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Financial Sector-Development Project II

MID-TERM EVALUATION
CAPITAL MARKETS DEVELOPMENT PROJECT
PROJECT NO. 492-0447

PHILIPPINES

FINAL REPORT



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Submitted by:



Peat Marwick LLP
Policy Economics Group

Mid-Term Evaluation

Capital Markets Development Project

Project No. 492-0447

Philippines

Final Report

By KPMG

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ACRONYMS AND ABBREVIATIONS

AA	Arthur Andersen & Co.
AC	Andersen Consulting
ADB	Asian Development Bank
ARSA	Amended Revised Securities Act
BAP	Bankers' Association of the Philippines
BD	Broker-Dealer
CFA	Chartered Financial Analyst
CH	Clearing House
CMDP	Capital Markets Development Project
COP	Chief of Party
DOF	Department of Finance
EO	Extension Office
FINEX	Financial Executives Institute of the Philippines
GOP	Government of the Philippines
IFC	International Finance Corporation
IG	Inspector General
IHAP	Investment Houses Association of the Philippines
IPO	Initial Public Offering
IRA	Individual Retirement Accounts
ISC	International Securities Consultancy
IT	Information Technology
KPMG	KPMG Peat Marwick
OFM	Office of Financial Management-USAID
ORP	Office of Regional Procurement
PACD	Project Assistance Completion Date
PCDI	Philippine Central Depository, Inc.
PESD	Private Enterprise Support Division-USAID
PIC	Project Implementation Committee
PMC	Project Management Committee
PMO	Project Management Organization
PP	Project Paper
PSE	Philippine Stock Exchange
PW	Price Waterhouse
RCBC	Rizal Commercial Bank Corporation
RFP	Request for Proposals
RSA	Revised Securities Act
SAP	Second Annual Plan
SEC	Securities and Exchange Commission of the Philippines
SOW	Scope of Work
SRO	Self-Regulating Organization
TA	Technical Assistance
USAID	U.S. Agency for International Development

EXECUTIVE SUMMARY

A. Project Purpose and Background

This mid-term evaluation of the Capital Markets Development Project (CMDP) is an assessment of the status of Project implementation after more than two years post-authorization. Authorization of the Project occurred on September 29, 1992 and the authorized funding level is \$13.5 million. The Project's technical assistance (TA) contract with Arthur Andersen (AA) was signed on September 30, 1993. The Project assistance completion date is September 30, 1997. The grantees are:

- The Philippine Securities and Exchange Commission (SEC) - Public Sector
- The Financial Executives Institute of the Philippines (FINEX) - Private Sector

The Project goal 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 investment information available to capital market participants through TA, training, policy analysis and reforms, and commodities such as computers and computer software.

B. Evaluation Purpose and Methodology

The purpose of this evaluation is to:

- Determine the effectiveness of the implementation approach generally and on a component-specific basis;
- Assess Project impacts;
- Assess progress toward achievement of purpose-level indicators;
- Determine the adequacy of grantee, contractor and USAID Project management and oversight;
- Assess and document the Project's relative successes or failures to date;
- Make mid-course corrections, when appropriate; and
- Document lessons for the design of future developmental projects for the capital markets in the Philippines and elsewhere.

Methodology:

The methodology involved a review of studies of capital markets in other countries and all substantive reports from the Project, as well as a sample of its managerial and financial reports. The methodology also involved interviews with USAID and the Asian

Development Bank (ADB) staff, the Financial Executives Institute of the Philippines (FINEX) and the Philippine SEC staff in Manila and Cebu, officials of the Department of Finance (DOF), issuers, underwriters, Philippines Stock Exchange (PSE) staff at both the Manila and Makati exchanges, broker-dealers, transfer agents, security depository staff, and staff of the two clearing and settlement banks.

Finally, these methodological efforts were directed towards answering 35 questions provided in the Scope of Work (SOW) for the evaluation. These questions focused on processes, relationships, management of the contract to date, and accomplishments of both the private and public sector components. USAID staff added an additional question, asking the evaluation team to suggest methods for USAID to use to manage the contract in the future, given USAID's continued reduction in staff.

C. Findings

Public Sector Component

Top level staff in both components of the Project are well-qualified and enthusiastic, and they are progressing in a very well organized manner. Numerous accomplishments can be cited for both components. For example, the public sector component, which is aimed at, among other goals, revising the securities registration process and improving the surveillance and enforcement functions of the SEC, has both designed many of the regulations for and obtained widespread staff acceptance of the need for security laws and systems based on the principles of full disclosure and use of self-regulating organizations (SROs) combined with SEC oversight and enforcement. However, the SEC Chairwoman is reportedly opposed to the use of these principles. She appears to prefer to maintain the current system of merit regulation¹, which she personally enforces on (a) the broker-dealer community by, for example, signing each of their licenses at renewal and (b) issuers and underwriters by negotiating the price to be set for new issues. The reported dominance of the Chairwoman, in spite of the recognized mandate for the five commissioners to function in a collegial fashion and make decisions by majority rule, has greatly impeded Project efforts to change the antiquated and weak surveillance, enforcement and corporate disclosure activities of the organization.

¹/ Merit regulation exists when administrators have the power to forbid sale of securities based on their judgement that the investment is unsound due to their perception of (a) excessive risk, (b) too much compensation to promoters or issuers, (c) an excessive price for the shares, or (d) previous illegal or questionable conduct of promoters or issuers.

Notwithstanding the lack of change in SEC procedures, the Project has prepared it for change, and change will occur if the Commission begins to operate "en banc", that is using majority rule. The evaluation team found virtually universal acceptance of the principles of full disclosure, surveillance and enforcement among SEC staff. Moreover, SEC staff have personally helped develop and voluntarily implemented recommendations of all of the Project's Task Forces. For example, approximately 60 SEC staff have frequently worked 8 to 10 hours of weekly overtime to begin reorganizing and combining the SEC's nine separate storerooms for documents and records. Currently, there is one for each Department. They have also approved reorganization of their work flows and their duties to improve SEC efficiency based on their participation in Project Task Forces. Essential to this reorganization is the creation of "work cells". It is alleged that the Chairwoman of the Commission states that the work cells are illegal and continues to prevent the reorganization on that basis, even though all of the other four Commissioners have stated that they believe the work cells to be legal. This evaluation report provides much more detail about these problems within the SEC, but the major point to be made is that the public sector component of the Project has approached its responsibilities in a systematic fashion.

The contractor for the public sector component categorized requirements contained in the Award Contract into specific tasks. Then it created task forces within the SEC and staff to accomplish these tasks. Tasks were grouped into series based on their goal, e.g., securities licensing and monitoring, broker-dealer licensing, market surveillance, records management, and clearing and settlement. The Task Order Closing Reports produced are listed in Annex E. SEC staff and Commissioners are committed to the changes embodied in the Closing Reports.

Private Sector Component

FINEX, the private sector grantee, has organized itself very well to implement its mandate. It has created a Project Management Organization and a well-specified set of committees to accomplish Project related objectives. Accomplishments include:

- Establishment of a training program for the internationally recognized Chartered Financial Analyst (CFA) program. The program will generate significant fee income for FINEX for the foreseeable future.
- Curriculum development for training courses for security salespersons (the equivalent of the US Series 7 license) and broker-dealer office managers (the equivalent of the US Series 24 license for principals). The SEC currently provides both the training and testing for these licenses. Separation of training from testing will remove potential

conflicts of interest among SEC trainers and testers and will have little impact on SEC fee revenue, but it will add significantly to FINEX fee income.

- Provision of both front-end study and equity for the new Philippine Central Depository Incorporated (PCDI). The depository is designed to provide state-of-the-art book entry services for debt and equity securities, and it will begin to operate in July-August, 1995. FINEX will use the \$1 million Challenge grant provided for in the Project to purchase 10 percent of the equity in the depository corporation, which is expected to be very profitable. The Challenge grant will be discussed in more detail subsequently.
- Preparation of internal infrastructure for selection of students for short-term training in-country, in third-countries and in the United States. FINEX has established a budget for this training and has defined selection criteria and identified members of a committee to screen students. It has also prepared lists of acceptable courses in-country and in third-countries. No candidates have yet taken courses, but virtually all preparations are completed.
- Development of a seminar/workshop program in which FINEX will share on a 50-50 basis with its affiliates the cost and profit accruing to any affiliate in the Philippines that conducts seminars/workshops for fees. This program is expected to provide training to potential issuers of securities and to retail investors. No training has occurred to date, but the program is less than one year old and expectations are very positive.
- Participation in the DOF's new Project Management Committee (PMC), which was constituted to ensure effective implementation of the Project.
- Participation on a 50-50 basis with PSE in the funding of a \$150,000 subcontract for a study to specify system requirements for surveillance needed in the PSE to monitor and record unfair trading practices.

Though distinct from the Project, the PSE is closely related to it and has experienced significant progress that impacts the Project. The PSE is particularly important because it would become perhaps the first SRO if the SEC were to implement the SRO market regulation principle.

Though FINEX has made significant progress, systemic problems must be addressed and acceptable solutions to these problems will require changes in practices of powerful interest groups. A point of departure is FINEX's intended use of the Challenge grant to fund its equity investment in the new security depository.

The original grant agreement called for use of the Challenge grant for setting up a corporation to provide "trading, clearing and settlement services". The idea was to challenge the private sector to contribute capital to create a corporation with a mandate to perform these services. The grant is now targeted to be used, however, to fund FINEX's 10 percent equity holding in the PCDI, which is to be the country's book-entry facility. At the same time, Citibank is now structuring a second corporation that will perform clearing and settlement functions to complement the PCDI.

USAID's willingness to consider use of the Challenge grant for the PCDI appears justified to this evaluation team even though (a) the PCDI's mandate is not financially risky and (b) it leaves incomplete a crucial component of clearing and settlement, namely a guarantee fund to preclude systemic risk in the settlement of securities trades. The intended purpose of the Challenge grant is to encourage private investment in clearing and settlements, create "reflows", i.e. cash flow to help insure FINEX's sustainability, and to earn FINEX a seat on PCDI's board of directors. FINEX is now on the board and proformas for the PCDI suggest positive cash flow within three years. Private sector investors consider the PCDI to be a very profitable investment, however, so the Challenge grant was not needed to stimulate its capitalization.

Clearing and Settlement

The "challenge", however, is still to create an acceptable clearing and settlement system. A complete system is essential for a well-functioning securities market. Citibank is designing a clearing and settlement corporation and determining capital or premium requirements for a separate guarantee fund as described below. The evaluation team perceives no barriers to creation of the clearing and settlement corporation. It does, on the other hand, recognize obstacles to establishing the guarantee fund - an absolutely essential element of a clearing and settlement system. A midterm evaluation of a USAID project in Indonesia to develop such a system indicates that the project failed to do so for reasons unexplained in the evaluation. A final report on a similar, but much smaller, project in Kenya also reports project failure to develop a clearing and settlement system. Again, the reasons for failure are unexplained in the evaluation report.

The reason clearing and settlement systems are so difficult to create is the expense of guaranteeing protection against the risk associated with security settlements in developing countries. Clearance and settlement fund adequacy is also impacted by the capital strength of broker-dealers. Hence, implementation of the AA recommendation on net capital is important.

Present broker-dealer allotments for IPOs have negative impacts on issuers, underwriters and investors. The evaluation team recommends that broker-dealers be required to either distribute

their allotment to their customers within a specified period of time or purchase the undistributed allotment with their own capital and without credit. Credit to finance bona fide distributions should not be prohibited.

Interviews also suggest that current work of Citibank's financial advisory contract with PSE will produce the design for a clearing and settlement corporation, but only begin to design a guarantee fund that the corporation is expected to administer. Discussions with Citibank staff indicate that the investment advisor engagement (contract) will deliver two products: (a) specification of the structure and capital requirements of the corporation, together with the methods by which the clearing corporation would manage a settlement guarantee fund, and (b) an assessment of the requirements of a guarantee fund for all PSE products. These deliverables are due by June 12, 1995. The question is whether broker-dealers will find the cost of an adequate guarantee fund prohibitively high.

The evaluation team believes that the success of the clearance and settlement initiative will depend on the willingness of the SEC and the PSE to require an adequately capitalized settlement fund and reduction of systemic broker-dealer risk. The AA consultants are currently addressing in Task Order 45 the clearance and settlement process, and broker-dealer capitalization in other Task Orders.

USAID needs to satisfy itself that Project efforts are sufficient to produce the guarantee fund, a key component of the Philippine capital market structure. The evaluation team believes that a structure is being created to satisfy these goals, but its implementation needs to be insured strategically and in an accelerated manner.

D. Conclusions

1. Public Sector

The major conclusion reached in this evaluation is that the Project is well-designed and is being implemented in a manner that should result in:

- A full disclosure system to replace or supplement the currently used merit regulation system,
- Market regulation systems that are managed by Self-Regulatory Organizations (SROs) such as the PSE with SEC oversight responsibility,
- Effective SEC enforcement, and
- A trading, clearing, settlement and depository system capable of satisfying global standards.

It further appears to the evaluation team that the AA consultants are at work on providing the Philippine capital

market with just such an integrated regulatory system. If allowed to carry their recommendations forward as accepted by the SEC en banc, the Project should be successful.

2. Private Sector

For the private sector, work has progressed to provide:

- A service company to operate an equity and debt market depository,
- An organization is established and operating to promote training, advocacy, research and provide committee support services,
- A series of planned component completion activities which will provide fee revenues for sustainability of the Project outputs after the Project Assistance Completion Date (PACD).

It appears to the evaluation team that the grantee FINEX has established a framework to complete the work, and an expanded well managed project management office will promote sustainability.

E. Recommendations

The evaluation team's recommendations are set forth hereinafter and in Section V. The recommendations are:

1. Implement a full disclosure system ~~completely~~. Both the Private and Public Sectors should realize the necessity of this for a viable debt and equities market and should cooperate fully to achieve this goal. In this regard, the current position of the SEC Chairwoman must be addressed.
2. Reorient FINEX training to focus on creating businesses that create reflows. These businesses include:
 - CFA training,
 - Security sales and office manager training,
 - Issuer and investor workshops/seminars,
 - Evaluation services for mutual funds and other third-party investors, and
 - Evaluation services for debt securities.
3. Create a corporation to use FINEX's reflows when the Project Management Organization (PMO) terminates at the end of the Project. Investors in the PCDI could have first refusal to become stockholders in the corporation. An executive director for the PMO would be easier to recruit if he/she would look forward to becoming president of the corporation. The corporation would own FINEX's share of the PCDI and should receive the reflows generated from that ownership

interest. It would continue to provide training and other services that contribute reflows to the corporation. Such a corporation was specified in the original Project Paper (PP).

4. The AA component of the project should assist with the development of the guarantee fund. The guarantee fund is very important as is set forth in the letter from Keith Williams, Acting Chief Operating Officer of the Depository (See Annex J). Project policy implementation, which can reduce the risk the fund must bear, is just beginning. The AA team should accelerate work on clearance and settlement and net capital requirements with short-term advisors.

The SEC should be encouraged to take a more aggressive role in ensuring that the clearing and settlement funding corporation is adequately capitalized. A sensitivity analysis of alternative net capital requirements for broker-dealers should be part of the planning process for this role. The evaluation team does not believe that any person interviewed had developed a clear understanding of the actual capital requirements of the clearing-guarantee fund or levels of existing broker-dealer risk.

5. Study the broker-dealer allotment system as soon as possible, because it appears to restrict access of new issuers to the PSE and to the capital markets as a whole. Even Petron executives were required to negotiate with the brokers who, at first, wanted their standard allotment of 50 percent of the stock, then reduced their request to 10 percent. Before they conceded for no allotment, they threatened to prevent the listing if their allotment request was not honored.

The Petron offering was for a billion shares and raised approximately \$490 million in equity. A smaller company would not have been excused from the allotment system. The system can raise the price of offerings to the public because the brokers hold inventory in their own accounts until the share price rises, then they sell. It is also unfair to underwriters who are forced to take back stock from offerings that do not sell well.

