are lured by more satisfying employment in other Asian countries with more advanced capital markets and more progressive business environments.

The Securities and Exchange Commission(SEC)

Since its establishment in 1936, the responsibilities and powers of the SEC have expanded considerably. The SEC currently exercises jurisdiction, supervision and control over all corporate bodies, partnerships and associations and is responsible for the enforcement of a number of laws, including the Corporation Code (1980), the Revised Securities Act (1982), the Investment Company Act (1960), the Finance Company Act (1969), and Presidential Decree 902A (prosecution of corporate cases.)

The SEC is, in actuality, a "corporate law authority" as it deals with more than 200,000 corporations, partnerships and associations, including over 170 companies which have gone public and are listed on the exchanges. Listed companies are, therefore, a fraction of the SEC's portfolio. Only one department(out of a total of nine), the Brokers & Exchanges Department, deals exclusively with securities's market, institutions, and instruments. The other eight departments deal with all of the 200,000 corporations (of which only about 35,000 are in active operation), including all of the publicly-listed companies. It is, therefore, conceivable that any

investment made in improving the SEC's efficiency and professionalism would be applied to all departments and that the securities' market, institutions, and instruments capability would benefit proportionately. One of the fundamental issues regarding the enhancement of the SEC's operational efficiency is its structural framework which is to be addressed by the Asian Development Bank's technical assistance study on "Institutional Strengthening of the SEC." The ADB study will be completed before the end of 1992 from which USAID could draw findings for fine-tuning its own approach and determining more specific targets in order that technical assistance provided by donors focus on those activities that deal exclusively with the securities' market, institutions and instruments.

The SEC's current responsibilities far exceeds its ability to implement them. The Commission, which was initially entrusted to administer and enforce provisions related to public offerings of securities and trading securities in the secondary market, currently administers and implements 20 different laws and presidential decrees. The discrepancy between the SEC's human resource and technical skill levels and its mandated responsibilities is considerable. In the area of securities market regulations, overlap and duplication of rules, regulations and procedures are prevalent. The SEC lacks the information technology capability necessary to monitor the capital market and keep the Commission's management, as well as the market participants, informed. The private sector investor's concern over the Commission's ability to perform it's mandate due to structural deficiencies will be addressed by USAID's project.

The Stock Exchanges

The Manila and Makati Stock Exchanges, operate under systems and procedures totally inadequate to handle a high volume of stock trading and to ensure that the rights of investors are protected adequately. At present, it takes an average of approximately fifty days -- from the date of trade to the date of receipt of physical certificate -- to clear a domestic stock trade on these exchanges. One main bottleneck is in the transfer agent's capability to process and release new stock certificates to the stock clearing house. Furthermore, there is no central depository system to hold the securities after they have been cleared. Neither of the exchanges have an efficient automated reporting system to disseminate price and transaction information from the floor of the exchanges to the brokerage community and investing public, both domestic and foreign. The exchanges employ a double auction method of transaction trading, done through the "open cry-out" system with bid and prices posted manually on a board on the floor of the exchange. Settlement and clearing procedures are conducted independently for each exchange, are paper-based and only partially automated, utilizing an antiquated batch processing system. Inefficiencies in the settlement process are a major factor holding back the development of the securities market, and contributing to

the market being unable to compete for either local and foreign investment. Both exchanges are separately evaluating the feasibility of computerization, and a local vendor-firm is in the process of preparing a computerized trading system program for the Manila Exchange, without considering integrated clearing and settlements, and with no funding plan.

In May 1992, the preliminary legal documents for the establishment of a Philippine Stock Exchange (PSE) were finalized and signed by the Presidents of both the Makati and Manila Stock Exchanges agreeing to an eventual merger in cooperation with the SEC. Although the agreement to merge and even collapse operations into the new Philippine Stock Exchange exists, a significant amount of study on operationalizing such an activity still has to be carried out. The SEC has taken on the responsibility for conducting this study.

The basic advantage of moving into an integrated and automated market operations system is to enable the Philippine market to come on stream with other modern international capital markets, utilizing international trading, clearing and settlement standards. This will lead to transparency of market operations intended to attract foreign and domestic investors.

(At the end of this Technical Analysis Annex is a more detailed discussion on the Existing Market Operations in the Philippines and the Proposed Automated Market Operations Systems.)

2. AREAS OF REFORM

The Philippine capital market is characterized by a crisis of confidence whereby the Philippines finds itself falling further behind other Asian emerging markets that at one time looked to its stock markets for leadership and example. Stagnation of the long-term equity securities market has been attributed to the lack of supply of high grade investable securities and the limited number of investors participating in the securities market. On the supply side, there are only 165 companies listed (as of March 1992) on the two stock exchanges; only 70 of the top 1000 corporations are listed, and the securities of only some 20 listed companies are actively traded. Closely held corporations avoid going public and listing because of: fear of loss of family control; hesitancy to disclose fully operational activities to the public; availability of cheaper alternative sources of funds for business expansion in the form of short-term debt; higher financial cost to raise funds in the securities market; and, the lack of sufficient incentives for going public and listing on the exchanges. On the demand side, the number of direct individual investors is less than one percent of the population, as compared to ten percent in advanced economies.

The demand for securities, as an alternative avenue for saving and investment, has been seriously hampered by the lack of confidence

in the stock market attributed to the following: the lack of adequate investor information and transparency of transactions; the scandals and irregularities of the past have made it difficult to regain the confidence of the general public in the securities market; the lack of regulatory, monitoring and enforcement measures which would provide protection against abuses; inadequate types and denominations of financial instruments that can meet the differing needs of savers/investors; the institutional weakness of securities market institutions in the provision of professional client-services and information; and, the lack of interest on the part of potentially major institutional investors, such as insurance companies and pension funds, to participate, actively, in the securities market.

As such, a fundamental lack of liquidity in the marketplace is rooted in inefficient order execution and high transaction costs due to current trading practices based on antiquated processes and systems which represent a major factor holding back the further development of the marketplace. The most logical approach in dealing with these inefficiencies which deter investor confidence is to migrate to an automated system. There are serious misconceptions on the part of the exchanges and the regulatory agencies regarding the costs associated with automating the securities trading system. These misconceptions include: the need for substantial investments in real estate and computer hardware/ software; the need for an exchange trading floor; the value of an "open cry-out" system; and, the value of physically merging the current organizations and systems of the two exchanges.

Despite these concerns, the exchanges and the SEC have defined similar objectives and development goals: a unified national securities trading market; automated trading, clearing, settlements and central depositary systems; professionalized stock exchange management; and strengthened SEC capability to effectively regulate, as well as manage the developmental aspects. Due in large part to the lack of hard, state of the art information, generated by an independent outside party, progress in working towards these objectives has been slow. The Capital Markets Development Council organized in October 1991 as a collaborative private sector-public sector policy dialogue and reform activity, has been slowly breaking down the barriers to communication between the regulatory agencies and the private sector capital markets participants.

During the past five years numerous studies have been conducted/ funded by official donor agencies including USAID, the Asian Development Bank, and the World Bank, in order to determine the cause-and-effect of the stagnation of the capital markets, and to prepare recommendation for improving various segments of the capital market. These studies comprise a staggering amount of information regarding the present status of the Philippines' capital market, problems that impedes the growth and recommendations for improvement. A few of these recommendations have been implemented, leading to some minor improvement in the capital market performance, as can be observed in the market's 1992

activities. However, implementation of most of the recommendations requires: (1) commitment on the part of the market's private and public sector participants, (2) development and enhancement of expertise and professionalism in both public and private sector securities market institutions, (3) training in technical areas in order to take advantage of advances in technology, (4) capital equipment and information-technology software, and (5) education of the general public, basically through provision of investor information.

3. Private Sector-led Approach to Financial Sector Development

The approach of the project is to work primarily with the private financial sector and, secondarily with public sector regulator agencies (through the Securities and Exchange Commission) in implementing specific project activities. The private sector component will be operationalized through a cooperative grant agreement with the Financial Executives Institute of the Philippines (FINEX), which will administer and make available project assistance to groups in the business community through sub-grants on a cost-sharing basis. FINEX is a private sector non-stock, non-profit national organization whose members, include leading financial executives in the present government, the Chief Executive Officers of leading domestic and multinational corporations, and the senior executives of the major financial institutions in the Philippines. These members provide their time and efforts to the organization on a voluntary basis. The objectives of FINEX, as described in its charter, are quite compatible with the objectives of the Project. FINEX demonstrated it's commitment to the development process in 1990 when it formed the Capital Markets Development Committee and later in 1991, took the lead in establishing the Capital Markets Development Council, which is a collaborative private-public sector policy dialogue body comprised of senior-level government and private sector leaders committed to reforming the Philippines' capital market. Substantive policy reform activities conducted by FINEX in the past demonstrates organizational familiarity with the policy, regulatory and institutional issues at hand As such, FINEX has already incurred "sunk cost" on this project. Technical assistance, commodities and institution support provided in the project are structured to build on FINEX's base to enlarge their physical presence nationwide in support of advocacy that will lead to policy reform. The identification and selection of FINEX, as the Private Sector Project Implementor, provides a broader appeal to the financial community, whose support is commitment required for the success of the project.

The selection of the Securities and the Exchange Commission(SEC), as the target of GOP project assistance is most fitting, considering the institutional development role and the mandate which the Commission is expected to fulfill. The project seeks to develop the organizational and institutional capability of the SEC to transition from a purely supervision and regulation role to that of sectoral development and regulatory oversight. Technical

assistance in the areas of: professionalization, automation and information technology, regulation, organizational development and training will be provided to meet this objective. The move towards self-regulation of capital markets institutions can only be achieved with the commitment of the private sector. The GOP has likewise recognized the need for private sector leadership of this sectoral reform process, as evidenced in the Capital Market Development Council, which has FINEX as the Council's Chairman Organization, and with the Central Bank and the Securities and Exchange Commission as joint co-chair organizations.

This private sector-led approach to financial sector development has been as determined as appropriate, cost effective, and sustainable. The approach recognizes and builds on the fact that developing the capital markets is primarily the concern of the private sector and empowering the private sector to take the lead responsibility for introducing innovations increases chances for success of the project. Given the fact that innovations rapidly take place in the financial markets, this implementation strategy is superior to a government sector approach, as the private sector, not being constrained by bureaucracy, would have the flexibility, adaptability and responsiveness required of the executing agency.

Given the tangible benefits to be derived from the project, the private sector can readily contribute financial expertise and resources to project activities. The specific cost-sharing and/or leveraging mechanisms for funding of project activities have been developed and tested in previous private enterprise projects in the Philippines, demonstrating the private sector's willingness to commit and pool resources, focused on achieving mutually beneficial sectoral improvements. The provision of automated securities trading, clearing and settlements, investor information, and training and education services all with national outreach, directly benefits private sector users, which would be willing to shoulder a greater part of the costs required for success. This leveraging strategy assures cost-effectiveness and sustainability of the project's outputs.

A. The Financial Executives Institute of the Philippines(FINEX)

FINEX was established in January 15, 1968, has over 600 member companies nationwide, and is a leading member of the International Association of Financial Executives Institutes. The membership includes the entire financial community, mainly chief executive officers and chief financial officers, securities brokers/dealers, bankers and investment bankers, insurance companies, etc., both local and international. Under the umbrella of FINEX are the other key financial sector associations namely: The Bankers Association of the Philippines (BAP), Investment Houses Association of the Philippines (IHAP); Philippine Association of Securities Brokers and Dealers(PASBD); The Philippine Institute of Certified Public Accountants (PICPA); and others. Their credibility in the entire business community is quite high such that, The Capital Markets

Development Council, has elected FINEX as chairman of the Council.

B. **The Capital Markets Development Council**

The Capital Markets Development Council (CMDC) was formed in October 16, 1991, 1991 after nearly five years of dialogue on its mandate. As such, the activities covered in our proposed project which have been studied by USAID since 1986, are a spontaneous response to the creation of the CMDC and are development needs identified and requested by the private sector. FINEX, a non-governmental organization (NGO) recognized by both the GOP and the private sector as the leader in capital markets reform, permanently heads the Council. The co-chair is shared by the public sector represented by the Securities and Exchange Commission(SEC) and the Central Bank (CB). Here, the GOP has likewise recognized the need for private sector leadership of this reform process. The Council is comprised of: senior GOP officials (including the Secretary of the Department of Finance, the Chairperson of the Securities and Exchange Commission, The Governor of the Central Bank, the heads of the Bureau of Internal Revenue and the National Economic Development Authority) as well as senior executives from the private sector representing the securities brokers/dealers, bankers, investment houses, finance companies, the corporate legal sector, and the academe. Since its creation, the council(and it's technical committees) meet fortnightly and has come to agreement on an agenda for sectoral reform. Among the more important items tagged for immediate implementation are: reduction of administrative orders and policies proven as impediments to development; professionalization of all market participants; improved automation; and the creation of an investor information data base corporation. The Council has also served as the vehicle to bring together the two stock exchanges which have recognized the need for closer coordination through automation. With this private/public partnership for capital markets reform, the prospects of success in the identified areas are higher than at any other time. Project assistance is designed to target development in transactional areas, such as training and technical assistance, which can quickly be applied. Although GOP policies and deep-rooted private sector rivalries and attitudes have added to the problem, the CMDC represents a medium for change. The project's private/public sector activity is designed to assist and accelerate the process of change, build consensus and consolidate efforts to ensure that a single and efficient process emerges. In order to balance developmental efforts, the private sector component will provide the "carrot" for reform through self-regulation, with the public sector reform, acting as the "stick", for enhanced surveillance and monitoring.

4. **Donor Coordination/Stratified Approach to Sectoral Reform.**

The World Bank(WB) and the Asian Development Bank(ADB), are both actively involved in capital markets development in the Philippines. Their activities are complimentary to USAID's Capital Market Development Project and while the USAID project is

independent of the ADB and WB projects, it can draw benefits from them. USAID has maintained regular and continuing donor coordination dialogue with both ADB and the WB. All three donor agencies are coordinating their respective capital market projects and do not envision any duplication of efforts.