This will be controversial, but the effort will be worthwhile. The ADB supports revising the current distribution system. The current allocation system results in delayed distribution of securities and provides opportunities for brokers to manipulate the market to gain unfair advantage. A Task Order is recommended as means to begin the required analysis.

6. Authorize a Task Order to make recommendations concerning the issuance of Class A and Class B stock. Class B stock has historically been issued to track foreign investment in

certain industries. The practice originates from a constitutional provision prohibiting foreign investors from owning more than 40 per cent of publicly held companies. Relatively high foreign demand for Class B stock often results in it selling at a premium over Class A stock.

The constitutional provision is not likely to change. Hence, without A and B designation of stock the law could be violated, placing some investors and issuers at risk. At the same time, the price of some securities may be artificially increased due to foreign investor demand even in the face of that risk. A Task Order would be helpful in coming to grips with the issue. Perhaps the SEC should issue tracking guidelines to ensure compliance with the constitutional provision without A and B stock. The Task Order should also study the price implications of removing the A and B classes in the absence of revision of the constitutional provision. Finally, the Task Order might study whether issuers are discouraged from going public if they do not have the ability to issue differential voting stock. This is not a high priority task, but it should be accomplished within the next year.

7. The SEC should release to the public the annual financial statements that corporations are required to make each year. Currently, the Chairwoman of the SEC reportedly has a relationship with the firm CIBI to publish for commercial sale an annual report - "The Philippine 5,000" - which contains extracts of data from the corporate submissions to the SEC. Production of this publication means that for three to twelve weeks after the peak report submission period, the public does not have access to these statements. Internally, it means the SEC cannot control the registry and distribution of these submissions. In addition, USAID's PP specified that FINEX should disseminate SEC public information. As a consequence, this possibility should be carefully reviewed.

PREFACE

Thanks are due to all individuals who met and provided information to the Evaluation Team. These individuals are listed in Annex A. Without their willingness to meet with Team members, sometimes on very short notice, and without their candid and thoughtful responses to the Team's inquiries, this report would not be possible.

Thanks are especially due to secretarial and support staff at USAID, FINEX and Arthur Andersen. Brad Wallach deserves special recognition for providing both a well-defined scope of work for the Evaluation Team and on-site assistance with logistics and clarification of evaluation issues.

Special thanks are also extended to the SEC Commissioners, who each met with the evaluation Team for extended discussions, and to the President and members of the Philippine Stock Exchange for their detailed description of their operations and future plans.

We thank the contractor, Arthur Andersen & Co., and the Grantee, FINEX Foundation, Inc., for providing extensive support documentation that enabled the Team to complete its tasks.

I. INTRODUCTION

A. Overview

This mid-term evaluation of the Capital Markets Development Project (CMDP) is intended to assess the status of Project implementation after more than two years post-authorization. Authorization of the Project occurred on September 29, 1992, and the authorized funding level is \$13.5 million.

The PACD is September 30, 1997. The Project has two components: a Public Sector Component and a Private Sector Component, each of which addresses an issue that is not being adequately met by existing programs and institutions. Grants are provided to finance each component. The grantees are:

- The Philippine Securities and Exchange Commission (SEC)
- The Financial Executives Institute of the Philippines (FINEX)

1. General Description²

The Project goal 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 investment information available to capital markets participants through TA, training, policy analysis, reforms, and commodities. The Project is intended to accomplish its goals and purposes through the Public and Private Sector Components.

The CMDP is a Project which is critical to the Philippine economy. The Philippines has significant unrealized potential for corporate and municipal financing. The Philippine capital markets do not contain an effective market-driven regulatory system. Without it they cannot sufficiently attract investors to provide debt and equity financing for economic growth.

2. The Public Sector

The USAID Project is a major effort to overhaul the regulatory structure of the Philippine capital market. It is designed to attract domestic and global investors, including

²/ This description is taken from both the Statement of Work for this evaluation and the Project Grant Agreement Between the Republic of the Philippines and the United States of America for the Capital Markets Development Project, September 29, 1992.

the investors and issuers in the multi-island provinces of the Philippines.

The intention is to require registration of securities and periodic reporting of material information and accounting data. These data will permit the market to price securities efficiently. This disclosure system will replace the current price-fixing, merit regulatory system. Furthermore, the disclosure system will be backed-up by:

- SEC enforcement capability, and
- Standards that proscribe fraudulent statements to investors, insider trading and both underwriter and broker-dealer abuse. Trading of securities in the secondary market will be subject to PSE regulation. The PSE is to be constituted as an SRO with the authority to monitor trading to prevent abuse and to require brokers to adhere to high standards when dealing with investors under pain of enforcement action by the PSE and the SEC. The SEC will have important public oversight responsibilities over the PSE-SRO.

The Project is particularly important because the Philippine equity and debt market will not grow unless investors are assured that they are investing in a market that has integrity. Such a market depends on an adequate disclosure system, a clearing and settlement process free of undue risk, and a regulatory system's willingness to enforce statutory and regulatory prescriptions.

This is a critical juncture for the Project. The evaluation team has interviewed numerous informed individuals and reviewed many documents. The universal view is that the Project is of essential value to the Philippine economy. It is also the prevailing view that the Chairwoman of the SEC does not share the basic goals of the Project and, in preventing the Commission from acting en banc, greatly retards the realization of Project objectives. The evaluation team was told that the DOF is reviewing the Chairwoman's current practice of exercising authority alone rather than as a member of the Commission en banc, and that the DOF position is that authority to make decisions is lodged in the Commission en banc. The DOF has not publicly taken a position on this issue, and may not since it is said to prefer that the SEC resolve its differences internally.

If the Project does not go forward, the effect on the Philippine capital market, and consequently on the economy, will be adverse. Lack of Project success would retard capital development and minimize the volume of securities available for trading in the capital market. Completion of the clearing, settlement and depository systems as well as

regulatory policies for both the SEC and PSE should ensure a safe and efficient market for all investors.

3. Private Sector

The Private Sector Component's activities are designed to produce outputs for the capital markets. The challenge grant, for example, is used to help establish an automated PCDI that connects the operations of securities markets to the regulatory framework facilitating disclosure and self regulation.

The TA activities, such as the depository, permit other participants to migrate to new automated systems. We emphasize that there is no off-the-shelf software and hardware package that provides a complete automated trading, clearing and settlement environment. The Project provided a depository platform, the equity securities market provided the trading platform, and the private sector banks will establish the clearing and settlement function. All of these activities enhance the qualities of the trading, clearing and settlement system and consequently the efficiency of the Philippine capital market. The challenge grant is designed to encourage the private sector to fund the capital requirements of the PCDI. The private sector will move from the current system to a totally automated clearing and settlement environment.

The additional funding designated for institution building allows the project components of Policy, Research and Advocacy and Training, Education and Research to inform the public, issuers and investors, of capital market issues and activities. This information is disseminated through seminars, training programs, conferences and committees.

The private sector is the net beneficiary of the project activities in the Philippine securities market, since issuers will be active if the systems help raise capital. Investors will be served if the markets operate efficiently.

At the completion of the Project the following major targets are expected to be achieved:

- An integrated and automated trading market operations system, owned and operated by the PSE, providing real-time trade reporting that will (a) link the unified stock exchange and the SEC into one network, and (b) improve access to the latest and most accurate information, thereby promoting efficiency in a transparent environment.
- Changes in SEC policies and regulations resulting in increased efficiencies by curtailing merit regulation by the

SEC, whereby the SEC may set the price of a securities offering, and in its place establishing a market-driven, full-disclosure system, administered by the PSE as an SRO and the SEC.

- Self-sustaining, private sector-run policy research, training and education programs that support capital markets, and require brokerage salespersons and their supervisors to pass written examinations.
- Changes in the private sector that result in self-regulation, backed-up by the SEC requiring broker-dealer licensing and adherence to standards of fair dealing and an automated market surveillance system capable of ferreting-out fraud.
- A clearance, settlement and depository system that will immobilize equity and debt securities. It will meet global standards for delivery of securities upon payment, thus eliminating systemic risk in the present system which has experienced unacceptable levels of delayed deliveries. It will further accommodate new products including options, warrants, swaps and convertible bonds.

B. Private Sector Component

Inefficiencies in trading, clearing and settlement procedures, and the concurrent lack of transparency in price and information dissemination, are retarding development and international acceptance of the Philippine capital market. A primary purpose of the private sector component of the Project is to supplement the new electronic trading system with a modern efficient clearing, settlement and depository environment. This component is also developing the institutional capabilities of a non-governmental organization, FINEX, to promote capital markets through training programs, policy development, and advocacy for the private and public sectors.

The Project makes funds available for TA to examine the various options and help put in place a fully automated trading, clearing and settlement system. This system is intended to be multi-owner and self-sustaining. It is also expected to operate on a nationwide basis and to provide on-line, real-time access to users. It is anticipated that such information access arrangements will be made with the private sector, utilizing the PSE, the automated market operations system, and other sources. Information obtained will be transformed and made available to users through network linkages with the central database.

Funding should be provided for training private sector participants to use the new automated system, securities marketing, and other relevant areas of capital markets development. Short-term training

courses held in the Philippines, the United States, or in third countries may be funded.

Educational development in capital markets subjects is also supported under this component through funding for research, development and implementation of a curriculum to be offered at a leading Philippine university for degree and non-degree courses on capital markets-related subjects.

C. Public Sector Component

This component of the Project is intended to enhance the institutional capacity of the SEC to regulate the securities industry. The goal is to provide appropriate investor protection and promote fairness and efficiency. A team of local and expatriate consultants, on both a short- and long-term basis, is assisting the SEC in the areas of capital markets regulation, automation, and professional and organizational development.

The Project includes funding for selected commodities, to be determined by the SEC based on the consultants' studies. It is anticipated that such commodities will be largely automation and data telecommunications equipment for the SEC and its extension offices (EOs). This equipment is expected to enhance market surveillance by the SEC. Commodities will include a host production computer system, user work stations, system software, and communications networks within the SEC Head Office and between the Head Office and EOs to support all major SEC requirements for automated records and information systems, including surveillance and oversight. The SEC began its involvement with the Project with no existing technology base and no data communications other than a small development machine and some freestanding personal computers.

The Project provides funding for TA to support the SEC's efforts in developing an in-house professional education program. Before the program is developed and fully functional, the Project will provide short-term training to upgrade the skills of SEC personnel. This may include U.S., third-country, and in-country training, as well as study tours of market operations in other Asian countries, such as Thailand and Indonesia.

II. METHODOLOGY

The evaluation team of four professionals conducted on-site interviews in Manila and Cebu and reviewed Project-generated documents. Numerous interviews were conducted with staff in the USAID, contractor firms, and in the FINEX and SEC organizations. In addition, interviews were conducted with:

- All five commissioners of the SEC, including the Chairwoman;
- Senior staff of the SEC;

- Government officials in the DOF;
- Capital markets staff at the ADB who are responsible for studies that were used to help design this Project, and who maintain a close relationship with Project staff on this Project;
- Issuers;
- Investment banks which serve issuers;
- Broker-dealers;
- Exchange staff of the Philippine Stock Exchange (PSE) at both floors, that is, the Tektite (Manila) and Makati floors;
- Securities depository staff;
- Clearing and settlement staff in clearing banks; and
- Transfer agents.

The team also reviewed studies of capital markets in other developing countries as part of its assignment to compare this project in the Philippines with those underway or recently completed in other developing countries. Countries for which studies were reviewed include:

- Sri Lanka
- Kenya
- Indonesia

The evaluation team's inquiry was directed towards answering 35 questions provided in the SOW for the evaluation. These questions focused on processes, relationships, and management of the contract to date, as well as accomplishments of both components. USAID staff added an additional question asking the evaluation team to suggest methods for USAID to use to manage the contract in the future, given its continued reduction in staff.

The team consisted of:

Dr. Allen LeBel

Team leader, Ph.D. Economist, Director of Research for two Securities Firms, one dealing in stocks and bonds and the other an introducing Broker for Commodity Futures. Past team member on numerous donor efforts to privatize state-owned enterprises and state-controlled commodity markets.

Hon. Charles L. Marinaccio

Attorney with 33 years of high level legal experience in courtroom, regulatory and legislative proceedings. Former Commissioner of the U.S. Securities and Exchange Commission (SEC). Former partner in a New York law firm. Currently a Presidentially appointed member of

the Board of Directors of The Securities Investor Protection Corporation.

W. Dennis Grubb

Broker, former Director of the Merchant Bank of Sri Lanka, a USAID project representing the Shareholders of Citicorp Investment Bank (Singapore) Ltd. and the Asian Development Bank. Commercial Loan Officer and Director of Marketing for U.S. and International Securities Firms.

Joseph R. Schenk

Managed Trading Clearing and Settlement Operations for New York and regional Stock Exchanges in the U.S. for Merrill Lynch as Vice-President, Senior Reengineering Manager and Operations Manager.

III. FINDINGS

A. Summary of Progress with Structural/Functional System to be Created

USAID signed Cooperative Agreement No. AID 492-0447-A-00-3055-00 with FINEX Research and Development Foundation, Inc. for the "Private Sector Component of the USAID/Philippines CMDP (492-0447)" on May 14, 1993. Later, on September 29, 1993, it signed a contract with Arthur Andersen & Co. (AA) to provide technical services for the improvement of the "Public Sector Component of the Capital Markets Development Project". The AA contract ends September 30, 1996, while the grant agreement to FINEX ends exactly one year later, September 30, 1997.

The evaluation team quite naturally finds both contracts partially completed. Charts are used in this report to characterize some of the more detailed progress made, such as the numerous reports completed by the AA team (see Annexes B and F). Reference to the Central Depository and other infrastructure and procedures will be used to describe the progress that FINEX has made to date. Almost 40 questions contained in the subsequent Section III.D. address process, management and administrative aspects of the two components of the Project. Four of these questions address accomplishments/shortcomings of the Project, lessons, possible need to continue the Project, and recommended management practices for USAID to use from June 1995 to the end of the Project.

In general, the evaluation team concludes that substantial progress is being made on both the Public and Private Sector Components, but 1995 is a critical year for implementation of

changes in policy. Without full implementation of the recommended changes in the Public and Private Sectors, the evaluation team doubts that the USAID Project will have the intended effect of creating a capital market in the Philippines that can generate investments at home and from abroad to finance economic expansion. The evaluation team finds that the most significant obstacle to full implementation is the unwillingness of the Chairwoman of the SEC to embrace Project objectives.

Full implementation of all the Public and Private Sector Components is needed as a package. Each part of the package is essential to the efficiency of the whole. For example, full disclosure in place of merit regulation can only work if the SEC puts in place the regulations for a disclosure system, and then is rigorous in penalizing fraud. And the disclosure system will ultimately not generate capital investment unless investors are satisfied that securities trading on the PSE is conducted with integrity, which in turn depends on SRO enforcement and SEC oversight; and investors must be assured of timely delivery of securities that they purchase.

B. Progress in the Public Sector Component

The Public Sector Component has made substantial progress in fulfilling the goals and purposes of the Project, and the AA team has been a key participant in this process.

1. Amended Revised Securities Act (ARSA)

A substantial amount of effort has gone into preparing draft amendments to the Revised Securities Act (RSA). Comprehensive changes in the Philippine securities laws are recommended. The SEC has published the Amended RSA (ARSA) for comment. Hopefully, in due course, the ARSA will be enacted by Congress. The changes substantially alter governing law in the following respects:

a. Disclosure

Eliminates merit regulation practices under which the SEC sets the price for public offerings, requires that prospectuses be given to investors purchasing securities pursuant to an offering or distribution, and modernizes procedures for securities registration and periodic reporting based upon full disclosure.

b. Accounting

Requires issuing companies to comply with internationally accepted accounting standards and requires issuers to keep accurate books and records.

c. Accuracy of Securities Registration Statements

Provides that securities registration statements must be filed by issuers who are responsible together with their underwriters, attorneys, and accountants for the disclosures made therein, and prohibits false statements in securities registration documents and provides civil liability for offending companies.

d. Underwriter Due Diligence

Requires underwriters to ensure that securities registration statements are free from material misstatements.

e. Insider and other Fraudulent Trading

Specifically, proscribes schemes to defraud investors, and with respect to insider information, requires disclosure or trading abstention.

f. Broker-Dealers

Requires registration of broker-dealers, and requires salespersons and supervisors to pass written examinations.

g. Industry Self-Regulation

Provides a statutory framework for an organization to register with the SEC as a self-regulatory organization (SRO) subject to SEC oversight. This legislative change will provide a statutory framework to define a disclosure-based and self-regulated Philippine securities market.

h. Corporation Code

Provides for non-member directors on PSE and other SROs.

i. Investment Houses

Requires underwriters to be registered as broker-dealers.

j. SEC Organization

Empowers the SEC to change its organizational structure. Market efficiency is reduced by the SEC's current price setting practices for securities offerings. Under ARSA, the SEC will retain sufficient authority to prevent fraudulent securities offerings from coming to market; however, it will not exercise price control. Market efficiency will determine the price of shares.

The ARSA does not deal directly, however, with distribution practices for securities that brokers currently acquire as principals for themselves and their favored customers. This system presently permits too many opportunities for fraudulent manipulations such as front-running (trading before customers) and withholding, and consequently it cannot be permitted to continue. In addition, the AA advisors have provided amendments to the Investment Company Act that will facilitate the establishment of mutual funds.

2. Proposed Program for Corporation Finance and Market Regulation

The proposed creation of a program to consolidate staff functions relating to Corporation Finance and Market Regulation is crucial to the fulfillment of the goals of the USAID Project. At the present time, disclosure, stock exchange and broker-dealer oversight are ineffective and poorly organized at the SEC. If the SEC is to achieve its goal as a market oriented disclosure agency overseeing an effective Self-Regulatory Organization (SRO), its organizational structure needs to undergo significant change.

The Chairwoman of the SEC opposes restructuring, as is more specifically analyzed hereinafter.

3. Accounting and Enforcement

For the year 1995, it is proposed in the Second Annual Plan (SAP) to follow-up the legislative authority granted in the ARSA to provide an effective accounting and enforcement regime at the SEC. No less than nine Task Orders are projected on accounting and enforcement for 1995. Actions to be specified range from draft rules and procedures to implementation of training projects.

It cannot be overemphasized how important accounting prescriptions are to the financial statements included in material information provided to investors under the full disclosure system. To date, the SEC has not strongly enforced prohibitions against insider trading and other abuses. This must change if the Philippine market is to fulfill its promise of capital formation in the economy.

4. Market Surveillance

For the year 1995, it is proposed to have in place SEC regulations that will enable the SEC to adequately oversee the automated market surveillance system of the PSE and to be connected real-time with the PSE through a computer hook-up.

5. Documents Management and Training

Substantial progress has already been made on centralizing and rationalizing the SEC documents management system.

6. Training

Significant progress has been made in training SEC personnel for a reengineered SEC.

7. Information Technology

The Project has performed a full assessment of automation needs, including those of the EOs. The assessment began with an identification of automation needs related to activities and workflows within the SEC. Continued discussion within SEC staff built a consensus about needs. Then these needs were translated into specific requirements for hardware.

C. Progress in the Private Sector Component

The Private Sector component is designed so that FINEX can provide sub-grants to improve the stock exchange and other securities related institutions.

The Manila and Makati Stock Exchanges were merged by President Ramos in April 1994, to become the PSE. The PSE is fully automated, and it has established rules for regulating itself and its 187 broker-dealers. The extent to which the PSE can regulate itself is unclear until the RSA is amended. Once amended, the RJA is expected to permit the PSE to be an SRO. In the meantime, the SEC could grant the PSE SRO status, but it has chosen not to.

In the interim, however, the Private Sector Component has made substantial progress toward fulfilling the goals of the USAID Project. The PSE has developed an automated trading system, is moving toward a clearance and settlement system that conforms to the G-30 standards, and has a central depository system due to commence operation in July-August, 1995.

1. PSE Automated Trading System and Market Surveillance

In tandem with the Project's activities, the PSE initiated its own automation activities. The PSE trading system uses the software package, MAK, adopted from the Chicago Stock Exchange in the US. It permits automated trading between brokers and will enable the SEC and the PSE to construct an audit trail of trades sufficient to identify insider trading and other market abuses such as broker "front running" (trading before customers). These accomplishments will form an integral part of the market surveillance system to be adopted by the SEC.

2. PSE as an SRO

The PSE is becoming well-organized to perform its duties as an SRO. The SEC, however, does not yet have the technical capability to oversee the PSE effectively. The Project is responding to this need. For example, the proposed SAP for the Market Regulation Program of the SEC is modeled after the United States SEC Division of Market Regulation. As such, it is likely to provide the SEC with the full capability to oversee the PSE as an SRO. The capability includes the ability to oversee and enforce the amended laws of the ARSA with respect to brokers, and to oversee the market surveillance system of the PSE.

3. Broker-Dealer Regulation, Training and Licensing

Broker-dealer licenses are frequently processed in a manner similar to IPOs. That is, broker-dealers are given licenses by certain individuals within the SEC, rather than by an organizational process that administratively treats all broker-dealers equally. The continuation of this practice limits the progress of Project components involving work flows, document flows and training. Some of the same SEC staff who write the exams that salespersons must pass to be able to work for broker-dealers also reportedly receive compensation for preparing salespersons for these exams. Trainers and exam writers should be two different groups.

The SAP and the work of the PSE should deliver a broker-dealer regulatory system. The Project Implementation Committee (PIC) is proposing to develop the training program for sales and management personnel involved in trading. This will allow the private sector to train students for the SEC exams for security salespersons and principals. At the same time, PSE has hired a consultant from the Mid-West stock exchange to assist with the enhancements to their regulatory and compliance systems. The private and public sectors are coordinating their efforts on broker-dealer regulations, training and testing. Final approval for all regulatory changes must be SEC approved.

4. Clearing, Settlement and Immobilization of Securities

A new central depository is scheduled to become operational in July 1995. The depository may cut settlement time from a "best case" 22 days to four days, but clearing and settlement continue to pose unacceptable financial risk for Philippine financial institutions. The Project's goal is clearing and settlement on "T+3" (settlement three days after trade date), that is, the Group of Thirty standard. "T+4" (settlement in four days) will be accomplished by book-entry via the PCDI eliminating the 18 days currently required for production and

delivery of stock certificates to and from transfer agents. "T+3 can only be reached after the banking system improves the speed of check clearance. The evaluation team is not aware of a target date for this improvement.

The evaluation team was told that the unwillingness of the banking community to accept clearance and settlement risk led to separation of the Depository function from the clearing and settlement function. Banker reluctance to accept clearing and settlement risk was not explained in detail to the evaluation team. Its basis can be inferred, however, from subsequent discussion in this section. The SAP established a working group for clearing and settlement, and it plans to write and implement procedures for the SEC to use to perform its oversight duties.

Citibank currently has a contract with the PSE to structure a corporation for clearing and settlements and to assess the capital/premium requirements for a clearance guarantee fund.

Tentative plans call for the clearance guarantee fund to be administered by the yet-to-be-created Clearing and Settlement Corporation. The guarantee fund is planned to be capitalized by means of self-imposed contributions by all broker-dealer members of the PSE. That is, the PSE would impose the contributions on each of its 187 members, but only after a majority of the members voted in favor of the required contributions. The fund is needed to insure that investor payments made to broker-dealers for securities will not be lost before settlement if a broker-dealer becomes insolvent. Insolvency of any broker-dealer (B-D) would trigger action by the yet-to-be created Clearing and Settlement Corporation to use resources of the clearance guarantee fund to prevent B-D default on pending transactions.

Creation of the guarantee fund is handicapped, however, by certain B-D practices that create profit for B-Ds and risk for both the securities system and the B-Ds. For example, B-Ds are permitted to free ride (own securities without paying for them by settlement date) and to hold securities in their own account without net capital requirements. These highly leveraged activities make B-Ds very vulnerable to failure during times of stressful financial conditions. Moreover, financial stress need not be market-wide for certain B-Ds to fail in the Philippines. Adverse price movement on one initial public offering (IPO) could, for example, cause B-Ds to become insolvent if they were to take their usual allotment of 50 percent of an IPO's shares into their B-D accounts and then could not return them at issue value to the issuer if the IPO's share price declined while they held the shares in their inventory. Nevertheless, the capital appreciation that B-Ds realize on stock positions they control with low capital investments will make them reluctant

to change their very profitable practices. These practices, however, will also add considerably to the capital requirements needed for the guarantee fund, and consequently to the contributions that the B-Ds will be required to make to the fund if they approve of it.

In the currently unregulated environment, B-Ds can conceivably hold stock inventory on five to ten percent margins, margins normally found only in the commodity markets. B-Ds would be classified as speculators, not hedgers in commodity markets, but speculator buy-sell practices in developed commodity markets are structurally different from B-Ds practices in the Philippines. Speculator practices in well-developed commodity markets provide protection against price risk experienced daily in these markets. In the Philippines, the markets lack the liquidity and the brokers lack the daily experience of commodity market volatility. As a consequence they are not at all likely to perform effectively if such volatility were to occur. Yet, their unregulated leverage exposes them to the episodic volatility that is almost certain to occur occasionally in their market.

The AA task force team could perform a sensitivity analysis of the fund's capital or premium cost if certain Project policies were operational now. One example is the SEC's proposed "net capital rule", which is contained in Closing Report B23. This exploratory process should perhaps be conducted with Citibank, which is scheduled to deliver an assessment of possible cost of a guarantee fund by June 12, 1995.

D. Team Response to Evaluation Questions in Scope of Work

- #1. How does the design of the CMDP compare or contrast with USAID or other donor efforts to enhance the efficiency of securities markets in developing countries? Which, if any, features of the CMDP are innovative or unique? Is the Project design appropriate for the achievement of its stated objectives?**

A starting point for examining the CMDP in the Philippines is to compare project components with several other USAID capital market projects. The team reviewed evaluation reports for Indonesia, Kenya, and Sri Lanka. In addition, the ADB, a donor agency working closely with USAID/Manila, is included in the comparison. The matrix is Annex F.

The first common characteristic is that all projects impact the equities securities markets, either through direct assistance to stock markets or through a regulatory agency. An objectively

variable indicator of stock exchange assistance is whether the long term regulatory environment for securities improves the activities of the securities markets and increases use of debt and equity instruments. In Kenya, the project focused on the Capital Markets Authority (CMA), and assistance to the Nairobi Stock Exchange has been via the authority. In Indonesia, the assistance is to BAPEPAM (a public finance and planning agency), and the rule is that all assistance to the stock exchange flows through BAPEPAM. The Sri Lanka project provides assistance to the regulator, the SEC, and directly to the exchange for equipment and TA to support the equipment component, which is a depository system. The ADB assistance in the Philippines is direct to the Government of the Philippines (GOP), in loans. However the ADB provides TA to study the interface with the GOP and its regulatory authority, SEC. The project goals are similar in all four countries, that is to enhance the operational capacity of the capital markets. The outputs reflect the country requirements.

Kenya is the only project which is not the beneficiary of project components creating a platform in any automated system. The other markets, ranked by market capital size, Indonesia, Philippines, and Sri Lanka all require project assistance to deal with clearing and settlement. In Sri Lanka and the Philippines, the creation of automated systems for a securities depository is a project feature.

A counterpart funding feature linked directly to the project exists in the Philippines and Indonesia. In Sri Lanka counterpart funding is accounted for in other USAID assisted projects. The ADB counterpart contribution is measured in GOP reform protocols.

The need for regulatory and policy reform is common to all projects. This includes operations reform in the organization and management of the regulators, as well as amending legislation in the Philippines, Indonesia, Sri Lanka and Kenya. In the Philippines, SEC task orders completed by the contractor have included policy reform, legislative change, information systems, records management, process reform through the work cell concept, and regional office management. A total of 70 Task Orders are planned and 40 were completed at midterm. The Sri Lanka project drafted the new Securities Exchange Commission Act, which amended the authority granted under previous legislation and restructured the formation of the agency. It changed from being a one man commission to a staff and support services unit which handles customer complaints, broker licensing, and compliance. The agency deals only with the capital market activities. The company registry function, under the Companies Act, is handled by the Corporation Registrar Office.

The enhancement of securities markets is also dependent on personnel trained to operate in an electronic environment. The projects all address this component from training data entry operators at the exchange, seminars and workshops on capital

markets and management topics, to restructuring agency organization lines of authority. The emerging markets standards are set by global requirements, as well as by domestic considerations. In Sri Lanka, foreign institutions are active in both the equity and debt markets, and domestic personnel are interacting with modern trading, settlement and clearing procedures and equipment in the global marketplace. The other three countries do not yet have modern clearing settlement systems. None of the countries has a clearing guarantee fund.

In all countries assistance is required to update essentially manual back office operations in the securities markets. All countries participating in global markets aspire to standards taken from the Group of 30 recommendations report of March 1989. The Group steering committee was drawn from the major world markets, and working committees drawn from individuals representing stock exchanges, investors, traders, bankers and regulators. The recommendations are a standard to be achieved. For instance, "T+3" is recommended for settlement, as noted earlier. In Manila, T+4 will exist when the Depository becomes operational in the summer of 1995. The key to approaching "T+3" is automated systems. The project assistance to Sri Lanka included commodity assistance to purchase the stock exchange computers. In Indonesia and Kenya, the projects did not include this component. However in the amended assistance to Indonesia, funds are included to provide TA to help plan a private sector depository system.

In the Philippines, a challenge grant is intended to provide the incentive capital for the private sector to create a service corporation. The remaining capital was subsequently subscribed by the private sector. This could be an example for Indonesia, Kenya and other countries to examine.

All the CMDP projects have significant training programs. In Sri Lanka and the Philippines, the CFA program has been initiated. The program certifies candidates through a three part exam. The CFA designation was developed in the United States financial community. The introduction of the standard in emerging markets is relatively new, but it will grow as the markets require more people in new institutions, such as money managers, banks and securities market-related businesses.

Training is not limited to industry specific institutions, such as licensing stock exchange brokers. In all countries surveyed, it is used for institution building. Each project emphasizes the need for an institution to carry on the enhancement of the securities markets. In the Philippines, the private sector component is designed to receive income from the service company (PCDI) to insure sustainability. The central depository system in Sri Lanka became profitable in the first year. To insure continuity, a fee is charged to market participants, the investors and the brokers separately. The regulatory agencies in all the projects receive

government assistance through appropriations for continuing operations.

The CMDP project in the Philippines has incorporated features not common to the projects surveyed. These are the:

- Mandate to establish a market surveillance system is a joint effort of the private and public sectors,
- Establishment of income flows to the private sector component service companies is intended for financing continuing operations,
- Use of task order methodology in the public sector insures that issues defined in the project design will be individually addressed and work completion plan presented,
- Abundant use of task forces formed in the private and public sector to provide input and consensus building for the project.

In Indonesia, Sri Lanka and Kenya, neither public nor private agencies have availed themselves of task forces and committees to assist the work.

Despite the lack of frequent communication between designers of the country projects, a great deal of similarity exists in the component design of each project. The goal of assistance to enhance securities market efficiency has been achieved in all countries at least to some extent.

The comparison of the Philippine CMDP with other similar projects is summarized in Annex F. The matrix in Annex F indicates that the Philippine CMDP contains the following activities:

- Counterpart funding,
- Comprehensive policy and regulation formulation,
- A Challenge grant,
- An investor information service,
- Private sector training, education and research for the securities markets,
- Creation of profit-making businesses such as the PCDI, training and investor services for private sector foundations,

Reference to Annex F summarizes projects in Indonesia, Kenya and Sri Lanka in terms of 10 design objectives and 12 features. The only feature that all projects have in common is a national orientation. The only feature absent from other projects is a security guarantee fund.