Donor coordination efforts have led to a **"stratified approach"** to achieving policy reform in the financial sector. The World Bank will take a macro reform approach to restructure the Central Bank into an independent monetary authority. This will break the link with deficit financing of the treasury as a result of the GOP's subsidies. As a result, the CB will move away from a fixation on short-term oriented public sector debt and concentrate on long term monetary policy rather than on fiscal policy. Over the long-term this will lead to declining peso interest rates which will make equity investments more attractive and fuel increased activity for the private sector stock exchanges. The ADB has $1.5 Million in technical assistance and a planned $100 million sectoral program loan for the GOP to reform/restructure the SEC from a judicial body into a service organization to promote, as well as, regulate the capital markets. This effort will require legislative changes championed by the Office of the President to which the SEC reports to, and the Department of Finance which will be funded under the ADB project.

USAID's project will benefit from the policy reforms gained in the above two activities with an estimated $300M effort over several years in phases envisioned for the policy reforms in this area. For a smaller amount of $13.5 million over 5 years with a private sector-led effort, USAID's project can position and lobby for the reforms to be approved by the GOP as well as manage implementation towards success.

The Asian Development Bank has three on-going technical assistance study projects for the Philippine capital market as follows:

A. Institutional Strengthening of the Securities & Exchange Commission. Under this technical assistance, consultants will prepare studies covering: the powers and jurisdiction of SEC; Policies, regulations and rules pertaining to registration, disclosures,underwriting, pricing of securities, financial reporting, trading of securities, code of conduct of securities market institutions, etc; and, organizational structures, systems and procedures, including staffing and training arrangements, operational procedures systems, status of computerization, and recommended actions for streamlining and strengthening SEC's organizational structure.

B. Stockmarket Development. Under this technical assistance, ADB consultants will conduct studies and prepare reports, including recommendations, on the following six major issues related to the Makati and Manila Stock Exchanges: 1) Feasibility analysis on the unification of Manila and Makati stock exchanges; 2) Feasibility study for the automation of the two exchanges with detailed plans

for the education and training of staff, participants and investors; 3) Feasibility analysis for a "Central Depository and Clearing System"; 4) Professionalization of the exchanges governance and management; 5) Listing rules and company disclosure requirements; 6) Organization of an Investors' Protection Fund, including the examination of the scope, structure, mandate, management and operations of the fund.

C. **Development of Long-Term Bond Market.** Long-term maturity instruments, particularly Government bonds, are often the bell weather issues of the debt market which sets interest rates for all other debt securities. ADB consultants will examine and make recommendations for the creation and maintenance of a corporate bond market with a range of maturities. They will also examine the feasibility of an asset securitization program for mortgage and other consumers loans.

In addition to the above TA projects, the ADB also has, under study, an sectoral adjustment loan program similar to that of the World Bank, anticipated to be in an amount of US$100 million, and expected to be approved during the first quarter of 1993. It is also anticipated that the loan will be made in tranches, subjected to conditions related to capital market development.

The World Bank sectoral adjustment loan program is targeted for the improvement of the capital markets environment. It is anticipated that an initial $200 Million loan would be approved during the first quarter of 1993 which will be used to clear the Philippine Central Bank's balance sheet from national government debt. This loan would be released in tranches, possibly with conditionalities related to policy and sectoral reforms leading to operational improvements in the capital markets and of the securities market. The GOP, more than ever before, will have to finance budget deficits by raising funds in the securities market rather than borrowing from the Central Bank. There is no grant money or technical assistance in the WB project, though a comprehensive study of the Philippine capital market was conducted by the Bank's staff and a two-volume report was prepared in February of 1992. The Bank's conditions for the loan would be drawn from the recommendations presented in this report.

All of the WB/ADB projects are either direct loans to the GOP or technical assistance for the conduct of studies and preparation of recommendations. They are not involved in the actual implementation process of sectoral and policy reform, which is the cornerstone and main focus of USAID's project. Furthermore, USAID's project could benefit, considerably, from the reports and findings generated by the ADB technical assistance projects, as well as from the conditionalities of the World Bank/ADB sectoral adjustment loan programs.

ANNEX H-2

Existing Market Operations in the Philippines

a. **Trade Execution**

Securities trading on the exchanges is still primarily a manual procedure based upon an "open cry-out" system. A great deal of time is spent in the execution of a single trade. Furthermore, there is good reason for prospective investors to question if trades are executed at the "best possible" price in light of these manual procedures. As such, the system lacks the precision and transparency that the investing public expects in order to have full confidence in the system. Trading is dependent on both buying and selling brokers negotiating the trades and manually recording them. A quote board is used which lists both buyers/sellers and bid/ask prices. When the buyer and seller reach agreement on price, the execution is manually recorded on the quote board and the selling broker prepares a sales contract which indicates the names of the selling and buying brokers and the quantity and price for each share. Sales contracts are then signed by both brokers, given to the trade recording clerks of the exchange which inputs the transaction directly into an exchange's computer-assisted system. The Purchase and Sales report is prepared and made available after the close of the trading floor. Brokers, then have 24 hours to review these reports and submit any necessary corrections to the exchange. Two(2) days after the transaction, Clearing Reports are prepared for the brokers and one(1) day later, the exchange sends these reports to the Clearing House, along with a diskette record of transactions for semi-automated processing.

b. **Clearing and Settlements.**

The Clearing House which uses the data diskette provided by the exchange to update and produce an internal transaction report on their own personal computer system. This internally produced report is compared with the report produced by an exchange, and if the review is favorable, then the Clearing House generates check payments and prepares advices and summary tickets, which are given to the brokers four to five (4-5) work days after the transaction for all required deliveries. This system is volume sensitive and clerical intensive. Volume upswings rarely come with advance notice such that delays for timely settlement become very costlyfor all parties. Five (5) work days after the date of transaction, a debit advice is issued to brokers with Net Due Clearing balances. The Clearing House requests payment from these brokers usually in the form of a "same day funds" instrument such as a cashier's check and an Official Receipt is issued each broker for all payments received. Only after Net Due balances are settled can the Clearing House release payments to brokers. Brokers are responsible for the delivery of certificates of ownership to the Clearing House before checks are released to them. These certificates must be accompanied by a Delivery Letter, as well as the appropriate Transfer Instruction and a Summary of Transactions.

The Clearing House then transcribes all this data for entry into its PC-based system and has four(4) additional days to process the data. Activity conducted during this period consists of balancing issuances against cancellation on a per issue basis and the preparation of transfer transmittal letters to authorized transfer agents, of which there are approximately forty in operation. The Transfer Agent has fifteen(15) days to process specific transactions. Part of this fifteen-day period is utilized by corporate registrars who, upon receipt of the newly issued certificates prepared by the Transfer Agent, record them in the books of the corporation. When the Transfer Agent receives the returned certificates from the Registrar, the Transfer Agent prepares a Billing Statement which is sent to the Clearing House to record the necessary amounts owed for documentary stamp tax and transfer fees. The Clearing House requires another two(2) days to perform clerical tasks necessary to communicate and collect these charges to the brokers and pay the Transfer Agents. When the Transfer Agent receives the payment he releases the certificates to the Clearing House.

Approximately twenty-seven(27) days after the initial transaction, the Clearing House processes the new certificates received from Transfer Agents attaching delivery letters, release and billing forms. Two(2) days later, the brokers review the certificates received from the Clearing House, verify their records, and release these to the customer. Problems with lost certificates sometimes occur in the shipment to and from the Clearing House, the Transfer Agent, the Registrar and the broker. The paperwork required to keep up with all transactions neccesitates broker/dealers having their own back office system support.

Finally, it should be mentioned that the estimated turnaround time (of about 29-30 working days from date of transaction) for these activities to be completed is not always met in today's low volume environment, and that the transfer cycle could easily extend to 40-50 days for some issues dependent on the state of the certificate records of the Transfer Agents, Corporate Registrars and Broker/Dealers.

TABLE___: Summary of Elapsed time for Present Trading, Clearing and Settlement Practices

Trade(T)	Completed Buy and Sell; Purchase and Sales Report prepared/sent to Broker
T+1(day)	Report reviewed by broker
T+2	Report prepared/sent to Clearing House,
T+4	Advice/Summary Tickets given to Brokers; Debit advice to brokers with Net Clearing Balances.
T+5	Payment made to Clearing House by Broker.
T+9-24	Clearing House to Transfer Agent to Corporate Registrars and back to Clearing House.
T+27	Clearing House processes new certificates for release to Brokers.
T+29-30	Review by Brokers; Release of certificates to clients.

Proposed Automation of Market Operations in the Philippines

Emerging markets are rapidly gaining in sophistication. Numerous markets are in the process of implementing more effective regulatory environments, enhanced market information systems, advanced trading systems, and centralized, streamlined clearing and settlement procedures. Efficient markets cannot function without credible information that is disseminated quickly to users. A new, revitalized securities market operation structure supported by a fully automated single national trading, clearing and settlement (back-office) system is critical for the Philippines to achieve strong economic development through its capital markets. A unified market operations system need not require physical unification of the two exchanges, as automated trading and data communication systems would link exchanges, regardless of location. Presently, clearing and settlement facilities are partially automated. Some of the larger broker-dealers have, on their own, automated some back-room services and operations. The present systems in use are decades behind the times, both in technology and in terms of market practices.

a. Automated Trade Execution

Implementation of a modern market operations system would dramatically reduce the management needs for the operational side of the exchanges. Ideally, the proposed system would have built-in surveillance capabilities, and by re-engineering trading processes, rather than by merely automating current manual, certificate-based operations, the need for inspection of broker/dealers would also be reduced. Such a system would have the following advantages:

- Achieves for an investor the guaranteed lowest best possible price in a completely fair market regardless of place of execution;
- Enhances the ability for increased volumes to be processed according to agreed upon trading rules;
- Helps ensure uniformity in reporting and permits a single focus for regulation enforcement;
- Avoids the need to dismantle and reorganize the current exchanges and the resulting time loss and associated risks;
- Permits flexibility in policy changes (such as rescinding the dual listing requirement by permitting trades to be executed only by brokers of certain exchanges);
- Allows the creation of additional exchanges in the future regardless of location, such as in the regions.
- Permits listing requirements to vary by exchange, thereby accommodating or encouraging exchange specialization by industry or location.
- Allows management of Customer Orders on an Automated Basis, e.g. allows the broker to verify customer credit and track the order until it is executed or canceled. This means that no client's order is forgotten, and broker/dealers are protected

against credit risks;

- Allows for transparency in the assessment of charges. When the trade is executed, the system automatically calculates the broker's commission, debits the investor's account, and credits the broker's account with the custodian for the amount of the commission.

Execution and priority of clients orders under the current system is inefficient and subject to inaccuracies and misuse that are hard to detect when the market becomes busy. The current system is appropriate only for a low-volume inactive market. Confidence in the fairness of the trading system is essential for market expansion. Orders must be executed on the basis of price-time priority. Automated trading ensures a fair market, since no order is forgotten and price-time priority is rigorously observed. Through automated trading, brokers are able to guarantee clients that the system is rigorously fair.

b. Automated Clearing and Settlement

A critical aspect of efficient securities market operations is automated clearing and settlement. Settlement is the exchange of securities(in the form of stock certificates of ownership) for money, in the performance of the trading contract. Settlement is by book-entry. Securities accounts with the centralized securities custodian are maintained by computer which is linked to the automated trading system. Once a trade is matched electronically, information such as the custody account of the buyer and seller, the price, and other details are electronically reflected in the accounts of the buyer and seller, which are debited and credited for cash and securities. The next day, investors receive written confirmation of the transaction from the custodian. In all developed markets, brokers are obliged to settle promptly, whether or not they receive the money or securities from their clients. Modern markets use central book-entry settlement which means that shares and money are exchanged by accounting entries in a special centralized depository institution which eliminates the risk of counterfeit certificates or bad checks. Fully automated settlement means that transactions are completely settled electronically within 2-3 days after execution, without effort on the part of the broker. Automated settlement increases brokers' profits, and expands the market by improving the quality of service to investors.

c. Automated Production of Customer Statements and Confirmations.

Rules issued by the regulatory body and exchange management typically require that broker-dealers keep updated and correct records of customer transactions and issue confirmations and receipts to document movement in a client's account. This accounting responsibility is shared by brokers throughout the world and when done by manual methods, creates cost that often absorb an estimated forty percent of commission income. To handle such

TABLE__: Comparison of elapsed times for Trading, Clearing and Settlement Practices

where T= represents the date of transaction or trade
T+1= represents 1 working day after transaction

Processes	Present Manual System	Proposed Automated System
Completed Buy and Sell; Purchase and Sales Report prepared/sent to Broker	T	T
Report reviewed by broker	T+1	T
Report prepared/sent to Clearing House	T+2	T
Advice/Summary Tickets sent to Brokers; Debit advice to brokers with Net Clearing Balances.	T+4	T
Payment made to Clearing House by Broker.	T+5	T+1
Clearing House to Transfer Agent to Corporate Registrars and back to Clearing House.	T+9-26	
Clearing House to Centralized Securities Custodian(Transfer Agents/Corporate Registrars) Investors receive written confirmation of transaction.		T+1-2
Clearing House processes new certificates for release to Brokers	T+27	
Review by Brokers; Release of certificates to clients.	T+29-30	
Custodian processes certificates for direct release to clients		T+2-3

"back-room" work manually requires a permanent staff of accountants, bookkeepers, and clerks which represents a fixed overhead expense that cuts into broker's profits every time trading volume declines. By automating such bookkeeping functions as the production of statements and confirmations, brokers are able to efficiently handle increased volume at less cost (perhaps as low as twenty percent of commission income).

d. Automated Market and Price Information.

Investors need to know as much as possible about market movements in order to make sound decisions. Price information is the prime ingredient in creating market interest. By automating price information, it can be transmitted rapidly to brokers' offices and to the press, both within a domestic market and throughout the world. Automated trading provides investors with detailed information on all offers to purchase of sell a security, which helps them determine a market strategy. Automated price information is the basic marketing tool of a modern stock exchange.