#2. In retrospect, was the selection of FINEX, AA and SEC as Project implementors appropriate? How have FINEX, and the SEC benefitted from the Project?

The Project evaluation team believes that the selection of FINEX, AA and SEC as Project implementors was appropriate, and that both FINEX and the SEC have benefitted from the Project.

Public Sector

The background relating to the Project begins with a Price Waterhouse (PW) study. PW was retained by the Asian Development Bank (ADB) to study the Philippine Capital Market in order to make recommendations to improve and strengthen the market to enhance capital formation and assist in the creation of jobs in the Philippine economy. PW prepared a comprehensive report that made numerous recommendations for strengthening institutionally the Philippine SEC. PW specifically recommended that the SEC replace merit regulation over securities offerings with a market-driven regulatory approach in which investors would make decisions based upon issuer full-disclosure and self-regulation by private sector entities such as the PSE. These measures represented adoption of international standards to assure investors a fair, orderly and efficient market.

In September 1992, USAID issued a PP for the Philippine CMDP. The PP is a comprehensive document setting forth specific parameters of a five-year \$13.5 million Project to enhance the efficiency of the Philippine securities market by improving the quality and transparency of information to capital market participants. The PP envisaged an enhanced PSE able to fulfill a self-regulatory role subject to oversight by the SEC. As an SRO, the PSE would regulate its member B-Ds and improve its trading and post-trading systems. The PP envisaged a modernized Philippine trading, clearing and settlement system, including a depository. That system would bring the Philippine trading markets up to G-30 standards for clearing and settlement in T+3 where delivery and payment for securities would occur simultaneously. The PP sought to reorganize and reform the SEC. It also sought to replace merit regulation of securities offerings with a disclosure-driven market place regime that would encourage public offerings of securities.

USAID held a competitive procurement to select a contractor to assist the SEC in this public sector revitalization. AA and PW were the only contractors that submitted proposals. After review, AA was selected as the contractor. Its strengths were considered to be its experience and its proposed approach to accomplish the goals of the PP.

In "face-to-face" meetings with the SEC and USAID, the AA Chief of Party (COP) was rated much more highly than the PW COP in "critical discussions" concerning technical issues raised by the SEC and USAID. These discussions related to the evaluation criteria set forth in the Request For Proposals (RFP). Moreover, the Committee which reviewed the Best and Final Offers from AA and PW concluded that AA was more responsive than PW to specific and significant

adjustments that USAID requested in the Project structure. Finally, the SEC en banc chose AA as the most qualified offeror.

Upon its selection, AA undertook a comprehensive debriefing of the PW recommendations in relation to its obligations under its award contract and the goals of the PP. AA staff did this in consultation with the ADB and SEC.

In retrospect, the evaluation team believes the selection of AA was a good choice. The personnel AA assigned to the Project clearly had the background to complete the Project, and the methodology they have engaged in to accomplish their task is reasonable. It is designed to identify the capabilities and institutional strengths and needs of the SEC in relation to the goals of the PP and the specific parameters of the Project outlined in the award contract. It resulted in specific recommendations, expressed as annual plans, to move the SEC from a corporation code administrative agency to a full disclosure and effective enforcement driven regulatory agency overseeing the Philippine capital and securities markets.

The PP outlined the organizational constraints that might be encountered at the SEC in bringing the Project to ultimate completion. These constraints included administrative discontinuity and lack of experience in implementing matters covered by the PP. Since the SEC's organizational constraints have manifested themselves during Project implementation, the choice of AA as a third party implementor rather than the SEC as a primary party implementor has been shown to be appropriate. AA has worked closely with Commissioners and staff of the SEC and is recognized as having provided tangible benefits to the SEC. It has prepared the foundation for a substantially enhanced SEC to become a market-driven securities regulator, a goal that is enthusiastically supported by SEC staff and its Commission, with the reported exception of the Chairwoman.

The achievements of the AA to date are substantial. AA found that the internal procedures of the SEC were overlapping, inconsistent and applied on a personal and individual basis by SEC personnel. Under AA guidance, Standard Operating Procedures (SOP), or process workflows, were developed for each SEC unit involved in key programs. This process rationalized procedures in priority areas. AA has drafted amendments to the RSA. This Act provides a foundation for a market driven regulatory structure. AA has revised the Philippine Investment Company Act and has provided recommendations and guidance to the SEC on the full range of issues that must be addressed to reorganize the SEC into a disclosure driven regulatory agency.

The enthusiasm at the SEC to meet the challenges of the future Philippine capital market is in line with the AA technical support regime. The evaluation team believes significant credit should be given to the AA team, to the Commission en banc and to the SEC

staff for continuing to implement the Project step by step in spite of opposition from the SEC Chairwoman.

Private Sector

In retrospect, the selection of FINEX to implement the private sector reforms was appropriate. FINEX was the national financial organization with the broadest scope of interest and experience which fit with the goals and purposes of the Project.

FINEX's membership consists of 700 senior executives of financial institutions, corporate issuers, and potential issuers. At the time of Grantee selection, FINEX already had a functioning capital markets development committee. This committee considered agenda items at its meeting concerning the management of the stock exchanges, securities issuances, securities distribution, and training of its members to enhance their knowledge of capital markets and to be competitive on a global basis.

FINEX was considered to be a better choice than other organizations such as the Bankers' Association of the Philippines (BAP), Investment Houses Association of the Philippines (IHAP), Philippine Association of Securities Brokers and Dealers (PASBD) and Philippine Institute of Certified Public Accountants (PICPA), each of which had a narrow focus on capital markets issues. FINEX, for example, conducted seminars at the regional level in order to enhance the delivery of capital markets information and services to the provinces.

FINEX has benefitted from the Project in that funds supplied through the Project have enabled FINEX to expand its programs to meet the challenge of an invigorated capital market. The incorporation of the PCDI is a direct result of FINEX's TA for automated systems. The substantial USAID funding of this FINEX/FMO activity permitted the engagement of well-qualified consultants to plan, design and implement the delivery of a depository system. In the future, FINEX will receive dividends from the depository which helps insure FINEX's sustainability.

#3. Are the two components of the Project appropriately staffed and managed?

Public Sector

The evaluation team finds that the Public Sector Component is appropriately staffed and managed. AA has provided a COP for the Public Sector Component with the requisite background qualifications to manage the component. The COP coordinates the activities of the Public Sector Component with USAID staff, with the private sector component through the PIC, and with the SEC through the SEC Project Manager, Commissioners and staff. Two long term advisers assist the AA's COP. This well coordinated effort is

implemented through various SEC Task Forces which make efficient use of short-term consultants through SEC approved Task Orders. They work on organizational, human resources and technology improvements. The staffing and management of this component are sufficient to achieve the USAID Project goals, but the Commission of the SEC must operate en banc or the Chairwoman is likely to seriously or fully constrain progress.

Private Sector

The Private Sector is represented by a group of high-level executives who form the PIC. They include the President of FINEX and PIC Chairman, the President of the PSE, the Chairman of Union Bank representing the BAP and IHAP, the Chairwoman or a Commissioner of the SEC, the Executive Director of FINEX/PMO, the Division Chief and Project Management Specialist from USAID, and FINEX/PMO staff.

The Private Sector component is operated through the PMO, which is directed by Roman A. Azanza, who is also a Director of Crosby Securities. The PMO is divided into four components, Administration and Logistics, Institutional Support and Development, Finance and Legal, and Training Research and Education. The PMO should consider strengthening staff in its Finance and Legal section, but the other areas are appropriately staffed by professionals recruited from the private sector. Consideration should also be given to the fact that in 1996 Roman A. Azanza will be assuming the Presidency of FINEX. With the added workload of that Presidency he may not be able to fulfill the duties of Executive Director of FINEX/PMO. It is important for the continued success of the PMO that a full-time executive director be selected before Mr. Azanza assumes the Presidency of FINEX.

The PMO is not appropriately staffed and managed. As is discussed above, the Executive Director and Assistant Executive Director are voluntary, and the Project's activities require full-time project management. The evaluation team suggests at mid-term that at least one of these positions should be filled within 60 days.

The PMO staff provides excellent coordination and follow-up services to the PIC, CMDC, the Grantee Committees and individual members. The evaluation team suggests that job descriptions be reviewed to define fully lines of accountability within the organization and in relation to the Project outputs.

#4. Are the funds allocated for each Project component sufficient?

The 1994 Revised Budget and Implementation Plan for the USAID funded FINEX/PMO is almost \$5 million. According to information provided by Private Enterprise Support Division (PESD) staff, the

disbursements to date for the period ending March 31, 1995 total US\$699,436, leaving a balance of US\$4.293 million. In reviewing the summary of expenses and fund balances, the unexpended amount is sufficient for the completion of the Project. The only FINEX/PMO activity fully committed is the Challenge Grant of US\$1 million. The original baseline budget is the USAID contribution of US\$4.9 million plus the FINEX counterpart contribution of US\$1.09 million. These amounts total US\$6,083 million.

The amended funds allocated for the Technical Studies component are US\$945,500 as of March 31, 1995, the balance after budget revision is US\$393,738. The funds in this component were allocated to the design, implementation and installation of the PCDI. The remaining funds are considered adequate. PCDI is now incorporated, and shareholder equity will be used for any contingencies.

The largest single item in the budget is the US\$1 million Challenge Grant for the automated system. The PCDI is capitalized at US\$10 million, and the Challenge Grant will be the FINEX contribution to the equity pool. This is the only required contribution from the Project. If future equity calls are made for the PCDI, USAID will not provide additional funds.

The Policy, Research and Advocacy revised budget is US\$422,051 and is divided between Policy Agenda and Advocacy and CMDC Secretariat overhead. The Training, Education and Research budget is US\$931,000. This category has no counterpart contribution, and a budget reallocation has been requested to continue planned short-term training services to PACD.

The Institutional Building component is revised to US\$1,281,914. The grantee operates with an "advance for funds request" to USAID, and a lag exists between requests and postings to the reporting schedules. The system is essentially manual. The management reports expressed on Lotus spreadsheets are prepared from the manual ledgers. It is critical that a computerized accounting system be installed.

The funds allocated for the Public Sector Component appear sufficient. According to figures supplied by the AA advisors, the total budget is \$7.9 million, of which \$2.2 million has been spent, leaving a balance of \$5.7 million. We are informed that less than 50 percent of the non-IT budget has been spent. In addition, none of the IT budget of US\$ 1.2 million has been spent. The Public Sector budget components have not been the subject of any material realignment. A minor realignment is in process involving vacation leave for the AA consultants and expatriate expenses for home furnishings.

The Project Design called for three long-term advisers, and the Project is being implemented as designed. The Public Sector Component involves a comprehensive restructuring of the securities

regulatory apparatus. Three years of such an endeavor may be too short a time. The evaluation team was informed that there is a likelihood that funds will remain at the completion of the Project. The evaluation team recommends use of these funds to provide additional TA so that the SEC can continue its reform program.

#5. How has Private Enterprise Support Division (PESD) contributed to Project implementation? Has USAID Project management and oversight been adequate/effective? Has the Office of Financial Management (OFM) and the Office of Regional Procurement (ORP) provided sufficient guidance to FINEX and AA staff?

The PESD has contributed to Project implementation by providing coordination between USAID and the Private and Public Components to achieve project goals. The evaluation team has concluded that PESD is fully informed concerning the Project and implementation issues faced by the Public and Private Sector Components. It provides leadership and guidance when specific issues arise. For example, the PESD has played a vital role in coordinating with the ADB and the DOF so that the ultimate goals of the project would be given every opportunity to succeed despite the alleged determined opposition of the Chairwoman of the SEC.

PESD has contributed to AA's project implementation by applying a hands-on management approach, including attending coordinating meetings between the Project Components. The PESD has been a sounding board for project implementation since the inception of the project. The evaluation team finds that USAID management and oversight have been adequate and effective, particularly in respect to implementation of the Project over the reported objections of the Chairwoman of the SEC.

Requests to OFM and ORP are processed through PESD. The OFM has provided budgetary guidance to AA, and ORP has provided contract interpretive guidance. The OFM budgetary matters appear to have proceeded satisfactorily. While there was a short delay in contract interpretation by ORP involving home leave for AA advisers, the matter was worked out satisfactorily, and we find overall ORP guidance to AA to be satisfactory.

Guidance that the OFM within USAID has provided to FINEX includes:

- Determination of the allowability of project expenditures in accordance with the Cooperative Agreement. FINEX's Finance and Legal Officer reports that OFM has approved FINEX's advances on a timely basis and has helped FINEX staff manage its cash flows in accordance with contractual requirements.
- Procurement advice. The ORP has provided FINEX with guidance concerning USAID Procurement regulations required for

solicitation and procurement of technical consultancy contracts and office equipment.

#6. Are the Project operational procedures appropriate and efficient for each component?

Public Sector

AA's operational procedures appear very appropriate and efficient. Goals, strategies and work assignments are developed by consensus and are explicitly derived from existing policies. Annual plans created each year must be approved by SEC and USAID. Detailed work plans are specified in task orders which translate the annual plan into specific deliverables. In addition, SEC holds an annual off-site planning conference ("Corplan"). The AA team worked with the Commission en banc so that the 1994 Corplan exercise could be used to build understanding and consensus for policy matters, operational changes, and resulting process and structural changes. The goal of the 1994 Corplan Conference, for example, was to establish policy consensus and action priorities for the period 1995-97. Goals were adopted, strategies were selected to achieve each goal, and the policy source of each goal was identified as:

- Policies already endorsed by the Commission en banc, or
- Policies promulgated in relation to the USAID CMDP, the ADB Policy Agenda, DOF priorities and the previous Corplan Conference.

Individual commissioners took responsibility for the next year's work activity related to each goal. Tasks to be accomplished by task forces were specified for each goal. The entire process of developing the Corplan suggests that good working relationships exist between the AA advisors and the SEC counterparts.

Task force acceptance of advisor recommendations informally is perhaps the most reliable indication of success of the Annual and Core Planning process. Unless members of each task force approve of the work assigned to a task force, it doesn't get accomplished. The process is deliberately informal. Consultants work with SEC staff to form an opinion and make decisions about tasks. Task orders are written and must be approved formally by the COP of the AA team, by the SEC Program Manager and by USAID. Completion of a task order is reflected in a task order closing report to SEC and USAID.

The implementation process begins with a meeting of SEC task force members to discuss and review task order closing reports. If a task force does not like a proposed solution, then one member is likely to raise a number of precise questions about the proposal. Once objections are overcome, individual members of the task force offer to help, and the help can be quite intense. For example,

approximately 60 members of task forces worked 8-10 hours a week overtime for months to reorganize the document records in the SEC. Task force staff have voluntarily offered to help with each of the task orders. In particular, members of other task forces have given considerable time and energy to key legislative changes, organization and program/process restructuring, EO restructuring, information technology (IT) plans, and SEC/PSE working relationship enhancement. This demonstrates that the rationale for each task order is accepted at the grassroots level within the SEC.

Private Sector

The Private sector component is managed more like a small business start-up company. Under the terms of the Cooperative Agreement, the Grantee (the FINEX Foundation) was required to set up a separate office, staff it with new personnel and establish the operational procedures appropriate for each of its components.

The national FINEX Foundation is a membership organization of 700 executives nationwide who are organized in a professional affiliation. The organization is sound financially with revenues of approximately US\$200,000 a year from fees charged for luncheons, seminars, and special assessments. The expenditure is approximately US\$150,000.00 a year. The retained profits from its activities are re-invested in T-Bills (treasury bills) and other money market instruments. Therefore, the USAID funded Project components amounting to US\$4.9 million are handled by the PMO without co-mingling accounts with the FINEX Foundation. Since USAID approves the Project expenditures and performs audits, oversight is maintained on Project component expenditures. The PMO's PIC, which meets monthly, reviews the Project component progress and provides direct oversight of the procedures through its approval authority of all expenditures. With respect to the major sub-contracts of the PMO, PIC and USAID provide financial oversight.