TABLE___: Summary of Elapsed time for Automated Trading, Clearing and Settlement

Trade(T)	**Completed Buy and Sell; Report reviewed by broker; Report prepared/sent to Clearing House; Debit advice to brokers; Payment made to Clearing House by Broker**
T+1	**Clearing House to Centralized Securities Custodian (Transfer Agents/Corporate Registrars) and back to Clearing House; Investors receive written confirmation of transaction.**
T+2-3	**Custodian processes new certificates for release to clients.**

4. <u>Conformity to International Market Standards</u>

Modern securities market operations in developed and emerging markets base their systems on recommendations on clearance, settlement and securities custodianship as developed by the Group of Thirty(G-30) in 1990. The Group of Thirty, composed of international bourses/exchanges, markets leaders, securities settlement firms, and market institutions, developed these recommendations as the framework for implementing efficient clearance, settlement and custodianship for improving international cross-border securities portfolio transactions, soon after the October 1990 world-wide market collapse. These recomendations have since evolved into international market standards which enable emerging markets to attract and retain international and professional investors into their respective markets.

5. Structure of Securities Instruments and Custodianship

One essential feature of modern securities market operations is the revised structure of stock certificates and the fungibility of securities. Securities are said to be "fungible" when all securities or stock certificates of the same type and class are interchangeable for the purpose of settling transactions. This means that the serial number of a share is irrelevant for the purpose of settlement. Fungibility is simply a market custom or practice, such that when investors and brokers agree that they are trading the "rights to a certain number of shares" of a given type or class, but not the actual shares with specific serial numbers, fungibility is created.

"Collective safe custody" through a centralized securities depository is a capital market technique used in developed and emerging markets to achieve "fungibility" and to make book-entry settlement practical. Shares are classified to be in "collective safe custody" when shares of many investors are deposited with a single custodian, with instructions that such share be held collectively. Shareholders give up their right to receive an equivalent number of shares in the collective pool. When the shareholder withdraws the shares from "collective safe custody," he will probably receive a certificate with a different serial number from that which he deposited, but he will have the same number of shares of identical type and class. Developed and emerging markets have opted to classify, where appropriate with the legal infrastructure, securities either as "immobilized or dematerialized". Immobilization is simply the process where a specified number of securities certificates are deposited with the custodian for ease of transfer. In this process, physical certificates may still exist. Dematerialization is the process where the issuer structures the records of ownership of securities in the custodian's computer records and no actual physical certificates of ownership are ever issued or required, except for verfication statements issued by the custodian.

The organization of a Centralized Securities Depositary is advantageous to an investor for the following reasons: safekeeping of physical securities; efficient book-entry and physical movement of securities; substitution of ownership into book-entry records; ease of linkage with other depositories. For the issuer, advantages are ease in: administration of the collection and disbursement of dividends and earnings; the initiation of ownership transfer of registered securities; administration of ownership records. To achieve such a facility, integrated with the automated trading, clearing and settlements system requires a significant amount of planning and re-structuring of market operations, as well as specific sections in the Securities Act. The establishment and resolution of a revised legal infrastructure will focus on the substitution of ownership through "fungible securities" either in "immobilized" or "dematerialized" forms, as well as legal issues on authenticity and acceptability of such ownership records for normal business transactions.

ANNEX I

ADMINISTRATIVE ASSESSMENT

E. INSTITUTIONAL AND ADMINISTRATIVE ASSESSMENT

A. PUBLIC SECTOR COMPONENT

1. Administrative Assessment of the SEC

A separate report on the administrative assessment of SEC is shown in Appendix__. In summary, the following are the observations relevant to the proposed Project.

a. Organization. In general, a Study Team commissioned by USAID found the SEC's organization satisfactory. From interviews, the SEC explained that, although its current organization is able to execute its functions adequately, additional staff, equipment, and manpower training would be beneficial toward ensuring SEC's ability to serve its objectives in a more efficient and effective manner. With the exception of additional staff, these are precisely the areas, particularly in SEC's role in the development of the Philippine Capital Markets, where the Project is aiming to provide significant improvements.

b. Contracting Capability. SEC's experience in contracting for goods and services is limited. To date, the extent of the SEC's contracting capability has been confined to the procurement of office equipment, furniture and fixtures, and office supplies. In this regard, SEC follows procurement guidelines prescribed by the Government of the Philippines (GOP). It has a Committee on Bids and Awards comprising, at a minimum, three Department Directors and a representative from the Commission on Audit.

   From interviews, it was explained that the engagement of consultancy services do not necessarily undergo competitive contracting procedures. On occasion, consultants would be engaged upon recommendation by the proponent SEC Director and approval of the Commission en banc. The assessment of the SEC's contracting capability is generally satisfactory but its capability is considered limited in relation to the requirements of the Project.

c. Project Implementation Unit Within SEC. The organization of the SEC is prescribed by Presidential Decree (PD) No. 902A, amended by PD No. 1653. Adhering to these GOP guidelines, the SEC may not create additional departments, divisions, or units without an Act of Congress.

   At present, SEC has no organizational unit to act as a possible Project Management Organization (PMO) to implement the Project. This organizational constraint is highlighted by the proposed creation in 1992 of three new SEC departments: a Capital Markets Department, a Management Information Services Department, and a Commodity Futures Operating Department. In 1992, SEC proposed the creation of these three new departments, for which the Department of Budget and

Management has approved funding allocations (additional staffing and operating budgets). The actual creation and operation of these three departments, however, was halted after subsequent review by the GOP. It was argued by the GOP that, without an Act of Congress, SEC may not alter its organizational structure.

Based on this prior experience, it is possible that a new organizational unit to act as a PMO for the Project may encounter the same organizational constraint that was experienced in the 1992 attempt to create new departments. Therefore, it is recommended that an ad hoc project team be formed within the SEC, which will report directly to the Commissioner. A counterpart project manager should also be appointed. Although members of the project team will continue to hold their present positions, they will nevertheless be seconded to the project team as required.

Another organizational concern in using the SEC as the Project's administrative vehicle is the issue of possible lack of implementation continuity. As the SEC's Chairman, Associate Commissioners, and Executive Director are appointed by the Office of the President, there is a potential for implementation discontinuity throughout the life of the Project. Between 1986 and 1992, for example, there have been three different occupants of the Office of the SEC Chairman. The turnover of these senior SEC personnel, along with potential changes in focus, may affect the implementation of the proposed Project.

The Study Team thus assesses these factors as major organizational constraints in the possible selection of the SEC as the administrative vehicle to implement the Public Sector component of the Project.

d. Financial Monitoring and Reporting Systems. Presented in Appendix A to this Report (not included in this Annex but maintained in the official project file) are the funding, budget, cash disbursements, and cash receipts processes practiced by the SEC. As described therein, the financial systems being employed by the SEC are in accordance with procedures prescribed by the GOP.

The SEC's budgetary process includes: submission of budget to the Department of Budget, endorsement by the Office of the President, and approval by Congress. The allocation of funds is the responsibility of the Bureau of Treasury; GOP funds are withdrawn by the SEC through a bank account at Land Bank, Buendia Branch. Receipts collected by the SEC are deposited in a separate bank account at the Philippine National Bank, Ortigas Branch, which is under the control of the GOP. The SEC however, cannot withdraw funds from this bank account.

In general, the Study Team's assessment of the SEC's funding, budgeting, cash disbursements, and cash receipts processes is satisfactory. However, it should be noted that in the event the SEC is made the administrative vehicle for the Public Sector component, USAID funds will undergo GOP budgetary and funding processes as illustrated above and described further in Appendix__.

Under the GOP disbursement process, USAID funds would enter initially into the Philippine Treasury, which in turn will allocate/fund the programed monies to the SEC. Moreover, the GOP would have to prefund the Project expenses for the chosen disbursement period (say quarterly) to place the proposed Project disbursements in line with GOP disbursing procedures. Using the SEC as the administrative vehicle rather than an AID-Direct Contractor would result in a more complicated funding mechanism.

In sum, the SEC itself may not be the appropriate vehicle to implement the Project for the following reasons:

a. The regulatory entity that the Project seeks to improve is the SEC itself, which may be constrained not to pursue the Project vigorously out of deference to certain established practices and because of possible organizational limitations.

b. Because of the nature of its operations, the experience of the SEC in the procurement of goods and contracting for services is rather limited. In this regard, the SEC does not provide any advantage.

c. Creating an implementation unit within the SEC may entail bureaucratic problems. Although it is possible that these problems may be hurdled, the Project may be delayed.

d. There is a risk of breaking the continuity of implementation as a result of possible changes in the highest level of authority at SEC during the life of the Project.

e. Using the SEC as the implementing vehicle may result in a more complicated funding mechanism.

2. THIRD PARTY IMPLEMENTOR

The foregoing analysis points toward a third party as implementor and confirms the preference of USAID for a direct contractor as the implementing unit. Because much of the skills and experience that are necessary to implement the Project's Public Sector component can be better obtained from abroad, a direct U.S. contractor, as envisioned by USAID, is a logical choice.

J. IMPLEMENTATION ORGANIZATIONAL STRUCTURE

The more significant features of a proposed organizational structure are discussed in the succeeding subsections.

a. **Direct U.S. Contractor**

A U.S. Contractor should be hired by USAID to oversee the implementation of the entire Public Sector component of the Project. The Contractor will provide a Capital Markets Regulation Specialist who will also act as the Chief of Party (CoP) and will be primarily responsible for the implementation of the Public Sector component. He, therefore, will head the implementation unit. This specialist will also be directly responsible for the study, evaluation, and implementation of the Policy Reform element of the Project.

The Contractor will also provide the following additional required specialists:

- Automation specialist, who will be responsible for the procurement of commodities and the Information Access project element; and
- Organization and Methods specialist, whose focus will be to assist with the study and evaluation of the SEC organization, the development of an organizational training plan, the identification of training needs of SEC personnel, and the identification and selection of training courses to meet the identified training needs.

To function effectively, the CoP needs the support of an administration unit to be headed by a Administration Officer. This unit will provide administrative assistance to the entire implementation team, including all expatriate and local consultants. Recommended to be under this unit are:

- Administrative Officer
- Procurement Service Agent
- Accounting Section
- Administrative Support Section

1) **Administrative Officer**

The Project Administrative Officer shall be responsible for assisting the CoP in the implementation of the Project's Public Sector component and for managing day-to-day administration of the proposed Project.

2) **Procurement Service Agent**

As procurement by the Project Team is not expected to be a full time day-to-day job, and considering that this activity is a specialized work, the procurement of commodities (computer equipment, software, and other goods) will be handled by a procurement service agent to be hired by the contractor.

3) **Accounting Section**

This section will take care of fund receipts and disbursements and preparation of reports to be submitted to USAID. It will also be responsible for the preparation of budgets and establishment of proper accounting and internal control procedures. A lean structure is recommended, consisting only of a chief accountant and a bookkeeper/clerk.

4) **Administrative Section**

This section will provide secretarial and typing work, and messengerial services. To serve the CoP and the various consultants, it is estimated that two secretaries, a typist, and a driver/messenger will be needed for the duration of the Project.

5. **Expatriate Specialists and Local Consultants**

In addition to the three expatriate specialists mentioned earlier, the following local consultants are expected to be hired to assist the expatriate specialists:

- Research Consultant, who will assist the Capital Markets Regulation Specialist in the conduct of regulatory studies and researches, and in the implementation of the policy reform element of the Project;

- Policy Reform Seminar Administrator, who will assist the Capital Markets Regulation Specialist and coordinate with the Research Consultant in the organization and conduct of seminars for dissemination of policy reforms resulting from studies made by the Research Consultant.

- Information Systems Planning Consultant, who will assist the Automation Specialist in data modelling tasks, information technology reviews and planning, and in the

identification of commodities required to strengthen SEC's information systems.

- Training Consultant, who will assist the Organization and Methods Specialist in the review of SEC's organization, identification of training needs, selection of training programs and seminars, and coordination of training activities.

The local consultants will generally be hired during the implementation stage of the recommendations of the expatriate specialists. During this time, the expatriate specialists and local consultants will work together to implement the recommendations.

b. SEC Project Committee

As the SEC would be the subject of technical studies, evaluations, and recommendations that would be provided by the Contractor, it is necessary that an SEC Project Committee be created and a director appointed to coordinate the Contractor's work with the various departments, divisions, and units at the SEC, and ensure the implementation of recommendations made by the Contractor.

Generally, the Committee will be responsible for the following:

- Ensuring that the respective SEC organizational units participate in the studies and evaluations conducted by the Contractor,

- Coordinating the work progress of the Public Sector component of the proposed Project with the work being conducted under the Private Sector component,

- Participating in the review and acceptance of the recommendations made by the Contractor,

- Ensuring the necessary implementation of recommended changes made by the Contractor.

As the Contractor would have direct responsibilities to USAID, it is the assessment of the Study Team that the Project Committee would not add a bureaucratic step in the conduct of the Contractor's work. The participation of the Committee in fact would enhance the acceptability of recommendations made by the Contractor, thus, improving the chances of implementing the recommended changes. To be effective, the composition of the Committee must be at the senior levels of the SEC organization. Three alternatives were identified by the Study Team relative to the PIC's composition. The first alternative

is to have the it composed of the SEC Chairman and Associate Commissioners. Such a composition would place the responsibilities at the highest possible level at the SEC: the Commission en banc. Its disadvantage lies in the potential discontinuity of the Commission en banc's composition, which may change according to appointments made by the Office of the President. The second of the alternatives is to have the Project Committee composed of the various Department Directors (nine Directors in all), who - relative to Presidential appointments - are less susceptible to turnover. Its major disadvantage, however, lies in the fact that the decision-making level of the SEC remains with the Commission en banc. A Committee composed of Department Directors, thus, would result in a two-level decision process. The third alternative is to have the SEC Chairman or one of the other Commissioners to lead the project, with all the Directors of the various departments as members. This provides an improvement over the second alternative, as a person of higher authority will be chairing the Committee.

Of these three alternatives, therefore, it is recommended that the Project Committee be composed of the SEC Chairman and the Associate Commissioners.