For example, the largest component is the Challenge Grant (US\$1 million) which has yet to be advanced for FINEX's equity interest in the PCDI. USAID's objective in issuing the Grant was to give confidence to the incorporating investors (BAP, PSE, and others). USAID agreed to fund the grant, but the other parties had to incorporate and pay in their equity before USAID would release the funds. The incorporating shareholders have paid-in capital of approximating P187,000,000 (US \$7,500,000).

The second largest component is TA. The procedures to manage this component are incorporated in the sub-contract of suppliers such as International Securities Consultancy (ISC), Punongbayan, KPMG, and Citibank. The sub-contract was approved by the PIC and reviewed by USAID. With respect to the CMDP activities in the remaining components such as Training, Institutional Building and

Institutional Support, the PMO's management systems and PIC approval process are the controls for the Grantee expenditures.

In the case of Training, the Training Division Manager coordinates a committee of the national FINEX representing the broad-based FINEX membership. Proposals are vetted by the Committee and presented in written form to the PMO. The Training Manager refines the proposal for presentation to the PIC. The PIC takes up the proposal at the regular monthly meetings, and if approved, directs the Training Manager to timeline the Project. The implementation and follow-up are reported to the PIC. The Evaluation Team believes that the procedures and implementation must be strengthened if the component is to develop activities which create reflows to sustain it in the future. Again, this highlights the need for strengthened day-to-day management controls.

- #7. Are the financial records adequately maintained within FINEX and AA offices?
Are Project files accessible and complete?**

Public Sector

The financial records are adequately maintained. AA staff supplied the evaluation team with contract expenditure data by line item, e.g., Salaries & Wages, on a monthly basis. Staff also provided summary cost data aggregated to budget line item category, e.g., Policy Reform. All financial data is automated on a spreadsheet program. The Project files are adequately maintained. The AA long-term advisors provided all Project files requested to the evaluation team. These documents include all task closing reports. The only deficiency found was that the cover pages of the three part "Information Plan Report" for Task Order A02 did not state whether the Report was Part 1, 2 or 3 of the series. This very minor deficiency is mentioned only to indicate that the evaluation team reviewed all task reports and questioned AA's long-term advisors about a number of them. The report indexing system is effective and staff can produce any requested report in perhaps a minute or less.

Private Sector

Management actions are necessary to bring the records of the FINEX-PMO into full compliance, as noted above. USAID/Inspector General (IG) completed an audit during the week of May 1. The IG auditor told the evaluation team that the record-keeping system has some problems which are expected to be solved when new accounting software is installed.

The records available include a Chart of Accounts maintained on a PC Lotus Program. As noted above, the Project has ordered, but not received, an accounting software package. This system will permit

rapid production of trial balances and other accounting schedules. The system will also perform invoicing and payment functions.

The PMO has developed an organizational chart, established divisions corresponding to project components, and identified management and staff for such positions.

With respect to the PMO Project files, an orderly system is in place. The PMO has a Chart of Accounts for files which are easily accessible in proper storage cabinets. The files are maintained in chronological order with no indexing or cross-referencing systems. The PMO uses stand-alone PC work stations with Microsoft Word and Excel software. All memoranda, correspondence, and minutes are retrievable from the computerized directories. The contents of the printed files appear complete and can be cross referenced with the file directories.

#8. How is each component of the Project perceived by different interest groups?

The evaluation team has interviewed a broad cross-section of interest groups that will be affected by implementation of the goals of the Project. The team has found virtual unanimity of support for the Project. Strong support for the Project is particularly apparent at the SEC, with the exception of the Chairwoman, and in the private sector among brokers and investment bankers who see a need to raise the Philippine capital market to global standards.

Approximately 25 professionals were interviewed by the team to obtain a perspective on the Private Sector. These individuals were bankers, brokers and staff from the PSE and PMO. Interviewees spoke very highly about the Project. Staff from the two clearing houses, although positive about the overall Project, expressed some concern about their future in a new environment with the PCDI on-line. Brokers were also positive about the overall project, but they expressed some concern about how the goals of the Project were going to affect their businesses. Their concerns were not formulated in detail, but they may realize that the need for more regulations will jeopardize some of their transaction practices as is noted above in Section III.C. in the discussion of clearing and settlement risk.

#9. What has been the actual versus planned progress toward the outputs and purpose of the Project? What groups have benefitted from Project interventions? To what extent? What intended beneficiaries have not been adequately impacted, if any?

Progress toward Project Outputs and Purposes

Project progress to date that is related to outputs specified in the Logical Framework for the Project include:

- **Creation of self-sustaining SEC sub-offices** has begun. Specific staff at the headquarters' office of the SEC in Manila are now assigned to receive and follow-up requests from all SEC EOs. Possible improvements in communications between the EOs and headquarters were examined by AA Staff, and computers with modems were selected as the most cost effective alternative. Extension Offices (EO's) have installed fax machines while awaiting the modems. Hard copy flows of Commission decisions reach the EOs in three weeks now. Before the Project efforts to improve headquarters linkages to the EOs were begun, written decisions reached the EO's three to six months after the events.
- **Full automation of stock market operations in the fields of trading, clearing, settlements and investor information.** Full automation of stock market operations in the fields of trading, clearing, settlements and investor information is progressing well. The PCDI was created to provide a fully-modern central depository and will begin operations during July-August 1995. As noted above, Citibank, under a contract with the PSE, is designing the structure for a clearing and settlement corporation and assessing the capital/premium requirements for a clearing guarantee fund. Citibank's report is due on June 12, 1995.
- **Progress towards market transparency** is achieved through televised transmission of trade data as it occurs. Real-time reporting through global market data vendors has been set in motion by the PSE. To further improve transparency, SRO status for the PSE must be approved and the exchange must upgrade its trading rules and ensure their enforcement. A complete "order trail" is also required to support market surveillance and enforcement. This would identify the components of each execution, including full customer identification, time of entry, and all transaction data. This information plus corporate disclosure information will create a transparent market and investor confidence.
- **Strengthening the SEC's capabilities to carry out a better defined mandate.** The SEC has adopted Key Policy Issues and the Corplan. These will transform the SEC from a corporation code administrative agency to a market driven information disclosure agency. The SEC proposed in the ARSA to move from merit regulation to full disclosure. Task Order Closing Reports published by AA establish the framework for a system of registration of securities and periodic reporting by registrants. Reporting will conform to standard accounting principles. Decisions of the SEC en banc will result in a restructured staff organization capable of analyzing

registrants' information. This information will be made available to the public by virtue of a centralized documents system utilizing appropriate technology. The quality of issues information to be made available to investors should be enhanced substantially. It is likely to result in the ability of the market to price securities more effectively.

- **Enhancement of SEC Ability to Monitor Regulations**

Progress achieved includes:

- Strengthening the SEC's enforcement capability, which is designed to ensure that the full disclosure system works,
- Providing in Task Order Closing Reports for an enhanced B-D regulatory system that will be administered by the PSE-SRO, and for substantial oversight by the SEC in registration and capital requirements, and
- Providing, in Task Order Closing Reports, for a market-surveillance system established and administered by the PSE but subject to SEC oversight.

These actions should result in public dissemination of material information concerning issuers, and enable better pricing in both the primary and secondary trading markets. They will also help curtail insider trading and price manipulation by brokers.

- **Strengthening the private sector's ability to self-regulate.** In a series of Task Order Closing Reports, the AA advisors have provided the SEC with recommendations for a PSE market-surveillance system to be administered by remote terminals away from the PSE trading floor. PSE is to be the market surveillance operator with SEC exercising oversight. Rules were drafted for a market surveillance system, and a two-week training session was provided for SEC and PSE personnel. PSE has already established a Compliance Department. The PSE has referred cases of possible trading abuse to the SEC for appropriate enforcement action. Unfortunately the SEC has not conferred SRO status on the PSE. Nevertheless, the SEC has begun to coordinate its securities registration review process with the PSE listing process. Together, these reforms should protect investors by reducing trading market manipulation.
- **Strengthening the private and public sectors' capabilities to conduct meaningful policy dialogue with each other.** Substantial policy dialogue is carried out between the public and private sectors through the PIC, the SEC/PSE Task Force, the DOF PMC and the CMDC. There is much detail elsewhere in this report concerning the benefits of this coordination.

Unfortunately, institutionalizing public and private sector dialogue is hampered by the reluctance of the Chairwoman of the SEC to move forward on various aspects of the Project. The result is that the SEC is not engaged as deeply as it should be in private sector initiatives. This condition limits the effectiveness of working relationships among the involved organizations. It could also result in less than full institutionalization of the Project at the SEC.

- **Creation of an Investor Information Service.** As originally envisaged in the Logical Framework an investor information service would operate on a fee-for-use basis at the SEC headquarters and EOs. The types of information to be marketed are not defined. The Project has not provided any output toward the achievement of this objective. Apparently it is viewed as impractical because private sector vendors can provide such information. FINEX was designed to take advantage of such opportunities; however, it has not yet formulated any business plans. Notwithstanding this, the SEC is moving ahead with a centralized documents system that will enable private sector vendors to purchase market information from the SEC. They can resell the information to institutions and investors on a fee basis in the same manner that such information is marketed in the U.S. Please see Question 19 for more detail.
- **Creation of a self-sustained (through a fee-for-services mechanism) training program to develop the professional services of capital market participants.** As set forth in the answer to Question 19, the planning and execution of an investor information service component at FINEX has been deferred. FINEX has, however, begun a fee-for-service program for CFAs.

Groups that benefitted from the Project

A. FINEX

- Projected investment of US \$1 million of USAID funds enabled FINEX to acquire ten percent ownership of the new PCDI. This investment will give FINEX a continual stream of cash flow to run its other non-profit activities, which include training and other forms of professional development.
- Implementation of the three-year, CFA course. A second cohort is being recruited to begin training during the June-August 1995 period. Next year, the training system will be complete, with students in all three stages of the course work.

- Preparation of administrative procedures to implement short-term training and research/special studies, though no projects have begun.

B. SEC

The SEC has benefitted greatly from the project to date not only by its participation on the various Task Forces but also in the publication of SOPs, the ARSA, an IT capability, the AA work on an SEC documents system and the beginning of a coordinated effort with the EOs. For example, before the Project started, EOs did not receive basic policy from the SEC head office for months and were never supplied with decisions of the Philippine courts, limiting their capacity to function properly in their adjudicatory role.

C. Public Investors

With the adoption of the PCDI and the planned improvement in the clearing process and settlement system, public investors will benefit by timely delivery and settlement of security transactions. Investors already monitor reporting of trades on the PSE.

D. The PSE/Members

The PSE and its members will benefit from the PCDI which will streamline trades processing by reducing paperwork and staff time needed to process the trades. It also reduces exposure to loss or theft because certificates are no longer subject to movement.

What Intended Beneficiaries have not been adequately impacted, if any?

A major and implicit element of the substantive strategy is the CFA training. The target beneficiaries of this skill development should be domestic investors, not simply trainees or their employers. Investors were intended to be beneficiaries, but no plans exist to deliver investment information to them.

This can be best accomplished by assisting domestic investors with their investment decisions. This, in turn, can best be accomplished by using the CFA output to buildup the skill levels of (a) domestic mutual funds, (b) investment advisors, (c) money managers, and (d) debt rating services. The public should be encouraged, especially during the early years of capital market development, to invest in debt and equity through these organizations rather than directly in stocks and bonds.

Hence, FINEX should develop a strategy to increase investor alternatives. That is, FINEX could promulgate information

encouraging the public to use B-Ds and salespersons to gather assets and invest the assets in mutual funds or place them with investment advisors or money managers. Then FINEX could develop and promulgate a system to inform domestic investors of the performance of these mutual funds and other asset managers. Moreover, it could do this for a fee.

The national FINEX membership of 700 benefits from the Project's design for training programs, such as CFA. The candidates for the first stage were successful applicants from the membership. The admission of candidates from a broader base of the financial community (such as banks) should be included in the future applicant pool.

The deferral of the project output for Investor Information Service will enable planners to expand the delivery system to include non-financial institutions, including government agencies, libraries, schools and corporations that are willing to pay the subscriber fees. The original design targeted a small base of perhaps 50 organizations, including investment houses, new agencies, and the Central Bank.

#10. Will project components be sustainable after the Project Assistance Completion Date (PACD)? What revenue streams will the Project engender for the grantees?

The Private Sector portion of the Project appears sustainable due to FINEX's ten percent share in the PCDI; and reflows from the CFA training, training for licensed salespersons and principals, investor and issuer seminars/workshops and other activities. This will provide the organization with sufficient cash flow to fund its training and special studies mandates. FINEX's share of the cash flow from PCDI is expected to be positive within three years.

FINEX's sustainability will be more assured if it develops a clear training mandate. As is suggested above in Question 9, it could adopt a mandate to train and promulgate investment performance information to both FINEX's professional affiliates and the public. Changes could be made, for example, for quarterly track records of mutual funds and money managers. A fee system for investor performance information could assist the public by creating, more quickly than would otherwise be the case, a cadre of professional advisors for the public. That is, CFAs may interpret investment performance and, in turn, inform their clients of investment opportunities. Or mutual funds and other investment advisors might buy and promulgate performance information themselves.

The sustainability of the Private Sector Component is directly related to the credibility in the marketplace of the "core capital market organization", the PSE. The PSE is profitable and is likely to continue to be profitable. If it maintains its regulations, and

it has every reason to do so, its future is bright, provided that two other critical elements of the Project are implemented. First, the trading, clearing and settlement system requires an SEC with strong oversight capability and enforcement authority. Second, the system needs a fully guaranteed clearing and settlement system. Without these two components, the transparency of PSE trading and B-D practices will be questioned continually. Moreover, without these systems a domino effect of B-D failures could occur in times of adverse market conditions. Many components of the capital market system are complementary. Hence, a serious deficiency in any one of these critical components can seriously impair the entire system during times of stress.

With regard to the Project-initiated changes, the SEC has at least two critical challenges to overcome before it can be said that the Project changes have a meaningful likelihood of being sustainable. First, the SEC must be reorganized as the Project team has outlined in various reports. Failure to restructure the SEC by program areas will continue to fragment program management. This will lead to poorly defined training, rulemaking and enforcement. There is little tolerance for deviation from the reorganizational recommendations. Such failure could result in damage to the ultimate goals of the Project. That is, investor funds and investor confidence could be lost, thereby limiting further growth of the domestic securities market.

Second, the SEC must retrain its staff and adopt new technology in order to equip itself to oversee the technologically advanced PSE and B-D complex. It is in this context that the evaluation team believes that the SEC Commissioners and staff should be engaged more fully in gaining experience to apply the voluminous and complex recommendations set out in numerous Task Order Closing Reports. The evaluation team realizes the difficulty in doing this, given the Chairwoman's reluctance. Nevertheless, it must be accomplished. In time, the B-Ds will become at least as sophisticated as the PSE and underwriters. This will add still more challenges to the SEC.

To meet these challenges, the SEC must quickly develop training, new job descriptions and incentive systems related to the program reorganization cited above. Additionally, the team understands that the SEC can use 25 percent of its budget for salaries on a discretionary basis, including paying selected workers more than salary ceilings established by the Civil Service Commission. Perhaps the Civil Service should review the appropriateness of the entire pay structure within the SEC in view of its need to restructure and increase staff expertise stepwise in relation to the growing sophistication of the PSE, underwriters and other market participants.

If the Project is successful and the volume of registration statements increases as is likely, the SEC will have a built-in

revenue stream which can be used to augment and upgrade staff to further insure that Project goals are accomplished.

#11. What impact, if any, has the Project had in influencing appropriate policy /regulatory reform? Is the process by which policy issues are identified appropriate and effective?

The Project has been the driving force behind the public issuance for comment by the SEC of the ARSA. The substantial changes which would be wrought by the ARSA are detailed above. The Project has instilled in the SEC staff and Commission en banc an enthusiasm for market reform. Similarly, the Project has moved the Private Sector toward a clearing, settlement depository system capable of meeting G-30 standards with appropriate oversight. The PSE, which is intended to be an SRO, is likewise enthusiastic about its evolving important role in overseeing the trading market.

The process by which issues are identified in the Public Sector is adequate and described in the response to Question 24. The process by which issues are identified in the private sector through the Project Implementing Committee is likewise adequate to raise the significant policy issues that need attention.

The Project has and is having a tremendous impact on policy in the private sector. The Project has influenced FINEX to recommend reconvening the CMDC and to enhance capital markets development in the provinces. At the PSE, the Project has influenced its movement towards becoming an SRO, starting a public information campaign, and most importantly the PCDI which will immobilize stock certificates. The Project has also influenced the clearing banks and the PSE to start development on an improved clearing environment. All these changes are leading towards the creation of a modern capital markets environment which will make the PSE a more competitive market in the Asian Region and attract foreign investors.

#12. Is the composition of the PIC appropriate and beneficial to the achievement of Project objectives? Has the Project adequately and effectively engaged the PIC members, both individually and collectively, in the course of Project implementation?

The evaluation indicates that the project adequately and effectively engaged the PIC members, both individually and collectively, in the course of the Project implementation.

The PIC members are: SEC, IHAP, BAP, PSE, FINEX/PMO, USAID and Ex-Officio Public Sector Representative, Ms. Molly Bayley. The quorum

is three, and all meetings have been held as scheduled. The membership represents many conflicting interests, which is evident in the list of agenda items.

A review of the PIC minutes highlights the key recurring agenda items. The meetings are held monthly and extensive minutes are well kept and circulated to all participants. Thus, the participants are fully informed on all agenda topics. It is recommended that the composition of the Committee remain intact since the group represents the project components of the CMDP. The inclusion of the Public Sector COP, Ms. Molly Bayley, began in October, 1994. She is an observer and ex-Officio member. This ensures a flow of information between the two USAID funded components.

#13. How has the difficulty in recruiting/retaining an Executive Director impacted Project management? Has the situation been rectified?

The lack of a permanent Executive Director has impacted the PMO's management. Mr Roman Azanza is the voluntary executive director. He spends an undefined amount of time at the PMO due to his other responsibilities. He is Managing Director of Crosby Securities (Philippines) and is the President-elect of FINEX for 1996.

A full-time Executive Director or Project Manager is required on site to implement a management information system and direct complex tasks. Management tracking systems are needed in component activities as well as accounting and support services, if complex, completed projects are to be achieved. A full-time person is required. Therefore the evaluation team recommends hiring a CEO.

Other problems that have resulted from the lack of a permanent executive director include:

- Delays in recruitment of professional staff for Project component management,
- Lines of accountability for Project activity are not formalized,
- Delays in implementing a computerized system to track Project performance, and
- Inability to determine financial positions of Projects and possible budgetary constraints on a daily basis.

Steps taken to improve the situation include:

- Mr. Azanza's assumption of Executive Director status on January 1, 1995, improved staff moral and activity immediately,
- Establishment of deadlines to complete the Project activities tracking system, and

- Procurement of an accounting/financial package which is expected to be operational in June 1995.

Despite the limited progress that the PMO has made in the absence of an Executive Director, the evaluation team finds that the lack of an Executive Director continues to pose significant problems.

#14. Was the decision to segregate the clearing and settlement functions from the Project-assisted central depository appropriate? How does that decision impact the desired automation of "backoffice" market operations?

The decision to segregate the clearing and settlement functions from the PCDI was appropriate, but attention needs to be given to the clearing guarantee fund. The present processing of trades begins with an automated execution system which locks-in trades, i.e. insures the buyers and sellers are matched to the trades they must clear and settle. The only exceptions to the locked-in trade rule is (a) when a PSE computer failure occurs, (b) when orders are missed or duplicated, or (c) an evident mistake is made when the broker is changing the price or quantity of an existing order. At the end of the trading day (12:10 pm), the PSE's Market System sorts all locked-in trades by broker and security. A copy of each broker's trades is delivered to his printer on the trading floor by 1:00 pm. Each broker then performs a comparison process, matching each of his completed order tickets to the Exchange run. There are rarely any changes made during the comparison process; and by 2:00 pm on the trade date, the PSE is in a position to deliver the entire day's locked-in trades to the clearinghouse for clearing and settlement.

This component of the Capital Markets Project is current and timely. The PSE's daily output enables the broker to complete comparison (comparing his trades to those that the Exchange has locked-in) in his back office. This is done manually. However, with the Exchange System in place, if a broker chose to automate this phase of his back office, the interface with the Exchange System could be easily accomplished. The delivery of trade data to the clearinghouses, which is manual, could also be by transmission from the PSE when the clearinghouses are prepared to receive automated transmissions.

The next processing phase is clearing which, at present, is a very labor and paper intensive process. Clearing is also subject to broker fails (inability to deliver or pay for securities) and the financial exposure that fails cause. The clearing function is solely a brokerage house process as compared to the depository which will be supporting both brokerage houses and banks.

As the CMDP progressed, it became clear in August 1994 at the FINEX/PIC meeting that the banking industry did not want to be a part of the clearing process and its inherent risks. That is, the banks did not wish to guarantee that investor funds placed with B-Ds would not be lost in the event that one or more B-D's became insolvent. In September 1994 at the FINEX/PIC meeting, alternatives for a clearing organization were discussed, and PIC moved forward anticipating the "Challenge Grant" for the development of the depository.

With its immobilization of securities in an automated book entry environment, the depository will greatly enhance the broker's back office and the clearinghouse processing. The PCDI will reduce or eliminate the need to:

- Store certificates in a vault at brokers' offices,
- Deliver certificates to buyers,
- Collect certificates from sellers,
- Sign certificates for delivery to clearing agent,
- Prepare and deliver stock assignments to clearinghouses,
- Sort, verify, and compare certificates at clearinghouses, and
- Generate new certificates for each trade by the transfer agent.

Another important benefit to the back office and the clearinghouse, as well as to the investing public, will be the elimination of the delay of fifteen or more days for the transfer agent to return new stock certificates, thus making settlement possible on T+3, thereby meeting the G-30 requirement.

With all the benefits to be realized by the implementation of the central depository, there is still a need to modernize and automate the clearing process. The PSE and the two clearinghouses, with Citibank as investment advisor are addressing a need for a Clearing House (CH) to be funded 40% by the PSE, 30% by Equitable, and 30% by RCBC (Rizal Commercial Bank Corporation). This CH is the Corporation that Citibank is currently structuring under contract to the PSE as referenced above in Section III.C. This Corporation is being designed to manage the clearing guarantee fund, which is expected to be a stand-alone organization. The Corporation would establish and execute procedures to minimize B-D defaults in the event that certain B-D's become insolvent. It would use the clearance guarantee fund's resources to repay investors for any losses resulting from B-D defaults. The Corporation might also become an SRO that supervises B-D conformance to practices that protect the financial strength of the overall B-D system. The current estimate of the equity needed to establish the Corporation is US\$2.5 million.

The segregation of clearing and settlement isolates the brokerage functions, which includes payment from or delivery to the investing public, and from the depository which is a brokerage and banking

function. This environment will make back office automation simpler as each brokerage firm can set its own priorities and then interface electronically with each organization independently (PSE, CH, PCDI). Larger firms with more capital will be able to automate faster and expand their business by offering clearing services to the smaller firms. The decision to proceed, by separating the depository from the clearing function, places a heavy responsibility on the PSE and on the SEC to carry out their existing oversight responsibilities as well as implement the 1995 proposed oversight regulations. They must ensure that the regulations require the clearing agency to be adequately capitalized to remove inordinate risk from the process and to ensure that brokers themselves are adequately capitalized. Serious attention needs to be given to the adoption of a mark-to-market net capital rule that would be applicable to brokers. Such a rule would help insure that brokers comply with all delivery, payment and custodial regulations.

- #15. Have Citibank, KPMG, ISC and Punongbayan consultants contributed appropriately to the development of the automated system? Has there been adequate oversight and coordination of their respective inputs?**

Punongbayan Corporation's consultants did not directly contribute to the development of the automated system. However, they did an excellent job of identifying (with flow charts and narrative) the movement of a transaction from its origination with the broker as an order through its execution at the PSE where it becomes a trade. The charts show that these trades pass from the broker and PSE to the clearinghouse for comparison, clearing and settlement, and then on to the transfer agent for verification, recording and origination of new certificates. Finally, the trades return in certificate form to the CH and/or broker, who then delivers the stock certificate to either the broker's vault, the custody bank or the customer, thus completing the transaction cycle. Their report also identifies all reports used throughout the entire cycle. This research laid the foundation for automation of this manual environment.

KPMG contributed significantly to the development of automation by identifying the costs involved in clearing, settlement and custody for both equity and debt products. They also identified interim solutions to resolve existing backlogs causing delays. These possible solutions to backlogs were controversial and included imposing a four-day trading week on the PSE, a major buy-in program, or postponing future IPO's. KPMG's role was to present these possible solutions for public consideration. None of these solutions were formally adopted, but the current practice is to limit IPO's to approximately one per month. The informal limitation on IPO issuance is designed to accommodate the limited capacity of the market to absorb equities rather than to reduce the backlog.

The backlog subsided without regulatory action as the bull market subsided and as workers were replaced in a protracted labor strike at a major transfer agent.

ISC was engaged as a consultant to perform financial analysis for the development of a clearing, settlement and depository corporation. In mid-1994, the PIC agreed to separate clearing from the depository. Citibank, as investment advisor to the Corporation, developed the PCDI ownership subscriptions as 30% PSE, 30% BAP, 10% Development Bank of the Philippines, 10% FINEX, 5% IHAP, 5% Social Security, 5% Citibank and 5% to be shared between the ADB and International Finance Corporation (IFC). Citibank was engaged as investment advisor to develop the financial side; however, after the incorporation of the PCDI, any cost incurred by Citibank for work performed will be paid for by the shareholders of PCDI, not by FINEX.

All of the above consultants laid the groundwork for the present ISC tasks involving the development of an automated PCDI. ISC has successfully completed legal, operational and hardware components of the depository. ISC developed specifications, completed RFP's, submitted reports to USAID/PIC and received approval for the development of the depository which is presently nearing completion.

Oversight and coordination during the planning and procurement process were effective. As the depository comes on line and the capital markets community starts to interact with the new PCDI, oversight and coordination must be expanded to insure community acceptance and the success of the depository.

#16. Was the decision to forego a training needs assessment appropriate?

FINEX's decision to forego a training needs assessment for short-term training seems appropriate. It issued a RFP for the job on July 15, 1994, and amended it on August 25, 1994 to include interviews with "visionaries" of capital markets to develop an overall strategy for training. The amendment was subject to PIC approval. The PIC decided that the contractor selected in the original procurement was not qualified to perform the visionary portion of the needs assessment, and it decided to hold the needs assessment in abeyance indefinitely. Subsequently, the PIC decided to obtain training and strategic direction for short-term training from the five FINEX Committees. These committees concern:

- Professional Development,
- Business Education,
- Capital Market Development Project,
- Affiliate Development, and
- Technical Studies.

The evaluation team lacks the necessary information to be in a position to make a judgement concerning the competence of Asia Business Consultants, Inc., the finalist in the RFP procurement, to produce useful results from a survey of visionaries. The survey approach, however, does not appear to be an effective methodology to obtain visionary guidance. A more appropriate approach would be to compensate a selected group of visionaries to write a short paper expressing their suggestions for a broad training strategy.

In terms of visionary strategy itself, FINEX management seems to have forsaken the idea. It is taking micro suggestions from its affiliates concerning short-term training and research/special studies. Visionary ideas can perhaps be formulated at the grassroots level. At a minimum, suggestions that the PIC accepts are likely to be relevant and practical.

Longer-term training focuses on courses of study that are well-defined in other countries and have obvious usefulness in the securities industry in the Philippines. These include CFA, Salesperson supervisory, and Office Manager training.

The evaluation team suggests that FINEX focus on helping domestic investors to invest in the stock market by:

- Training professionals to analyze registration statements and periodic reports so that market prices of securities are determined more effectively in both the primary and secondary market,
- Developing indicators and a reporting service to inform investors, perhaps quarterly, weekly or daily, about the performance of their mutual funds and money managers, and
- Teaching domestic investors that the B-D and salesperson roles are to gather and provide materially accurate information to them and that investments should be suitable to their financial condition.

FINEX's second focus might be to assist potential issuers to learn about alternative ways to raise capital. The efforts of the FINEX office in Cebu to educate local government officials about the possible use of municipal bonds for water distribution projects is a good example of such activity.

#17. How can the training component of the project be better defined/implemented?

The training component of the private sector effort should be augmented to include separate courses for trading, clearing and settlement, and depository operations. Private sector training can be improved through FINEX activities which are discussed above in relation to Question 16.

The public component has performed micro assessments to determine the usefulness of selective courses, but it has not completed a comprehensive training needs assessment. The decision was made to postpone a comprehensive assessment of training needs until after the SEC is reorganized into work groups and into new departments to meet its revised mandate. This approach is designed to allow training to be delivered to staff groups who would then focus their new skills on specific regulatory processes and programs rather than dissipate their efforts across their currently fragmented functional activities. Its revised mandate is to function as a regulator in an environment of full disclosure, effective SROs, no merit regulation, and both strong SEC oversight responsibility and effective enforcement powers. It is alleged that this reorganization has not occurred yet, as noted earlier, due to the Chairwoman overriding the votes of the other four SEC Commissioners. We understand that the DOF is reviewing the situation and that the DOF position is that authority to make such decisions is lodged in the Commission en banc. As noted in Section I.A. the DOF has not taken a position publicly and is also considered to prefer organizations to resolve their differences internally.

A second reason for not conducting a comprehensive training needs assessment is that the current SEC promotion process moves workers to a new department every two years without regard to skills matching criteria. Hence, the career ladder is not a step-wise professional development ladder.

The consultant's training approach was useful for preparation of the SEC for reorganization, but training needs will change after the reorganization occurs. The current approach is to:

- Be on-site to jointly develop with SEC staff the Annual Plans, reorganization plans and other operational and policy issues.
- Provide ad hoc training resources for special topics that the Project recommends or SEC staff wish to learn more about. For example, the consultants organized a two week "tutorial" on insider trading and market manipulation in 1994. The training was conducted by short-term consultants who are specialists on these topics.
- Provide half-day workshops/seminars with Project experts on clearing and settlements and other technical topics related to SEC mandates.

#18. Has FINEX adequately and appropriately used the policy analysis and advocacy support funds? How might utilization of this component be improved?

FINEX has not made complete use of the Policy Research and Advocacy Funds, although four project activities are recorded. A concept

paper entitled "FINEX Policy Studies Facility" was completed in July 1994. This concept paper suggests issues for PMO intervention. Possible activities include liquidity measures in the financial markets, mutual funds, review of PSE listing rules, tax issues, minimizing fraud activity in the T-bill market, Individual Retirement Accounts (IRAs), establishment of a skills bank, public information, and an education program for reporters.

As a supplement to address policy advocacy, the FINEX support of the CMDC Secretariat advances CMDC's ability to prepare reports and conduct follow-up research. This is an important activity for the project.

The advocacy component has assisted FINEX, the national organization, in delivering services for the regions. A planning conference involving 50/50 cost sharing, and five FINEX regional affiliates chapters (Bacolod, Cebu, Davao, Socsargen, and Northern Mindanao) was held to promote the advocacy agenda through the national FINEX.

A publication entitled "Philippine Stock Market" is due for publication in August 1995. The 15,000 word publication on eight issues will be distributed to the public. The copy is being prepared under a subcontract to ISC. Other publications should be encouraged.

In 1995, the project retained a public relations consultancy to prepare articles on the activities of the CMDP. The firm was hired on a monthly retainer. This activity should be expanded with a PMO manager designated to prepare ideas for this consultancy and to track the implementation.