4. FUNDING MECHANISM

The funding mechanism for non-commodities that will be used for the Public Sector component of the Project is the monthly cost reimbursement method - the method that USAID usually adopts for direct U.S. contractors. For commodities, the direct payment method will be used, as usually practiced by USAID.

B. PRIVATE SECTOR COMPONENT

1. IMPLEMENTATION VEHICLE

In selecting a Project Implementor for the Private Sector component of the Project, the Financial Executives Institute of the Philippines (FINEX) was preferred over other financial organizations which had also been considered by USAID, such as the Bankers Association of the Philippines (BAP), and the Investment Houses Association of the Philippines (IHAP). This preference is based on the consideration that the membership of FINEX extends to the entire financial community and not just confined to specialized activities like commercial banking or investment houses. Moreover, FINEX chairs the Capital Markets Development Council.

A review of the organization and financial system of FINEX is presented in Appendix B to this report. (Appendix B is not included in this annex but a copy is maintained in the official project file.)

The Study Team assessed that FINEX possessed several advantages as the potential implementing agency. Foremost of these advantages is that this non-government organization has a membership roster of over 500 individuals, representing for the most part the chief financial officers of leading corporations in the Philippines and ranking officers of major financial institutions. FINEX is a highly respected institution in the country and possesses a high level of credibility in the business community. Of equal importance, FINEX has spearheaded in recent years the movement toward the development of capital markets in the country. FINEX, in 1991, formed a Capital Markets Development Committee which was the catalyst in the later establishment (in November 1991) of the Capital Markets Development Council, a forum consisting of very senior executives in both the public and private sectors involved in developing the Philippine Capital Markets.

FINEX, however, is not without its disadvantages as the Private Sector component's implementing agency. The Institute is a professional association of financial executives and, as such, it is a volunteer organization. Its set of officers generally changes every year, and therefore the Institute does not have permanent personnel. Its primary source of revenue is dues collected from its members, and its major disbursements are for salaries of its secretariat, and cost of membership programs, meetings and fellowships. As an organization, the experience of FINEX in big-scale undertakings is limited.

In its present form, the FINEX organization is not capable of administering a project of the magnitude of CMDP. However, with proper design and staffing by qualified personnel, the creation of a separate Project Team to act as the administrative vehicle for the Private Sector component would overcome current deficiencies in the FINEX organization to implement the Project. Similarly, the existing contracting capability and disbursement capability of

FINEX were assessed to be limited in terms of implementing a project of this nature. Specific recommendations for strengthening these capabilities are presented in later sections of this Report.

2. FINEX OR FINEX FOUNDATION

The issue of selecting between FINEX and the FINEX Foundation as the implementing agency was also evaluated. The FINEX Foundation serves as the research arm of FINEX and is involved in providing grants for scientific research and development work. The Foundation's funds are provided by FINEX. Also, the Foundation's members are selected from the members of the FINEX organization.

Based on the Study Team's review, there were no significant differences between FINEX and the FINEX Foundation that would favor the selection of the Foundation as the proposed Project's implementing agency. On the contrary, the following disadvantages were identified:

- FINEX has a larger membership body than the Foundation.
- The FINEX Board meets more regularly than does the Foundation Board; and,
- FINEX has an established source of revenue (membership dues, etc.) in contrast to the Foundation which obtains its funds from FINEX itself.

With these disadvantages, it is preferable to use FINEX itself as the implementing agency rather than the FINEX Foundation.

A first step in the use of FINEX as the Project's implementing agency is the registration of FINEX as a Private Voluntary Organization (PVO) with USAID. At present, FINEX is not a registered PVO with USAID, and it is necessary that it register in order for it to qualify for project funding as PVO.

3. IMPLEMENTATION ORGANIZATIONAL STRUCTURE

As explained earlier, FINEX itself does not have the organizational machinery to implement a project of the magnitude of the Project. It is therefore necessary to create a suitable organization for this purpose. The important features of this organizational structure are discussed in the succeeding subsections.

a. FINEX Project Implementation Committee

As mentioned earlier, it is recommended that a separate Project Team be created to administer and manage the implementation of the Project's Private Sector component. In the organization of the Project Team, the non-permanent nature of the tenure of the FINEX Board of Directors should be given consideration.

The members of the Board of Directors of FINEX are elected by the membership body annually. Thus, the Board's composition changes every year. The President of FINEX also changes yearly, and so with the majority of the members of the Board. This annual transformation of the Board's composition brings to light the issue of continuity in the implementation of and management focus on the Project during its five-year life.

In order to surmount this organizational issue, the creation of a Project Implementation Committee (PIC) is recommended. The major responsibility of the FINEX PIC will be to ensure continued focus on the Private Sector component's implementation by the Project Team. The PIC will also be responsible for monitoring the progress of the work of the Project Team, reviewing and approving contract awards recommended by the Project Team for the procurement of goods and services, and coordinating the progress of the work for the Private Sector component with the work being conducted under the Public Sector component.

Composition of the PIC. It is suggested that the PIC have as many as seven members, consisting of the following organizations:

1. Perhaps as many as three members from FINEX itself, including the chairman. At least two of these members, one of which is the Chairman, should be permanent members, and the other one could be a rotating member.

2. One member should be a representative from the SEC Project Committee, whose cross-membership would ensure the exchange of information and liaison between the Public Sector and Private Sector components.

3. One member each from the Makati and Manila Stock Exchanges.

4. One member from the Bankers Association of the Philippines and Investment Houses Association of the Philippines who will be alternating from year to year.

The presence of other interested parties (other than FINEX members) in the PIC would provide a broader perspective in its work and at the same time help facilitate the implementation of the various elements of the Project.

b. Executive Director

A permanent executive director who will act as the chief operating officer to implement the Project should be hired. In this capacity, he will be responsible for planning, directing, and managing the day-to-day administration of the Private Sector component of the Project. The Executive Director should possess familiarity with capital markets in general, and the equity market in particular. In addition to his general management responsibility over the Project, the Executive Director will be

directly responsible for the organization of the corporate vehicle that is envisioned to own and operate the automated trading, clearing and settlements systems for the stock exchanges and for the Information Access and Policy Reform elements of the Project. The Executive Director should possess senior level experience in private industry, preferably in a financial institution, and should have advanced automated environment systems background.

c. Assistant Executive Director

Because of the many activities constituting the Project, it is recommended that an Assistant Executive Director be included in the Project Team. This person will be directly responsible for contracting actions, supervising the administrative unit of the project organization, and generally will be providing assistance to the Executive Director. He will also be directly responsible for the Training, Education and Research element of the Project.

d. Administrative Unit

Just like in the project organization for the Public Sector component, the Private Sector component needs an administration unit to enable it to implement the Project. This unit, which will report directly to the Assistant Executive Director, will have two sections, namely:

- Accounting Section. To provide continuity to the accounting function, it is recommended that this work be contracted out. Because of the relative mobility of accounting personnel, a professional firm may be able to provide permanence in this function. It is estimated that the contractor will assign a chief accountant and a bookkeeper/clerk to the Project. They will be primarily responsible for the preparation of budgets, and establishment of appropriate accounting and internal control policies and procedures. They will also be responsible for the proper monitoring and reporting of project funds in accordance with USAID requirements.

- Administrative Support Section. This Section will be responsible for providing secretarial, messengerial and other administrative support to the Project Team and to the expatriate and local consultants engaged by the Project Team. This section will consist of a secretary and a driver/messenger.

e. Foreign and Local Consultants

To implement the various project elements, the following foreign and local consultants will be hired:

1) Foreign Automation Consultants who will be involved in:

- Preliminary design of the automated systems

- o Procurement of actual systems design
- o Implementation planning
- o Contract management
  - o Migration to new systems

2) Organization of Corporate Vehicle that will own and operate the automated systems:

   - o A Financial Consultant, preferably an expatriate firm, will be hired to put together the equity owners.

3) Policy Reform Element

   - o A Research Consultant will be contracted to do various research work.

4. FUNDING MECHANISM

USAID will use the Periodic Advance mechanism for funding the Project's Private Sector component. Under this method, cash advances will be provided by USAID to FINEX quarterly based on the Project Team's forecast of expenditures for the next quarter.

The project team hired by FINEX must develop a financial accounting and management system that meets AID standards. In addition, USAID funds shall not be mixed with other FINEX-owned or controlled funds. FINEX shall deposit all USAID cash advances in a separate bank account, and shall make all disbursements for goods and services for the Project from that account.

ANNEX J

GRAY AMENDMENT CERTIFICATION

Annex J

CERTIFICATION PURSUANT TO UTILIZATION OF GRAY AMENDMENT ORGANIZATION

I, RICHARD A. JOHNSON, principal officer of the Agency for International Development in the Philippines, have fully considered the potential involvement of small and/or economically and socially disadvantaged enterprises, and do hereby certify that the U.S. technical assistance required under the program will be provided through open competition, with special consideration given to firms submitting proposals which utilize the resources of small and disadvantaged firms. Firms proposing to provide services will be required to utilize Gray Amendment entities as subcontractors (or as partners in a consortium) for procurement services and training. In addition, for program evaluation, contracts will be awarded to small and/or disadvantaged firms to engage in this work. My judgment is based on the recommendations of the Project and Mission Review Committees.

Original Signed

RICHARD A. JOHNSON
Acting Director, USAID/Philippines

ANNEX K

INITIAL ENVIRONMENTAL EXAMINATION

May 27, 1992

ACTION MEMORANDUM FOR THE ACTING DIRECTOR

THRU: John A. Patterson, Acting Deputy Director

FROM: Earl W. Gast, DRM/DI

SUBJECT: Capital Markets Development Project (492-0447): Request to Approve the Initial Environmental Examination (IEE)

Action Requested: Your approval is sought of the IEE for the Capital Markets Development Project (CMDP), which recommends a categorical exclusion under A.I.D. Regulation 16, Section 216.2 (c)(2)(i). Once signed, the IEE will be forwarded to the Asia Bureau for final approval.

Background: The Capital Markets Development Project, a $13.5 million private-public sector activity, aims to improve the quality and transparency of investor information available to the public and other capital market participants. The project will employ a two-pronged effort to achieve this objective. The first component will assist in strengthening the ability of the Securities and Exchange Commission (SEC) to carry out its tasks more efficiently. The project will make available technical assistance in areas such as capital markets regulation, automation, "professionalization", and organizational development. AID-financed commodities will upgrade the automation capabilities of the SEC as it relates to market surveillance, and assist the SEC in establishing satellite offices at regional sites. The project will also assist in developing software that will enable the SEC to link up to a new automated exchange system.

A private sector component carried out by a private voluntary organization (PVO) will seek to raise private sector funds to develop and install a new integrated and automated exchange. The PVO will also take the lead in carrying out policy change dialogue with the SEC through the Capital Markets Development Council. In addition, the PVO will take charge in orchestrating cost-shared training courses for the private sector as well as developing an investors' information service. No significant environmental effects are anticipated as the result of this project.

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Recommendation: The project consists of technical assistance, training, and developing automation systems that will improve existing systems and extend outreach to other Regions in the Philippines. A categorical exclusion is proposed under AID Regulation 16 (22 CFR), Section 216.2(c)(i), which allows for an exclusion when there is no significant impact on the physical environment. The Capital Markets Development Project meets this criterion. It is recommended that, based on the information above, you approve the attached IEE by signing in the space provided below and in the appropriate place on the IEE (attached).

APPROVED: Richard A. Jackson

DISAPPROVED: _____

DATE: 6/2/92

Attachment:
Initial Environmental Examination (IEE)

Clearances:
DRM/OLA:GMImhoff draft
ONRAD:KRushing subs.
PESO:BCornelio

Drafted:DRM/DI:EWGast:mfdr:5/27/92

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INITIAL ENVIRONMENTAL EXAMINATION

(A) PROJECT COUNTRY: Philippines

(B) ACTIVITY: Capital Markets Development Project (492-0447)

(C) A.I.D. FUNDING: $13.5 million

(D) PERIOD OF FUNDING: FY 1992 - FY 1996

(E) STATEMENT PREPARED BY: _____
Earl W. Gast, DRM
USAID/Philippines

(F) ENVIRONMENTAL ACTION RECOMMENDED: Categorical Exclusion under A.I.D. Regulation 16, Section 216.2 (c)(2)(i)

(G) ENVIRONMENTAL OFFICER CLEARANCE: _____
Kevin A. Rushing, ONRAD
USAID/Philippines

(H) DECISION OF USAID/PHILIPPINES DIRECTOR:

APPROVED: _____

DISAPPROVED: _____

DATE: 6/2/92

(I) DECISION OF ASIA BUREAU ENVIRONMENTAL OFFICER:

APPROVED: M. Lax, ASIA/DR/TR

DISAPPROVED: _____

DATE: 8-7-92

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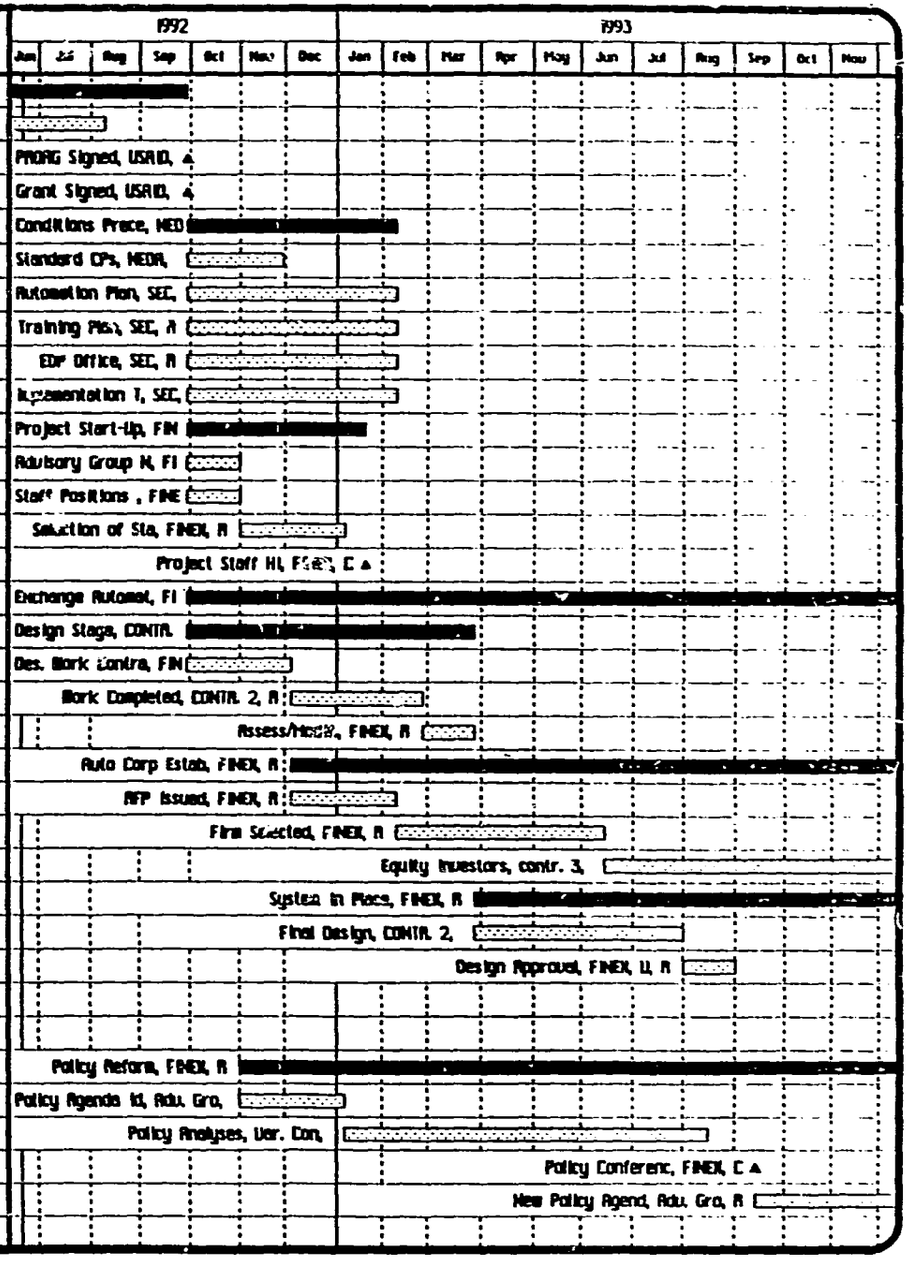
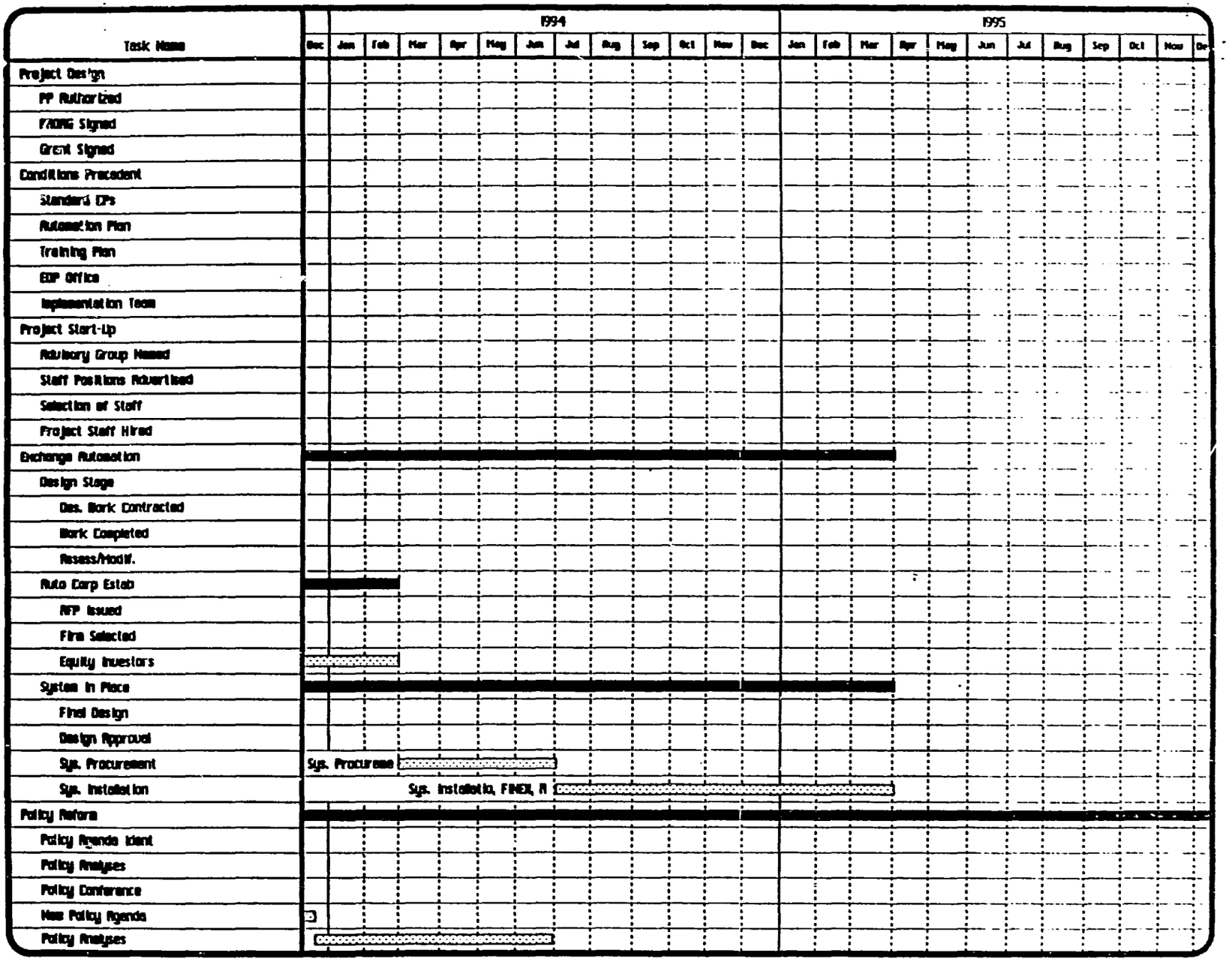
Annex L

PROJECT IMPLEMENTATION GANTT CHART
AND
PROJECT IMPLEMENTATION AND MANAGEMENT SCHEDULE

Task	Resources	Status
Project Design	USAID	A
PP Authorized	USAID	A
PROAG Signed	USAID	CA
Grant Signed	USAID	CA
Conditions Precedent	MEDA	A
Standard CPs	MEDA	A p
Automation Plan	SEC	A p
Training Plan	SEC	A
EDP Office	SEC	A
Implementation Team	SEC	A
Project Start-Up	FINEX	A
Advisory Group Named	FINEX	A
Staff Positions Advertised	FINEX, USAID	A
Selection of Staff	FINEX	A
Project Staff Hired	FINEX	C
Exchange Automation	FINEX	A
Design Stage	CONTR. 2	A
Des. Work Contracted	FINEX	A
Work Completed	CONTR. 2	A
Assess/Modif.	FINEX	A
Auto Corp Estab	FINEX	A
RFP Issued	FINEX	A
Firm Selected	FINEX	A
Equity Investors	contr. 3	
System In Place	FINEX	A
Final Design	CONTR. 2	
Design Approval	FINEX, USAID	A
Sys. Procurement	FINEX, CONTR. 2	A
Sys. Installation	FINEX	A
Policy Reform	FINEX	A
Policy Agenda Ident	Adv. Group	A
Policy Analyses	Ver. Contr	
Policy Conference	FINEX	C
New Policy Agenda	Adv. Group	A
Policy Analyses	Ver. Contr	




Task Name
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Project Design
PP Authorized
FAONG Signed
Grant Signed
Conditions Precedent
Standard EPs
Automation Plan
Training Plan
EDP Office
Implementation Team
Project Start-Up
Advisory Group Named
Staff Positions Advertised
Selection of Staff
Project Staff Hired
Exchange Automation
Design Stage
Des. Work Contracted
Work Completed
Reseas/Modif.
Auto Corp Estab
RFP Issued
Firm Selected
Equity Investors
System In Place
Final Design
Design Approval
Sys. Procurement
Sys. Procureme
Sys. Installation
Sys. Installatio, FINEX, A
Policy Reform
Policy Agenda Ident
Policy Analyses
Policy Conference
New Policy Agenda
Policy Analyses

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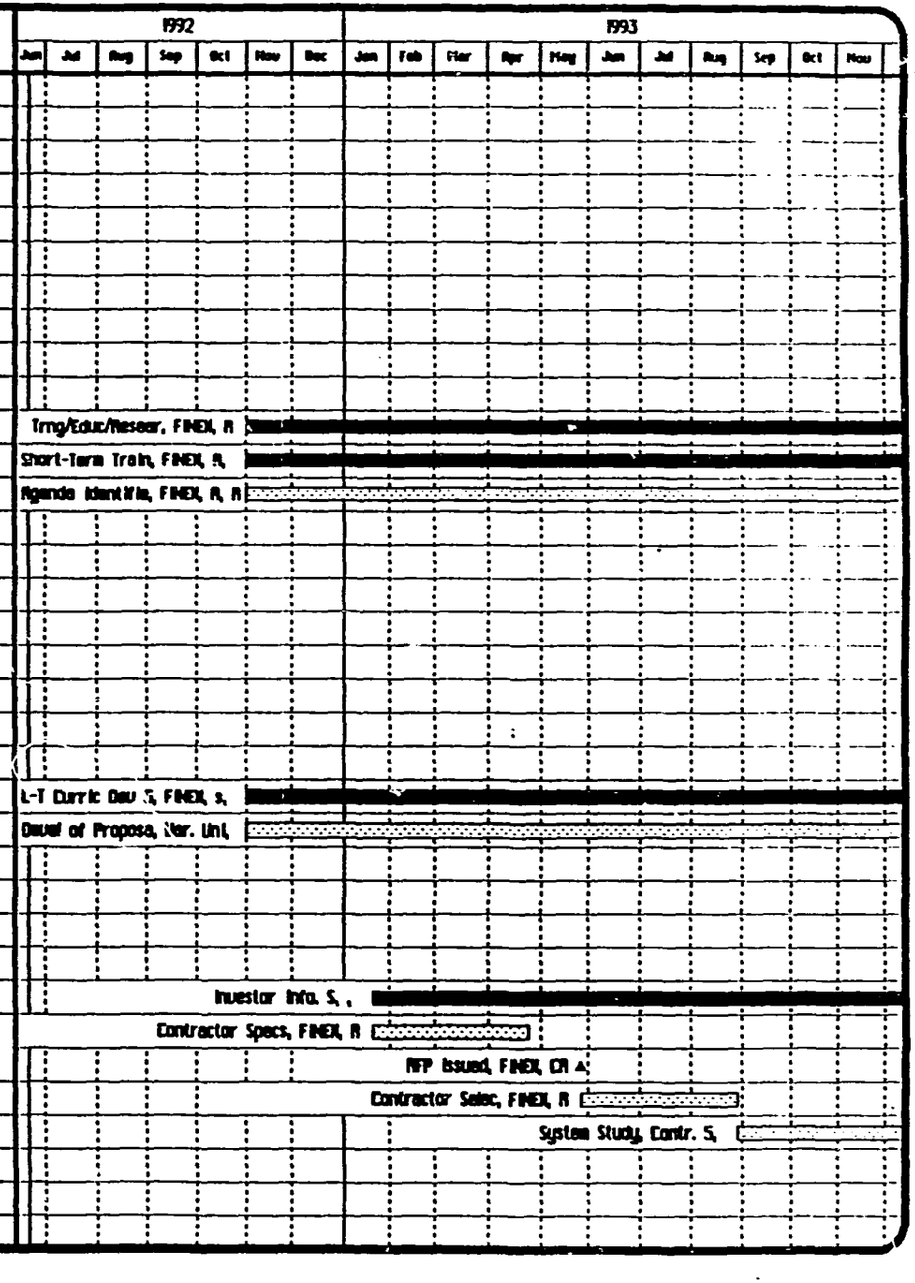
Task Name	1996												1997											
	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Project Design																									
PP Authorized																									
PRDNG Signed																									
Grant Signed																									
Conditions Precedent																									
Standard CPs																									
Automation Plan																									
Training Plan																									
EOP Office																									
Implementation Team																									
Project Start-Up																									
Advisory Group Named																									
Staff Positions Advertised																									
Selection of Staff																									
Project Staff Hired																									
Exchange Automation																									
Design Stage																									
Des. Work Contracted																									
Work Completed																									
Assess/Modif.																									
Auto Corp Estab																									
RFP Issued																									
Firm Selected																									
Equity Investors																									
System In Place																									
Final Design																									
Design Approval																									
Sys. Procurement																									
Sys. Installation																									
Policy Reform																									
Policy Agenda Ident																									
Policy Analyses																									
Policy Conference																									
New Policy Agenda																									
Policy Analyses																									

Task Name	Resources	Status
Policy Conference	FINEX	C
New Policy Agenda	Adv. Group	A
Policy Analyses	Ver. Contr	
Policy Conference	FINEX	C
New Policy Agenda	Adv. Group	A
Policy Analyses	Ver. Contr	
Policy Conference	FINEX	C
New Policy Agenda	Adv. Group	A
Policy Analyses	Ver. Contr	
Policy Conference	FINEX	C
Trng/Educ/Research	FINEX	A
Short-Term Training	FINEX, Adv. Group	A
Agenda Identified	FINEX, Adv. Group, C	A
Classes Organized	Contr. 4	
Sessions Held	FINEX, Instit.	A
Agenda Modified	FINEX, Adv. Group	A
Sessions Held	FINEX, Instit.	A
Agenda Modified	FINEX, Adv. Group	A
Sessions held	FINEX, Instit.	A
Agenda Modified	FINEX, Adv. Group	A
Sessions Held	FINEX, Instit.	A
L-T Curric Dev Grant	FINEX, subgrantee	A
Devel of Proposals	Ver. Univ.	
Proposal Review	FINEX, Adv. Group	A
Subgrantee Selection	FINEX	A
Curric. Dev.	subgrantee	A
Policy Research Grants	FINEX	A
Investor Info. Serv.		
Contractor Specs	FINEX	A
RFP Issued	FINEX	CR
Contractor Selected	FINEX	A
System Study	Contr. S	
Bids for Commodities	FINEX, Contr. S	C
Supplier Selected	FINEX, Adv. Group, C	A
Commodities Del/Inst	Contr. S	