In the legislative arena, the Project works closely with a legal consultant and the FINEX national committee on legal issues. The group includes attorneys from the Bureau of Treasury. It identified issues which are hampering growth in the Philippine capital markets. The committee is drafting testimony for the Omnibus Act which will be submitted to Congress in 1996.

Two permanent FINEX subcommittees are suggested. One is for exchange floor operations. The other is for data management for clearing and settlement and depository operations. These committees would be made up of employees specializing in each area from the PSE, brokers, clearinghouses, depository and banks. Meetings would be monthly to further enhance the completed CMDP.

#19. Was the decision to defer and ultimately delete the investor information service component appropriate?

The planning and execution of an Investor Information Service component has been deferred but not deleted. As a result of

FINEX/PMO planning and analysis, the investor information service emerged as a major undertaking. The PMO published an invitation to bid on a needs assessment study in October 1994 and received 12 responses for the RFP. In reconsidering the magnitude of the component, and the shortage of available staff to properly manage the component due to time constraint, the implementation was postponed.

The original Project envisioned a multi-user system including investors, bonds dealers, underwriters, brokers, and third-party investors. FINEX's application to USAID proposed funding for a contracting service company which would set up the necessary system. Examples of industry standards that could be emulated include such services as Quotron and Bloomberg. These systems are too costly for the Philippines, given the informal estimates of demand for information services. Moreover, the PSE has provided a real-time market data feed to several commercial market data vendors from its new trading platforms. Hence, the evaluation team believes the Investors Information Service should begin its search for products with the SEC public information files.

#20. Has there been adequate consultation/coordination between the Public and Private Sector Components of the Project? Between the Project and the CMDC?

The consultation and coordination between the Public Sector and the Private Sector Components is substantial and adequate to achieve overall Project goals.

The Public Sector Component comes under the ultimate jurisdiction of the DOF as the policy overseer of the SEC. The DOF has formed a PMC to ensure the efficient implementation of the Project. Its members are the DOF, the Chairwoman of the SEC, the Executive Director of FINEX, the Chairman of the CMDC and the President of the PSE. The DOF has named Commissioner Gloria as Project Manager at the SEC, and she reports periodically to the PMC. The Project Manager is the contact person at the SEC for AA coordination and for the work of the SEC Task Forces and Task Orders for short-term consultants.

The PIC is the coordinating body for the FINEX private sector component which consists of the Project Manager of the SEC, who is a member of the PIC, the Executive Director of FINEX, the President of the PSE, an investment banking representative and the AA COP. The Executive Director of FINEX is also the Chairman of the CMDC, the highest level coordinating committee maintaining responsibility for the Project on behalf of the GOP.

A joint SEC/PSE Task Force has also been established to coordinate specific questions that arise between the emerging self-regulatory

organization and the SEC. Both the Chairman and the President of the PSE and the Chairwoman and the Commissioners of the SEC sit on this body. While the PSE is not a Project component, it is the beneficiary and an integral part of the FINEX TA Component. Therefore, coordination between the SEC and the PSE benefits both the Public and Private Sector Components.

The evaluation team concludes, therefore, that this Project is well coordinated among its two overlapping components. The attitude of the Chairwoman of the SEC is seen by many as a barrier to accomplishment of Project goals. This information was provided by various interviewees without any prodding whatsoever. In response to a general question about how the Project was proceeding, a typical answer would be that it was going well except for the lack of collaboration of the Chairwoman of the SEC.

#21. Has Project support for the CMDC been productive and appropriate?

The CMDC took the lead in capital markets discussions when it was established in 1991. FINEX was awarded the Chairmanship. The Council did not meet in the last half of 1992 and all of 1993. In 1994, coinciding with the many activities of the FINEX/PMO, the council was reconvened. The PMO project pays for the support unit, known as the CMDC Secretariat. The Secretariat coordinates activities of the CMDC, plans and arranges meetings, prepares the agenda, and interacts with CMDC members and project component divisions. The Secretariat manages the day-to-day operations of the Council.

CMDC initiatives include:

- Capital Markets Development - using the capital markets development committee, the SEC and other government and private sector agencies for the implementation of proposed reforms.
- Regulatory Responsibilities - taking into account the recommendations of the ADB-TA 1641 and responsibilities of the SEC.
- Regulatory Framework - PSE and other associations are intended to be SROs under the watchful oversight of the SEC.
- RSA (1982) - considering the recommendations of the ADB-TA 1641.
- PSE - unification process to insure best prices for investors, study underwriters distribution system for IPOs, and introduction of a code of conduct.

The evaluation team concludes that project support for the CMDC is productive and appropriate.

#22. How have the relations between AA advisors and SEC counterparts evolved over time?

The evaluation team believes that the relations between the AA advisors and their SEC counterparts are professional and recognized as productive by SEC. Since the Project's inception, the SEC en banc and the SEC staff appear to have developed a close working relationship with the AA advisors.

Procedurally, the USAID Project is implemented at the SEC by a Commissioner designated as SEC Project Manager. The SEC Project Manager is a member of the Private Sector PIC and of the DOF PMC. The SEC Project Manager is pleased with the work of the AA Consultants. The AA advisors work with the SEC Commissioners and staff in identifying policy issues, after which the issues are thoroughly discussed with appropriate staff. AA first ascertains how the work of the SEC is done in a particular area and then comes up with ideas for reform to accomplish the goals of the Project. Next it presents its ideas to the SEC. The ideas are then discussed with SEC and staff and appropriate recommendations are worked out.

After recommendations are developed, they are taken up by the SEC Commission en banc, which has adopted most of the recommendations of the AA consultants. Two examples are the Key Policy Issues adopted by the SEC en banc on June 14, 1994, and the CORPLAN Conference of July 1994. The SEC en banc adopted as policy various key components that would provide greater efficiency and transparency in the offering and trading of securities. These two documents move away from merit regulation toward full disclosure and a self-regulatory system coupled with effective enforcement.

The implementation would move the SEC closer to accomplishing the goals of the USAID PP and the specific directives of the AA Award Contract. The description in Question 6 above of the voluntary cooperation of SEC staff on task forces demonstrates the Project's concern with consensus building. The fact that members of all task forces have willingly performed their work assignments suggests that the relations between AA advisors and SEC staff are effective and will become more effective over time.

AA provides a written weekly status report to the SEC Project Manager and USAID on work underway and work intended to be undertaken. The SEC Project Manager distributes the AA weekly report to the SEC en banc.

#23. Have the AA advisors established and maintained effective working relations, wherever possible/appropriate, with relevant counterpart staff? How could those relations be improved?

It appears to the evaluation team that with the exception of working relations with the SEC Chairwoman, the AA consultants have excellent relationships with SEC Commissioners and staff.

Disagreements with the SEC Chairwoman are basic and go to the heart of the key policy changes and issues envisioned by USAID for which the Project is intended. The situation would not appear to be easily solved by changes in USAID or AA personnel. The Chairwoman likes merit regulation and does not agree with its replacement by a disclosure and market enforcement regime. Likewise, the Chairwoman does not concur with making PSE a self-regulatory organization. The Chairwoman would like to continue the current procedural and substantive regime at the SEC and to utilize the AA consultants to make the SEC's administration of the Corporation Code more efficient.

The work of the AA consultants is appreciated and applauded by staff and the other SEC Commissioners. The work is considered to express the direction in which the SEC needs to go to develop the marketplace. SEC staff and commissioners desire to reorganize the SEC into "work cells" and to create "one stop" service divisions. These initiatives will enable the SEC to eliminate costly and ineffective overlap and will enable the SEC staff to develop expertise on registration statements and periodic reports of securities issuers. SEC staff are in danger of being demoralized by the Chairwoman, who it appears has thus far obstructed the reorganization for reasons that are not entirely clear.

#24. Are the Task Forces and Committees effective/productive?

The Task Forces and Committees established to carry out the work are considered to be effective. In addition, the Committees established to coordinate the relationships of the Project are effective and productive.

The Program Manager at the SEC is satisfied with the operation of the Task Forces and the Committees. She believes they are productive and help the SEC staff and Commission en banc. The AA consultants file a weekly report of their activities with the SEC en banc. Numerous Task Forces exist under the aegis of the SEC Project Manager. All key staff and the Commission participate. A Legislative Task Force is working on legislative changes needed to implement the USAID project. A Licensing and Monitoring Task Force is developing a structure to take the SEC from merit regulation to a full disclosure system. A Records Management Task Force is centralizing and automating the record-keeping and retrieval capacity of the SEC. An Information-Technology Task Force is creating an automatic capability and implementing a formal information plan for the SEC. A Joint PSE/SEC Task Force coordinates the efforts of the intended self-regulatory body with the SEC.

The Task Forces meet with the AA advisors to discuss policy issues. The consultants coordinate efforts by engaging short term consultants to carry out the directives of the Task Forces (by Task

Order). The Task Forces engage the SEC staff and Commission directly in the work of restructuring the SEC.

The Chairwoman has been critical of the Task Forces because they require SEC staff to work on the projects. She would prefer solutions to be recommended by the AA consultants independently, for acceptance, modification, or rejection at the highest levels in the SEC.

The evaluation team believes that the Project approach of engaging the SEC staff and Commissioners in the daily work of reorganization will enable the SEC to develop the expertise that will enable it to function more effectively.

#25. Are the AA advisors focusing on the appropriate policy/regulatory issues?

The evaluation team has concluded that the AA advisors are focusing on the appropriate policy/regulatory issues. It believes that the AA advisors need to devote more of their attention to adequacy of the clearing guarantee fund. This fund has not been a significant focus of AA activities. The task is to re-prioritize and reorganize the SEC from primarily an administrative agency to a complex securities regulatory agency: the magnitude of this change can easily be underestimated. The SEC will retain its corporate code and adjudicatory responsibilities and add substantial regulatory disclosure and market trading oversight capabilities.

AA advisors have focused on streamlining the SEC. A well-functioning SEC would review registration statements for primary public offerings; review periodic reports filed by publicly held corporations; require publicly held companies to adhere to internationally accepted accounting requirements using a strong enforcement capability; oversee a self-regulatory organization of B-Ds to ensure that trading, clearing and settlements of securities transactions meet G-30 standards for T+3 and delivery of securities upon payment; ensure that the SRO has a market surveillance system in operation sufficient to ferret out abuses by insiders and brokers; and insure that the SRO strictly enforces rules of fair trade and practice by B-Ds, backed up by net capital rules and rules respecting customer funds and securities. The AA consultants raise these issues with appropriate Task Forces and Committees, and they publish appropriate task order closing reports. The evaluation team finds AA's work to be successful.

Substantial work has been completed on a net capital rule. Net capital rules, mark-to-market accounting, and rules governing segregation of customer securities and use of customer funds are crucial to the elimination of undue risk in a well functioning securities market. The evaluation team believes that a net capital rule should be finalized by the AA consultants in cooperation with the PSE, which expressed an interest in the concept. The AA team

should coordinate the development of the rule with the overall risk assessment of the clearing and settlement system fund.

#26. Have the project components (regulatory reform, information technology, organization and human resource development) covered by the three long-term advisors been adequately/appropriately managed to date?

The regulatory reform, IT, and organization and human resources components have been adequately and appropriately managed to date.

The Annual Report sets the groundwork for a disclosure-based and self-regulated Philippine capital market. The SAP sets out specific implementation plans with respect to securities registration, periodic reporting, B-D registration and regulation, market oversight and surveillance, SEC accounting requirements, enforcement, and provides for an SEC Code of Conduct. Finally, an updated ARSA that significantly seeks to displace merit regulation by the SEC has been issued for public comment.

The most significant barrier to implementation of the USAID Project is the position taken by the Chairwoman of the SEC. To help manage this problem the GOP has moved supervisory authority over the SEC from the Office of the President to the DOF. The answer to Question 32 more fully discusses this development.

During 1994, the IT component terminated a local software contract, introduced a computer payroll system, assisted the SEC in providing a corporate name verification system, trained SEC staff in computer technology and developed an office automation strategy report. The SAP provides for reorganizing the management of the SEC's IT capability, maintaining databases, conceptualizing and implementing technical architectures, implementing a procurement plan, and establishing an SEC computer network.

During 1994 the organizational and human resources component achieved endorsement of the work cell concept by the SEC en banc. The SEC adopted a centralized records management control system. The SEC en banc also began to function as a collegial body by, for example, adopting a Corplan for 1995. The human resources component also was responsible for a significant number of training activities (see Annexes G, H, and I).

#27. Has the prime contractor (AA) made appropriate use of the four Project sub-contractors (Aries, INTRADOS, Andersen Consulting and SGV)?

It appears to the evaluation team that AA has made appropriate use of the four subcontractors, Intrados, Aries, Andersen Consulting

(AC), and SGV. During the first year of the Project, the regulatory components of the Project were emphasized. ARIES consultants were used for this task. Also during the first year, AC and SGV were utilized because of their expertise in information technology and organizational restructuring. A benefit of using AC and SGV on such assignments is their familiarity with local procedures and customs. Moreover, their consultants are already in-country and, consequently, do not require per diem and other costs associated with nonresidents. Hence, these consultants are often used for longer-term tasks.

Intrados, with expertise in training, was used less frequently in the initial stages of the Project when the concern was design rather than implementation. As the training component becomes more active after the regulatory and structural changes have been addressed, it is expected that Intrados will be utilized more frequently. Although use of the four Project sub-contractors has been uneven, their utilization was based on their expertise and the priorities of the Project at the time.

#28. Has the selection of short-term advisors been timely and appropriate? How have short-term advisors performed to date?

The evaluation team believes that the selection of short term advisors has been timely and appropriate and that the short-term advisors have successfully met the requirements of the Project to date.

As set forth in the answer to Question 24, the implementation of the public sector component requirements by AA are being accomplished by AA's close working relationship with the SEC Project Manager and the SEC Task Forces. After full vetting of issues in a particular Task Force, the Task Force will initiate a Task Order which is approved by the SEC en banc and USAID. The initial Task Order requires a short-term advisor to analyze and provide a report concerning a particular program area. The AA Advisors often assist short-term advisors to collect and interpret data and to consider courses of action.

Subsequent Task Orders focus on procedures, process engineering, rule writing, systems support, and training. For example, with respect to clearing and settlement policy issues under Task Order (C-44), a review was conducted to evaluate the effectiveness of the SEC program for overseeing the clearing and settlement process. This effort included analysis of the rules of the SEC and the PSE and the enforcement of these rules. An expert advisor in clearing and settlement was engaged short term. The short-term advisor prepared a report (C-44) which concluded that SEC oversight of clearing and settlement is deficient and that SEC rules, currently inadequate or ignored by participants, needed to be revised and enforced.

The SAP provides for an SEC role in clearing and settlement adequate to achieve the objectives of the USAID Project. Development of the SAP will require creation of a task order and then selection of a consultant. The short term consultant will prepare written specifications and procedures for the SEC to receive information necessary to monitor the clearing and settlement process. The SAP further provides for a newly trained SEC staff member to monitor and enforce the SEC rules and procedures.

The evaluation team believes that the process for selection of short-term consultants is adequate to assure that consultants are chosen with the requisite experience for the task. In summary, AA writes a memorandum to the appropriate sub-contractor detailing the skill requirements sought. The sub-contractor then conducts a search and provides data on qualified individuals to AA. AA then selects the most appropriate person for the task.

#29. Does the second year work plan for the public sector component reflect an appropriate mix of activities to achieve project objectives?

The evaluation team has concluded that the SAP for the public sector reflects an appropriate mix of activities to achieve the Project objectives. The SAP sets forth the specifics for the second year of the project which, if accomplished, should reach the goals of the Project outlined in the PP and the AA award contract.

The SAP builds on the accomplishments of the Annual Plan for 1994. In most respects, 1994 was the year in which the SEC Task Forces identified, at the internal operational level, the key issues that the SEC needed to address to move to a disclosure-based and self-regulatory regime.