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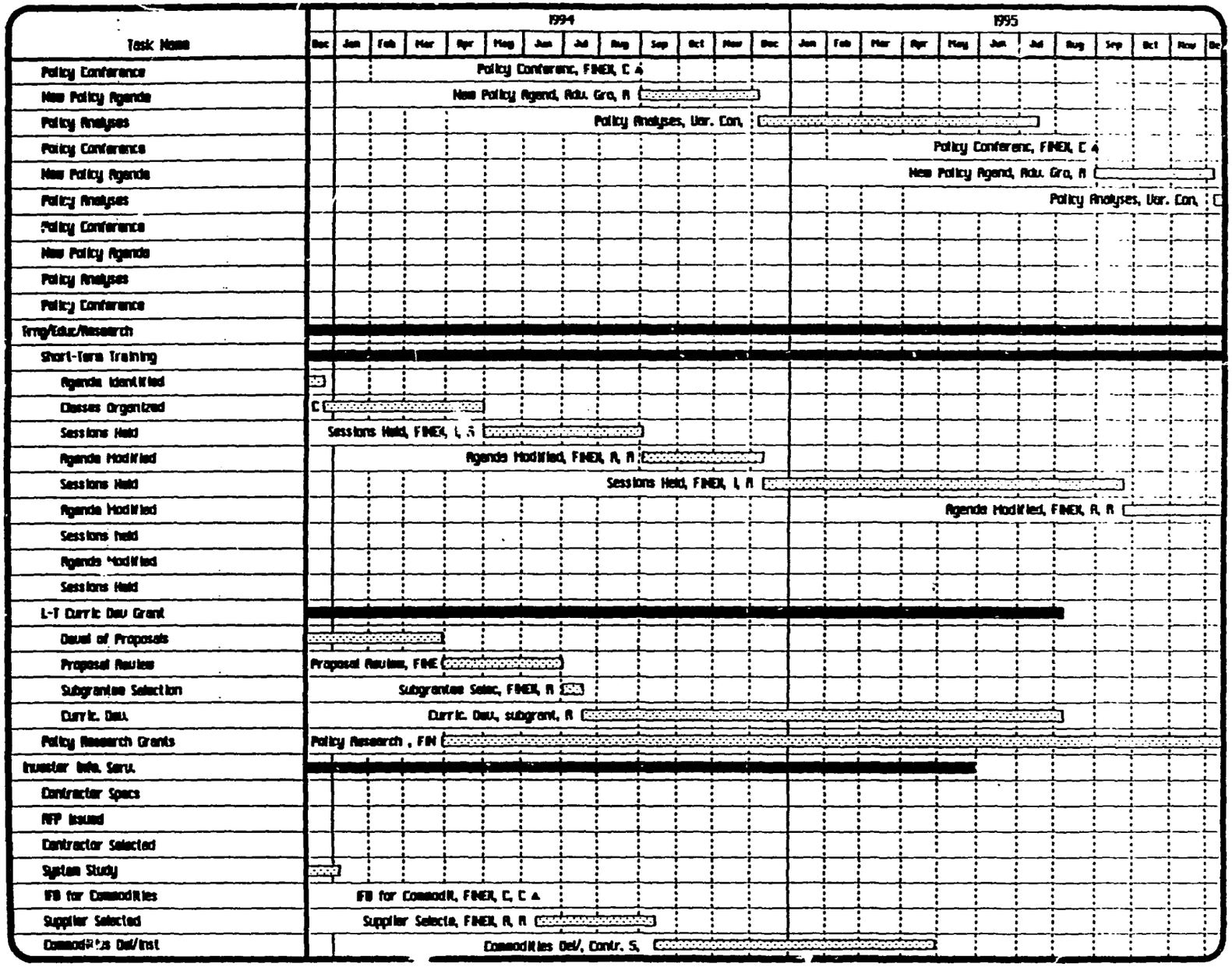
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Dec Jan Feb Mar Apr May Jun Jul Aug Sep Oct Nov Dec Jan Feb Mar Apr May Jun Jul Aug Sep Oct Nov
Task Name
Policy Conference
New Policy Agenda
Policy Analyses
Policy Conference
New Policy Agenda
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Policy Conference
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Policy Conference
Trng/Educ/Research
Short-Term Training
Agenda Identified
Classes Organized
Sessions Held
Agenda Modified
Sessions Held
Agenda Modified
Sessions held
Agenda Modified
Sessions Held
L-T Curric Dev Grant
Devel of Proposals
Proposal Review
Subgrantee Selection
Curric. Dev.
Policy Research Grants
Investor Info. Serv.
Contractor Specs
RFP Issued
Contractor Selected
System Study
IFB for Commodities
Supplier Selected
Commodities Del/Inst
Policy Conferenc, FINEX, C
New Policy Agend, Adv. Gro, A
Policy Analyses, Ver. Con,
Policy Conferenc, FINEX, C
New Policy Agend, Adv. Gro, A
Policy Analyses, Ver. Con,
Sessions Held, FINEX, L, S
Agenda Modified, FINEX, A, A
Sessions Held, FINEX, L, A
Agenda Modified, FINEX, A, A
Proposal Review, FINE
Subgrantee Selec, FINEX, A
Curric. Dev., subgrant, A
Policy Research , FIN
IFB for Commodit, FINEX, C, C
Supplier Selecte, FINEX, A, A
Commodities Del/, Contr. S,

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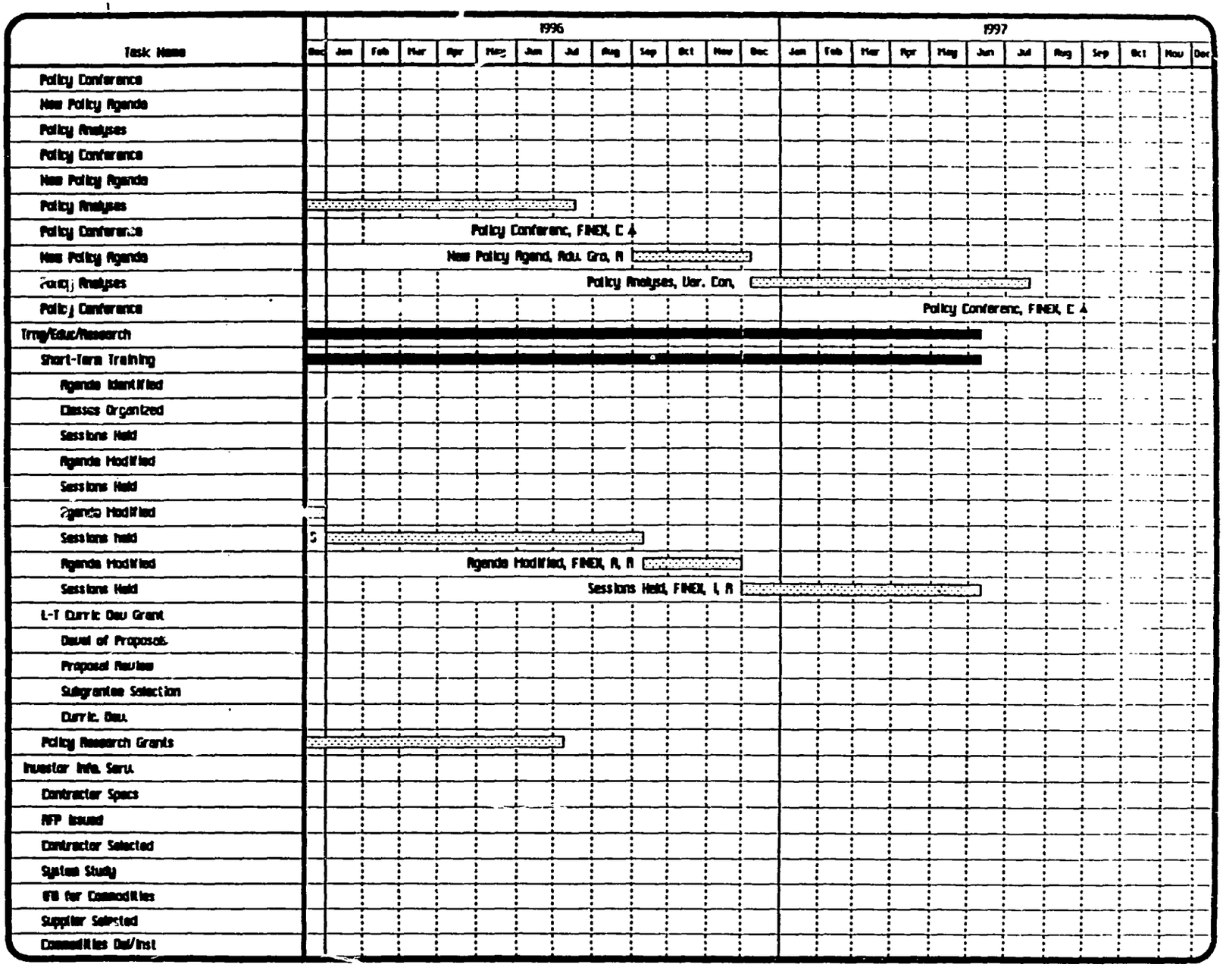
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Task Name
Policy Conference
New Policy Agenda
Policy Analyses
Policy Conference
New Policy Agenda
Policy Analyses
Policy Conference
Policy Conferenc, FINEX, C A
New Policy Agend, Adv. Gro, A
Policy Analyses
Policy Analyses, Ver. Con,
Policy Conference
Policy Conferenc, FINEX, C A
Trng/Educ/Research
Short-Term Training
Agenda Identified
Classes Organized
Sessions Held
Agenda Modified
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Agenda Modified
Agenda Modified, FINEX, A, A
Sessions Held
Sessions Held, FINEX, I, A
L-T Curric Dev Grant
Devel of Proposals
Proposal Review
Subgrantee Selection
Curric. Dev.
Policy Research Grants
Investor Info. Serv.
Contractor Specs
RFP Issued
Contractor Selected
System Study
IFB for Commodities
Supplier Selected
Commodities Del/Inst

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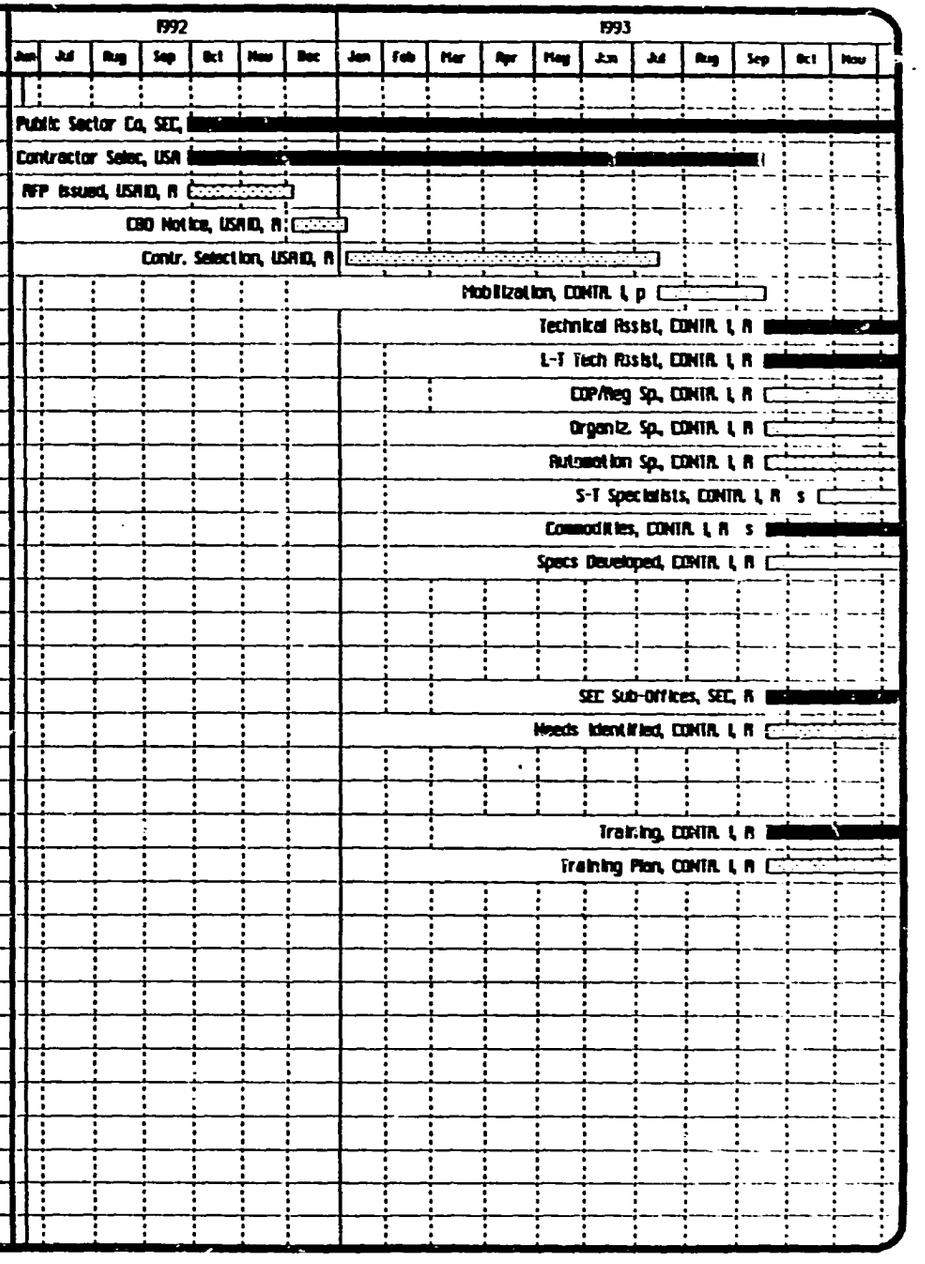
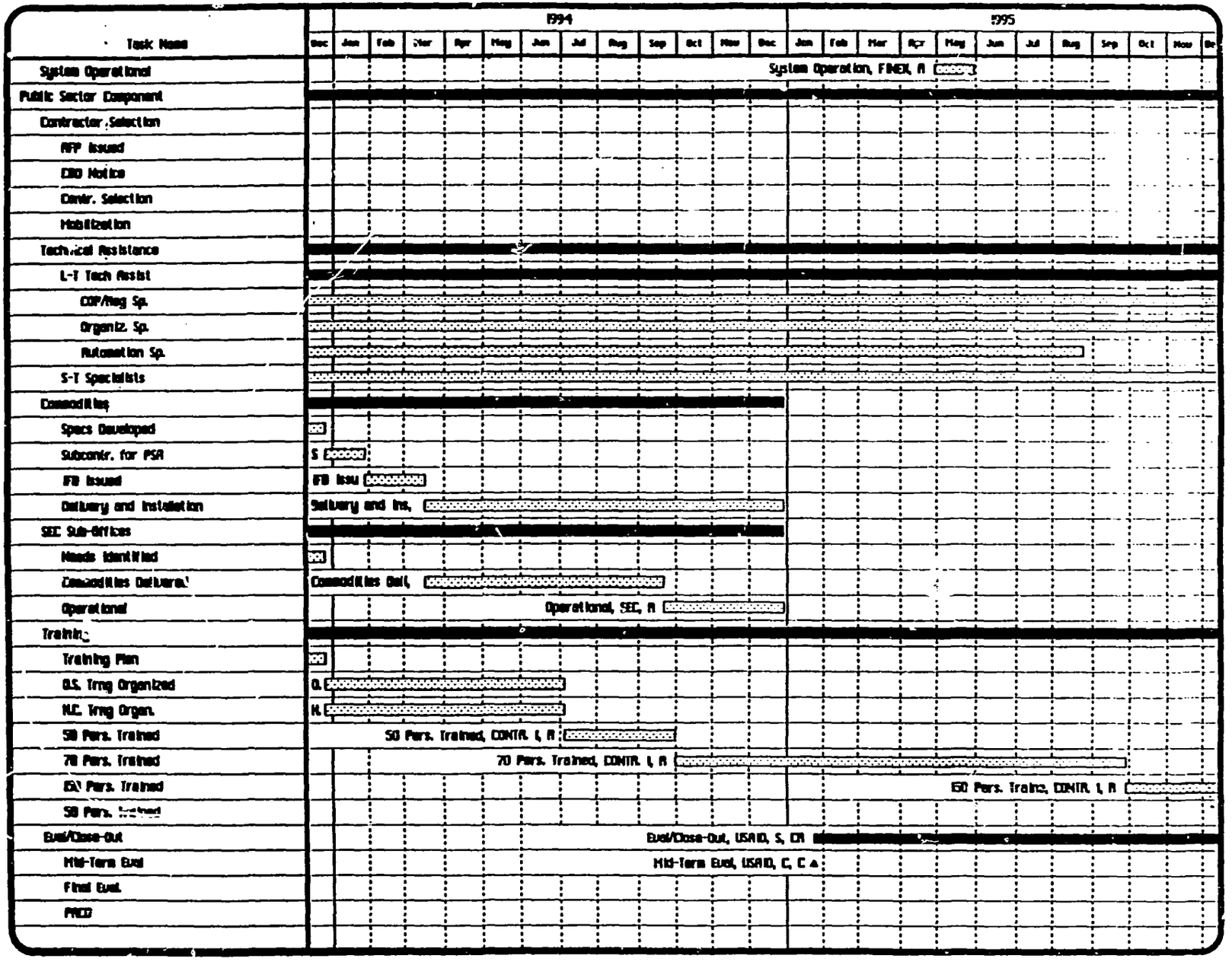
Task Name	Resources	Status
System Operational	FINEX	A
Public Sector Component	SEC	CR s
Contractor Selection	USAID	A s
RFP Issued	USAID	A
CBD Notice	USAID	A
Contr. Selection	USAID	A
Mobilization	CONTR. I	p
Technical Assistance	CONTR. I	A
L-T Tech Assist	CONTR. I	A
COP/Reg Sp.	CONTR. I	A
Organiz. Sp.	CONTR. I	A
Automation Sp.	CONTR. I	A
S-T Specialists	CONTR. I	A s
Commodities	CONTR. I, SEC	A s
Specs Developed	CONTR. I, SEC	A
Subcontr. for PSA	CONTR. I	A
IFB Issued	PSA	
Delivery and Installation	PSA, CONTR. I, SEC	A
SEC Sub-Offices	SEC	A
Needs Identified	CONTR. I, SEC	A
Commodities Delivered	PSA, CONTR. I	A
Operational	SEC	A
Training	CONTR. I	A
Training Plan	CONTR. I, SEC, USAID	A
O.S. Trng Organized	CONTR. I	A
N.C. Trng Organ.	CONTR. I	A
50 Pers. Trained	CONTR. I, Instit.	A
70 Pers. Trained	CONTR. I, Instit.	A
150 Pers. Trained	CONTR. I, Instit.	A
50 Pers. Trained	CONTR. I, Instit.	A
Eval/Close-Out	USAID, SEC	CR
Mid-Term Eval	USAID, Contr. 6	C
Final Eval.	Contr. 7	C
PACD	USAID	C

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Task Name
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System Operational
System Operation, FINEX, A
Public Sector Component
Contractor Selection
RFP Issued
CBD Notice
Contr. Selection
Mobilization
Technical Assistance
L-T Tech Assist
COP/Reg Sp.
Organiz. Sp.
Automation Sp.
S-T Specialists
Commodities
Specs Developed
Subcontr. for PSA
IFB Issued
Delivery and Installation
Delivery and Ins.
SEC Sub-Offices
Needs Identified
Commodities Delivered
Commodities Del.
Operational
Operational, SEC, A
Training
Training Plan
O.S. Trng Organized
N.C. Trng Organ.
50 Pers. Trained
50 Pers. Trained, CONTR. I, A
70 Pers. Trained
70 Pers. Trained, CONTR. I, A
150 Pers. Trained
150 Pers. Trained, CONTR. I, A
50 Pers. Trained
Eval/Close-Out
Eval/Close-Out, USAID, S, CR
Mid-Term Eval
Mid-Term Eval, USAID, C, C
Final Eval.
PACD

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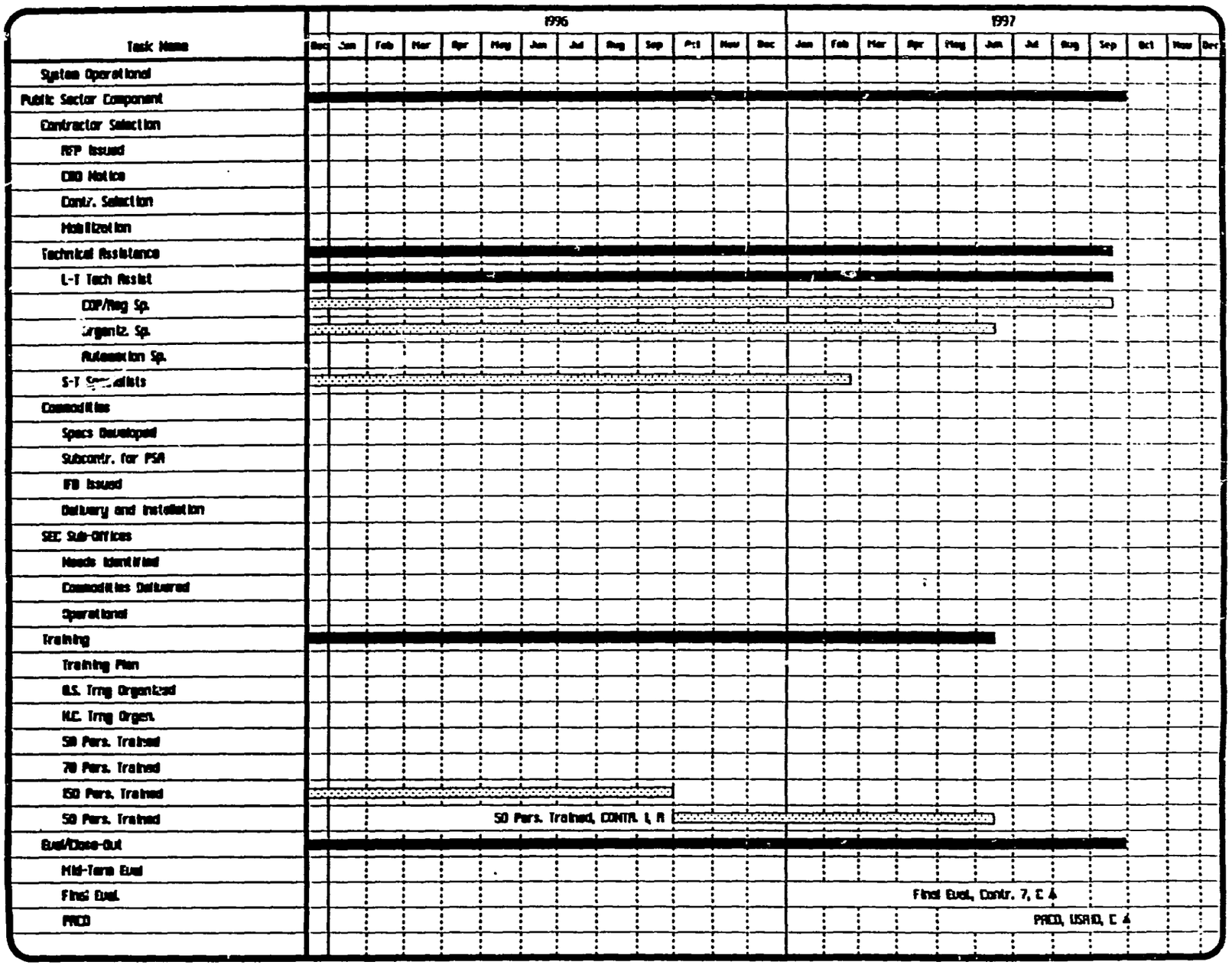
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Task Name
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System Operational
Public Sector Component
Contractor Selection
RFP Issued
CBD Notice
Contr. Selection
Mobilization
Technical Assistance
L-T Tech Assist
COP/Reg Sp.
Organiz. Sp.
Automation Sp.
S-T Specialists
Commodities
Specs Developed
Subcontr. for PSA
IFB Issued
Delivery and Installation
SEC Sub-Offices
Needs Identified
Commodities Delivered
Operational
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Training Plan
U.S. Trng Organized
H.C. Trng Organ.
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70 Pers. Trained
150 Pers. Trained
50 Pers. Trained
50 Pers. Trained, CONTR. 1, R
Eval/Close-Out
Mid-Term Eval
Final Eval.
Final Eval., Contr. 7, C 4
PRCD
PRCD, USAID, C 4

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IMPLEMENTATION SCHEDULE

ACTION	DATE	AGENCY
1. Project Design		
a. PP Authorized	August 92	USAID
b. PROAG Signed	September 92	USAID/ NEDA/SEC
c. Assistance Agreement Signed	September 92	USAID/ FINEX
2. Meeting Conditions Precedent		
a. Standard CPs	November 92	NEDA
b. Detailed Automation Plan	February 93	SEC
c. Training Plan	February 93	SEC
d. Creation of EDP Office	February 93	SEC
e. SEC Implementation Team	February 93	SEC
3. Contracting		
SEC General Contractor		
a. CBD Notice	December 92	AID
b. RFP Issued	January 93	AID
c. Contractor selection	July 93	AID
d. Mobilization	September 93	Contractor
4. Project Implementation - FINEX Component		
a. Project Advisory Group named	November 92	FINEX/ USAID
b. Project Staff Positions Advertised	November 92	FINEX/ USAID
c. Selection of Project Staff	January 93	FINEX
d. Advisory Group and Project Staff Meet	January 93	FINEX/ Advsry Group/ USAID

ACTION	DATE	AGENCY
5. Automation of Exchanges - FINEX		
a. Preliminary Design Work Contracted	December 92	FINEX
b. Work completed	February 93	FINEX
c. Advisory Group Assessment of Design	February 93	FINEX/ Adv Grp
d. RFP to establish Automated Exchange Corporation	February 93	FINEX
e. Final Design Work Commences	March 93	Contractor
f. Firm selected (ref. 5.d, above)	June 93	FINEX/ adv Grp
g. Advisory Group approval of design	July 93	Advisory Group
h. Design Completed	August 93	Contractor
i. Equity Investors Identified	March 94	Contractor FINEX
j. System Procurement begins	March 94	FINEX/ Contractor
k. New System in place	April 95	FINEX
6. Policy Reform Element - FINEX		
a. Advisory Group defines initial agenda	January 93	FINEX
b. Policy Analyses initiated	February 93	Contractor
c. Holding of joint Priv-Public Sector Conferences	September 93	Contractor
Year 2		
d. New Policy Agenda Developed	December 93	FINEX/ Adv Grp
e. Policy Analyses initiated	February 94	Contractor
f. Joint policy conference	August 94	Contractor
Year 3		
g. New Policy Agenda developed	December 94	FINEX/

		Adv Grp
h. Policy analyses initiated	February 94	Contractor
i. Joint Policy Conference	August 95	Contractor
Year 4		
j. New Policy Agenda developed	December 95	FINEX/ Adv Grp
k. Policy analyses initiated	February 96	Contractor
l. Joint Policy Conference	September 96	Contractor
Year 5		
m. New Policy Agenda developed	December 96	FINEX/ Adv Grp
n. Policy analyses initiated	February 97	Contractor
o. Joint Policy Conference	September 97	Contractor

7. Training/Education/Research - FINEX

a. Short-term (S.T.)training agenda identified	December 93	FINEX /Advisory Group/ Contr
b. Sub-Grant to University for long-term curriculum development	July 94-Aug 95	FINEX
c. Award of Policy Research Grant	March 94	FINEX/ Adv Grp
d. S.T. classes organized	May 94	FINEX/ Contract
e. Training Sessions held	May-Sept 94	FINEX/ Instns
Year 3		
f. Award of Policy Research grants	October 94	FINEX/ Adv Grp
g. S.T. training agenda modified	October 94	FINEX/ Adv Grp
h. S.T. classes organized and held	December 94-September 95	FINEX/ Instns
Year 4		
i. Award of Policy Research grants	July 95	FINEX/ Adv Grp
j. S.T. Training agenda modified	October 95	FINEX/

		Adv Grp
k. S.T. classes organized and held	December 95-September 96	FINEX/ Instns
<u>Year 5</u>		
l. Award of Policy Research grants	July 96	FINEX/ Adv Grp
m. S.T. Training agenda modified	October 96	FINEX/ Adv Grp
n. S.T. classes organized and held	December 96-September 97	FINEX/ Instns

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ACTION	DATE	AGENCY
8. Investor Information Services - FINEX		
a. Specifications for design contractor developed	April 93	FINEX/ Contractor
b. RFP for contractor	May 94	FINEX Contractor
c. Selected contractor completes system and software development study	January 94	Contractor
d. Concurrence of Advisory Group	February 94	Adv Grp
e. IFB for Commodities	June 94	FINEX
f. Suppliers selected	September 94	FINEX/ Adv Grp
g. Commodities delivered and installed	April 95	Contr/ FINEX
h. Investor Information Service System operational	May 95	FINEX
9. Public Sector Component - SEC		
a. Long-Term Technical Assistance to SEC	September 93-September 97	Contractor
(1) COP/Capital Markets Regulations	Sept 93-Sept 97	Contr
(2) Organizational Specialists	Sept 93-Jun 97	Contractor
(3) Automation Expert	Sept 93-Aug 95	Contractor
b. S.T. Specialists	Oct 93-Feb 97	Subcontr
c. SEC Satellite Offices fully operational	December 94	SEC/ Contractor
10. Commodities		
a. Commodity specifications developed	December 93	Contr/ SEC
b. Subcontract to 8-A firm firm for PSA services	January 94	Contractor
c. IFB for Commodities issued	March 94	PSA
d. Commodities delivered and installed within SEC & satellite offices	December 94	PSA/ Contactor/ SEC

11. Training

a. Project Training Plan Developed	December 93	Contr/SEC/ USAID
b. Overseas Training (including study tours) arranged	July 94	Contr/ SEC
c. S.T. in-country training organized	July 94	Contractor

ACTION	DATE	AGENCY
Year 2		
d. 50 persons trained	September 94	Contr/ Instns
Year 3		
e. 70 additional persons trained	September 95	Instns
Year 4		
f. 150 additional persons trained	September 96	Contr/ Instns
Year 5		
g. 50 additional persons trained	June 97	Contr/ Instns
12. Evaluation/Close Out		
a. Mid-Term Evaluation	January 95	USAID/ Contr
b. Final Evaluation	August 97	USAID/ Contractor
c. PACD	September 97	USAID/ /SEC/ Contractor

Annex M

JUSTIFICATION FOR NON COMPETITIVE SELECTION OF FINEX AS PROJECT IMPLEMENTOR

OPTIONAL FORM NO. 10
MAY 1962 EDITION
GSA GEN. REG. NO. 27

UNITED STATES GOVERNMENT

Memorandum

TO : Mr. S. D. Heishman
Chief, CSO

DATE: August 24, 1992

FROM : Bruno Cornelio
Chief, PESO

SUBJECT : Justification for an Assistance Award Under Other Than Full and Open Competition and Non-Competitive Assistance

REFERENCE : Cooperative Agreement for the Private Sector Component-Capital Markets Development Project (CMDP)

This is to justify the selection of the Financial Executives Institute of the Philippines (FINEX) as the recipient of an assistance award for implementation of the Private Sector Component of the Capital Markets Development Project (CMDP). The total estimated value of this assistance agreement is $5.75 million.

Discussion: The goal of the CMDP is to enhance the operational capacity of the capital markets so that an increase in the number and types of equity and debt securities becomes available to investors, thereby attracting additional investments and contributing to overall economic growth. The project purpose is to enhance the efficiency of the securities market by improving the quality and transparency of investor information available to capital market participants.

The approach of the project is to work primarily with the Philippines' private financial sector and, secondarily with public sector regulator agencies (through the Securities and Exchange Commission) in implementing specific project activities. The use of a private sector-led effort to evolve the market in partnership with public sector reform actions as innovative mechanisms for development will be stressed.

After careful consideration, USAID in collaboration with the GOP (through the Securities and Exchange Commission) determined that the private sector component activities would be best delivered through a Cooperative Agreement between USAID and a private Filipino entity which would serve as project implementor for this component. The nature of CMDP is such that the implementor will administer and make available project assistance directly and/or indirectly to other private sector parties and business groups, through sub-grants on a cost-sharing basis for the amount of $5.75 million, in order to achieve project objectives. Since the bulk of activities center on the transfer of funds to others to accomplish an economic purpose rather than fees for services, and

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since the level of success and therefore, the exact outputs of our assistance cannot be fully known nor predicted in advance, a contractual arrangement would not be appropriate.

At the same time, the various components of CMDP are complex and could require modification during the course of project implementation. Since USAID wishes to retain some approval and/or concurrence rights over these potential changes in criteria or policy during the life of the project, substantial involvement by USAID is required. Therefore, a cooperative agreement rather than a grant is appropriate.

It was also determined that the most effective way to achieve results through a cooperative agreement would be with an existing Filipino non-profit non-governmental organization, focused on financial sector reform, and with sufficient management capacity and a proven track record of performance in the private sector.

Justification: In selecting a Project Implementor for the Private Sector component of the Project, the Financial Executives Institute of the Philippines (FINEX) was preferred over other financial sector organizations which had also been considered by USAID, such as the Bankers Association of the Philippines (BAP), and the Investment Houses Association of the Philippines (IHAP). The membership of FINEX covers the entire financial community and is not just confined to specialized activities like banking or investment houses. In fact, the membership of FINEX overlaps with both the BAP and the IHAP.

FINEX, established in January 15, 1968, has over 600 member companies nationwide, and is a leading member of the International Association of Financial Executives Institutes. FINEX is a private sector non-stock, non-profit national organization whose members, include leading financial executives in the present government, the Chief Executive Officers of leading domestic and multinational corporations, senior executives of the major financial institutions in the Philippines, securities brokers/dealers, bankers and investment bankers, insurance companies, etc., both local and international. Under the umbrella of FINEX are the other key financial sector associations namely: The Bankers Association of the Philippines (BAP), Investment Houses Association of the Philippines (IHAP); Philippine Association of Securities Brokers and Dealers (PASBD); The Philippine Institute of Certified Public Accountants (PICPA); among others.

These members provide their time and efforts to the organization on a voluntary basis. The objectives of FINEX, as described in its charter, are quite compatible with the objectives of the

Project. Their credibility in the entire business community is high. As such, the Capital Markets Development Council, has selected FINEX as Chairman of the Council.

FINEX demonstrated it's commitment to the sectoral development process in 1991, when it took the lead in establishing the Capital Markets Development Council (CMDC), which is a private-public sector collaborative partnership for policy reform and dialogue in the development of the capital markets in the Philippines.

The GOP has likewise recognized the need for private sector leadership of this sectoral reform process, as evidenced in the Capital Market Development Council, which has FINEX as the Council's Chairman Organization, and with the Central Bank and the Securities and Exchange Commission as joint co-chair organizations.

Substantive policy reform activities conducted by FINEX in the past demonstrates organizational familiarity with the policy, regulatory and institutional issues at hand. As such, FINEX has already made a commitment to the areas of development targeted by this project.

Technical assistance, commodities and institution support provided in the project are structured to build on FINEX's base to enlarge their physical presence nationwide in support of advocacy that will lead to policy reforms. The identification and selection of FINEX, as the Private Sector Component Project Implementor, provides a broader appeal to the financial community, whose support and commitment is required for the success of project activities.

This private sector-led approach to financial sector development has been determined as appropriate, timely, cost effective, and sustainable. The approach recognizes and builds on the fact that developing the capital markets is primarily the concern of the business community and empowering the private sector to take the lead responsibility for introducing innovations increases the chances for success. Given the fact that innovations rapidly take place in the financial markets, this implementation strategy is superior to a government sector approach, as the private sector, not being constrained by bureaucracy, would have the flexibility, adaptability and responsiveness required for implementation.

Given the tangible benefits to be derived from the project, the private sector can readily contribute financial expertise and capital resources to project activities,where required. The

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specific cost-sharing and/or leveraging mechanisms for funding of project activities have been developed and tested in previous private enterprise projects in the Philippines. This demonstrates the private sector's willingness to commit and pool resources, focused on achieving mutually beneficial sectoral improvements. The provision of an automated trading system, market information services, policy research, training and education services all with a national outreach, directly benefits private sector users. FINEX will initiate the provision of these services and secure capital resources from other private sector market institutions, which will shoulder a greater part of the costs required for success. This leveraging strategy assures cost-effectiveness and sustainability of the project's outputs.

In the following pages is an excerpt of Annex I: Institutional and Administrative Analysis of the CMDP Project Paper, for your review and reference.

In the opinion of PESO, FINEX clearly has predominant capability within the field of eligible project implementor organizations in the financial sector to implement the Private Sector Component of the Capital Markets Development Project.

Recommendation: That you concur in the determination of the Technical Office(PESO) that: a) FINEX has a predominant capability to implement the proposed Private Sector Component of the Capital Markets development Project based on it's experience and leadership in financial sector reform and development, and it's demonstrated technical competence in the specific areas of project assistance; and, b) That a non-competitive award of the cooperative agreement in the total estimated amount of $5.75 million to FINEX to carry out the proposed activities is fully justified in accordance with the requirements established in paragraph 2B3(b) of Handbook 13.

Concur: SD Heishman

Do not Concur: _____

Date: 8/25/92

Attachment: Institutional and Administrative Analysis

ACTION: AID-3 INFO: AMB DCM AA RA ECON/8

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DE RUEHC #4294 1280432
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TOR: 04:37
CHRG: AID
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USAID/C&R

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E.O. 12356: N/A
TAGS:
SUBJECT: NEW ACTIVITY DESCRIPTION FOR CAPITAL MARKETS DEVELOPMENT PROJECT (492,0447)

1. AA/ASIA APPROVES THE NEW ACTIVITY DESCRIPTION (NAD) FOR THE CAPITAL MARKETS DEVELOPMENT PROJECT (CMDP). THE MISSION DIRECTOR, USAID/PHILIPPINES, HAS AUTHORITY TO APPROVE SUBSEQUENT DOCUMENTS FOR THIS ACTIVITY.

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DUE DATE 5-12-92		

2. WE APPLAUD THE MISSION'S INNOVATIVE APPROACH TO ENGAGING PLAYERS WITH DIVERSE INTERESTS IN ACTIVITIES TO INCREASE INVESTOR CONFIDENCE IN PHILIPPINES CAPITAL MARKETS.

3. ON THE BASIS OF THE BUREAU REVIEW OF THE NAD, WE RECOMMEND THAT YOU CONSIDER THE FOLLOWING IN FINAL PROJECT DESIGN.

A. LINKING CMDP AND MACROECONOMIC POLICY REFORM

-- PROGRESS OF THE GOVERNMENT OF PHILIPPINES (GOP) IN THE AREA OF MACROECONOMIC POLICY REFORMS, PARTICULARLY IN THE FINANCIAL MARKETS SECTOR, WILL IMPACT UPON THE SUCCESS OF CMDP. THE PROJECT PAPER SHOULD CAPTURE THE

RELATIONSHIP BETWEEN MACROECONOMIC POLICY ACTIVITIES (USAID'S AND OTHER DONORS') AND CAPITAL MARKETS DEVELOPMENT. DOCUMENTATION OF LESSSONS LEARNED FROM THIS PROJECT ABOUT THE LINKAGE BETWEEN POLICY CHANGE AND CAPITAL MARKETS DEVELOPMENT CAN INFORM FUTURE DESIGN OF SIMILAR PROJECTS ELSEWHERE IN A.I.D.

B. PRIVATE SECTOR COMPONENT

WE SUPPORT THE PLANNED, FOURYEAR PROJECT LIFE INSTEAD OF THE USUAL FIVE-PLUS YEARS. WE RECOMMEND THAT THE PRIVATE SECTOR COMPONENT BE GIVEN ONLY ONE OR TWO YEARS' TRIAL AND THEN DROPPED IF UNPRODUCTIVE. EITHER THE PRIVATE SECTOR WILL HAVE PICKED UP THE BALL IN THIS TIME, OR SOMETHING IS WRONG. THIS PROJECT APPROACH SHOULD ALSO BE DOCUMENTED IN THE PROJECT PAPER.

4. REQUEST THAT MISSION FORWARD THE INITIAL ENVIRONMENTAL

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JS UNCLASSIFIED STATE 228266

ACTION: AID-5 INFO: [illegible] ECON/E

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E.O. 12356: N/A
TAGS:
SUBJECT: EXPIRATION ON CONGRESSIONAL NOTIFICATION - PHILIPPINES

1. CONGRESSIONAL NOTIFICATON FOR PROJECT 492-0447 CAPITAL MARKETS DEVELOPMENT FOR DOLS 10,000,000(SAI/G) EXPIRED WITHOUT OBJECTION ON JULY 14, 1992.
KANTER
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7-21-92		

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Received in DRM 7/17/92
Time
Clearance/Action Log 782-
Document No. AID/W Due
Applicable to

ACTION TAKEN
Date 7/20 Initials