The SAP is a blueprint for implementing the reforms identified by USAID and the ADB and is further identified and analyzed by the SEC Task Forces and Task Orders issued. The SAP was approved by the SEC en banc to implement the Key Policy Issues and Corplan of 1994.

Specifically, the SAP provides for:

- Final drafting of key legislative amendments to the RSA and other statutes;
- Drafting rules for displacement of merit regulation with securities registration requirements and periodic reporting by issuers;
- Writing new procedures for securities registration, examination, comments process, financial, legal and accounting analysis, and related organizational reengineering and training (including restructuring and realigning program

functions and training into one department from related functions currently spread across four departments);

- Drafting rules for B-D and employee licensing;
- Writing procedures for B-D regulation and PSE self-regulatory oversight by the SEC;
- Reorganizing the Broker and Exchange Department to manage a Market Regulation program and training of SEC personnel;
- Developing a timetable for implementing market surveillance by the PSE pursuant to guidance of SEC/PSE Task Force, including placing a terminal created at the SEC;
- Establishing a working group including private sector representatives to assist the SEC in overseeing a clearance and settlement system that meets the goals of the PP;
- Designing and installing a SEC records management system;
- Establishing an SEC computer network and developing computerized information systems;
- Recommending changes in laws, rules, practices and procedure for increasing SEC oversight of financial disclosure to bring accounting standards for companies issuing securities to acceptable standards;
- Implementing a new enforcement program at the SEC for investigating and prosecuting violations of rules covering disclosure, broker fraud, insider trading and market manipulation; and
- Establishing a formal SEC rulemaking process and publishing a complete compilation of all current SEC rules.

The Project objectives are to reform the Philippine capital markets to encourage more companies to issue securities that will be distributed to the public. In order to accomplish this goal the regulatory regime at the SEC needs to be refocused away from merit regulation to a disclosure based system. Significant reliance on such systems falls upon the ability of the regulatory agency (the SEC) to require the disclosure of financial information backed up by the use of its enforcement authority. The SAP contains the elements of an effective SEC capability to accomplish these goals.

#30. Has USAID responded appropriately to implementation issues involving SEC counterpart commitments?

It appears to the evaluation team that USAID has responded appropriately to implementation issues involving SEC counterpart commitments.

The USAID Grant to the GOP for the Project is in the amount of \$13.2 million. According to the documentation, governments that receive USAID donor assistance are required to provide a 25 percent counterpart contribution. The required contribution may be in cash or in kind, such as office space for consultants.

USAID, the DOF and the SEC have had several meetings and exchanges of correspondence over the matter of the adequacy of the counterpart contribution to date. The required counterpart contribution for the Project during Life-of-Project is \$2.088 million (Pesos 52.2 million). As of March 10, 1995, according to a letter from Director Schofield to the DOF, the GOP counterpart contribution amounted to approximately Pesos 2.5 million or 4.81 per cent of the required counterpart contribution. The Schofield letter stated that, since the Public Sector Component was halfway through the Life-of-Project, the counterpart contribution should have been almost Pesos 26 million. The letter pointed out that unless the counterpart contribution increases rapidly during the next six months, the GOP may not be viewed as able to comply with the overall counterpart contribution. In such a case, USAID would be required to issue a Bill of Collection against the GOP for the shortfall.

Accordingly, USAID has withheld approval of SEC acquisition of commodities pending resolution of the counterpart contribution issue "and other policy-related concerns". Subsequently, the DOF responded to Mr. Schofield's letter of March 21, 1995. The DOF letter referred to the Contribution Report for 1994 and stated that the counterpart commitment was at 29.64 percent under the terms of the Report. The letter expressed confidence that the entire counterpart commitment would be met before the end of the Project.

The evaluation team also understands from USAID that the SEC Commission en banc has decided to fund certain hardware that will be creditable to the counterpart commitment. If funded, this would raise the percentage substantially. The matter is now under discussion at USAID. The issue of counterpart contributions and other policy-related concerns are all related to the implementation of key policy changes at the SEC, approved by the SEC en banc, but prevented from being carried out by the SEC Chairwoman.

#31. How has this component of the Project supported the Asian Development Bank efforts to promote capital markets reforms? Has the coordination between USAID-funded technical assistance (TA) and the ADB been adequate/appropriate?

The evaluation team believes that the Public Sector Component of the Project has supported ADB efforts to promote capital market reforms. The team's interview with the ADB staff managing the ADB efforts at capital reform in the Philippines revealed that ADB is well satisfied with its working relationship with the AA consultants. More than 20 meetings have been held between AA and ADB. One particular instance of cooperation between AA and ADB was their joint effort to have non-members of the PSE sit on the Board of Directors of the PSE. ADB believes, correctly, that effective

governance of the PSE is crucial if it is to fulfill its self-regulatory role.

ADB believes that the work of AA under the USAID contract picks up and advances the work begun while using PW as its consultant in 1993: to reform the SEC so that it becomes a disclosure oriented agency overseeing a self-regulated industry. In its Memorandum of Understanding (MOU) with GOP with respect to the ADB loan, the ADB provided a matrix of specific agenda items that it expects the SEC to achieve. This matrix is consistent with the reforms recommended by AA under the TA contract with USAID.

#32. What are the implications of the shift in SEC oversight from the Office of the President to the Department of Finance to Project implementation? How might the Project profit from this shift in operational terms? From a policy/advocacy perspective?

The evaluation team believes that the shift in SEC oversight from the Office of the President to the Department of Finance (DOF) is potentially beneficial to Project implementation. There may be some negative long term implications to the shift in authority in theory. Nevertheless, given the ability of the current incumbent Chairwoman of the SEC to frustrate the essential goals of the Project, DOF oversight poses the most practical method of implementing the project.

As a model, the USSEC, which oversees the largest financial market in the world with the highest integrity standards, suggests the need for an independent SEC subject only to presidential authority to designate and remove members of the Commission. However, the Chairwoman of the SEC believes that her authority to act as the chief administrative officer of the SEC gives her the authority to countermand substantive rulings of the SEC en banc.

The evaluation team finds that the Commissioners and staff of the SEC are particularly frustrated with a process whereby recommendations have worked their way up the organizational chain within the SEC, have been approved by the SEC en banc, and are then get side-tracked. The evaluation team has concluded that the Chairwoman has frustrated Project implementation.

Given the frustration in implementing the Project, the evaluation team views the Philippine President's authorization to the DOF to oversee the SEC to be a positive factor for the Project. It potentially has the following beneficial effects:

- Implementation of the work cell concept, which is designed to put the SEC on a path to effectively process registration statements for new securities offerings and to ensure ongoing

disclosure by issuers as well as to provide the structure for SEC oversight of the Philippine self-regulatory organizations,

- Encouragement of SEC staff participation in the process of developing a self-regulatory organization,
- Encouragement of movement away from SEC control over the pricing of IPOs and advancement of the reform of the IPO distribution process, and
- Centralization of SEC documents management and dissemination of information to the public.

The DOF appears to desire to take the actions needed to move the Project forward. On January 24, 1995, the DOF issued Order No. 4-95 which adopts the SEC Key Policy Document and Corplan Memorandum of 1994, and adopts an implementation plan for the Project. Commissioner Gloria, a strong supporter of Project implementation at the SEC, was named the SEC Project Manager by the DOF. The PMC (comprised of the Secretary of Finance, the Chairwoman of the SEC, the Chairman of the CMDC, the President of the PSE and the Executive Director of FINEX) was assigned to carry out the Project according to the implementation plan adopted by the DOF.

It remains to be seen whether the DOF can take timely action over the objections of the Chairwoman of the SEC on particular issues. For example, on the implementation of work cells, the Secretary must address the recent negative opinion of the Civil Service Commission. The Secretary might profitably seek an authoritative opinion from the Department of Justice regarding the limitations on the authority of the SEC Chairwoman as the SEC administrator, or to clarify the authority of the SEC en banc.

While the authority of the DOF over the SEC may have benefits in the short run, SEC must be constituted as a quasi-independent body eventually. This is necessary because if the SEC is to accomplish its mandate, it will inevitably be faced with tough enforcement decisions related to high visibility individuals and companies. Such decisions ought not to be subject to direct management control by an outside agency.

#33. What are the principal accomplishments/shortcomings of the Project implementation to date? How could Project implementation be improved?

Public Sector

The Project has recorded a number of accomplishments. ARSA has been written and published for comment. SOPs have been written. They standardize for the first time procedures of the various SEC offices. Other major accomplishments include:

- A year's work on various Task Forces designed to move the SEC from merit regulation to full disclosure,
- Preparation of an organizational framework for analyzing registration statements and periodic reports,
- Specification of a framework for B-D licensing and regulation to include significant SRO responsibility,
- Specification of a framework for a market surveillance system to include significant SRO responsibility, and
- Development of recommendations for financial statement accounting and enforcement.

Project implementation is expected to improve through DOF pressure on the SEC to decide issues en banc rather than through the decisions of the Chairwoman by herself.

Private Sector

On the private sector side, a corporation has been established to provide a depository for equity and debt issues. The depository forms the core of a clearing and settlement system that should eventually meet G-30 standards.

PSE has moved ahead on an automated trading and market surveillance system. The PSE appears to be leading the way in this regard.

Project implementation could be improved by designating the PSE as an SRO, even prior to enactment of the ARSA. This would give a clear mandate to the PSE to proceed with dispatch along the path to self-regulation.

A. Accomplishments of FINEX

FINEX has created the Project Management Office to implement its CMDP-related projects. Progress made with these projects includes:

- Sponsorship of a TA study to identify a feasible clearance and settlement system. The study, managed by Citibank, is expected to be completed in July or August, 1995;
- Formation of a Training and Research Committee within the PMO. It is composed of representatives of FINEX, BAP, IHAP, PSE and the SEC. It assists with implementation of the Training, Education and Research Components and serves as the clearinghouse for all requests received by the PMO for training;
- Specification of the process by which candidates apply for training, and development of an inventory of in-country and third-country training courses;
- Development of a program in the Philippines for the internationally recognized certification program for CFAs.

The program's first cohort has almost completed the first year of the three year program;

- Specification of a new and yet to be used seminar/workshop program that is designed to make a profit. The program will be conducted by FINEX and its affiliates, including affiliates in all provinces. FINEX and any affiliate that implements the program will share costs and profits on a 50-50 basis. Training will inform potential issuers of possibilities to raise capital through debt and equity, and teach investors how to invest in the stock market;
- Award of a \$75,000 sub-grant to the PSE to study its Market Surveillance System;
- Creation of a PIC for the private sector, which is composed of representatives from the SEC, IHAP, FINEX, BAP and PSE;
- Assistance with creation of a PIC for the public sector which draws its membership from the DOF, PSE, CMDC, PMO and SEC;
- Promotion of policy discussion concerning the Central Depository, ADB's Policy Reform Matrix and ad hoc policy issues such as chain listing rules and IPO tax hearings;
- Development of a depository which should begin operations by the end of June;
- Industry leadership within the financial community in assisting the Capital Markets Project;
- Reactivation of the Capital Markets Development Council in 1994;
- Improvements in the Philippine Clearinghouse for the domestic debt market;
- Promoting FINEX's activities related to capital markets development with the assistance of a public relations consultant;
- Issuance of a publication entitled "Key Issues in the Philippine Capital market", which is intended for public distribution;
- Analysis of possibilities of a fee-based nationwide computerized information service for investors;
- Creation of infrastructure to implement short-term training courses;
- Completion of a technical study of FINEX's possible role in developing courses for securities salespersons and B-D office managers, creation of a code of ethics for financial institutions, recommendations for the ARSA, and introduction of mutual funds into the securities market; and
- Establishment of the Capital Markets Development Institute together with definition of its mandate.

B. Shortcomings of FINEX's PMO/PIC include:

- Lack of identification of a viable investor information services program;
- Inability to develop a short or long-term training strategy. A contract was awarded, but then held in indefinite abeyance

- due to the belief that the contractor could not develop a "vision" of what the training goals should be;
- Delay in developing efficient clearing and a brokers guarantee fund;
 - Need to develop training of clearance and settlement staff to review operational procedures and make suggestions for improved systems and procedures;
 - Slow start up and fractionalized responsibilities of PMO staff due to problems in recruiting an executive director;
 - Planning the development of the PCDJ required most (approximately 80 percent) of PMO staff resources during the first 18 months of operation. This suggests overemphasis on a single effort, because FINEX has other important mandates that relate to training, investor services and other start-up activities that can generate reflows;
 - Inadequate project management due to the lack of a computerized task management system; and
 - Uncompleted planning for provincial participation in securities markets.

C. Possible improvements in the Project include:

- Development of automated information systems for user groups in organizations; and
- Formulation of business plans for activities that can generate reflows to insure FINEX sustainability.

#34. What lessons have been learned during the course of project implementation that may be applied to future project design efforts?

The first lesson learned is that a thorough commitment regarding reform should be required from all levels of the agency sought to be reformed. Perhaps nothing could have altered the SEC response to important components of the Project. On the other hand, given the present situation, it would appear that where similar projects are undertaken in the future, it would be beneficial to gain specific authoritative and written commitments at the outset from the head of the pertinent organization before embarking on the Project.

Second, the ultimate separation of the clearing and settlement function from the depository and the need for a settlement guarantee fund separate from the depository might have been foreseen by a closer examination of the U.S. model. If that need had been documented and confronted at Project inception, perhaps the clearing and settlement component would have proceeded along with the dispatch that seems to have accompanied the depository. Moreover, Project and market participants apparently proceeded with the development of the system without analyzing the important connection between the financial viability of a clearing and

settlement system and the conduct of risky B-D practices that affect the viability of a clearing and settlement system and which can be abated in whole or in part by regulation.

The current unfinished draft of a B-D net capital rule is partial evidence of this finding. So is the lack of specificity in broker expression of concern that the Project will impact their business, which is recorded above in the response to Question 8. The net capital rule is a strategically important means to control B-D risk, and it should be addressed to by all participants prior to project design. Moreover, adequate negotiation at project inception would mean that from that time forward brokers would know exactly how the project would affect their businesses.

The connection between clearing and settlement risk and B-D practices should be explained to all market participants before Project commencement in order to determine whether or not B-Ds can be regulated. Regulation costs the B-Ds profits. Non-regulation makes the risks generated by B-D practices unappraisable. Unappraisable risks severely limit possibilities for creating a viable clearing and settlement system. Yet the credibility and viability of the entire stock market depends on a fully-functional clearing and settlement system. The problem of limiting B-D risk is compounded since B-Ds generally decide the extent to which they will be regulated by means of majority vote within their stock exchange. Hence, early negotiation is needed in each project to determine whether or not B-Ds can be regulated, and, consequently, whether or not the project is viable.

The quality of a market's clearing and settlement system is also a barometer of market efficiency since the adequacy of the settlement system is related to B-D viability. B-D practices that contribute substantially to B-D risk also disadvantage either investors or issuers, and consequently limit confidence in the securities market. For example, free riding creates artificial demand for securities and upward pressure on stock prices because the shares are not paid for. Shares not paid for pose a market risk to B-D's. In addition, the market is intended to reflect effective demand, that is, demand for shares expressed as an unqualified financial commitment to pay for the shares within the framework of the market's margin and settlement regulations. Free riding disadvantages all investors because it distorts the market's process of price discovery.

Similarly, forced allotments of shares of new issues to B-Ds' own accounts, especially in the context of merit regulatory pressure on issuers to keep IPO prices low, can result in artificially low prices for IPOs and thus handicap the market's ability to raise capital for new issues. The economic cost of these inequities can be measured in terms of either a multiple of the net capital requirements of the clearing guarantee fund, which should be placed on the B-Ds holding such shares, or the financial loss to investors

and issuers. Perhaps without exception, those B-D practices that pose significant capital allocation issues also disadvantage investors and issuers. Both groups quickly become aware of the disadvantages and limit their use of the equities market to the detriment of all potential beneficiaries of the resulting lost economic growth.

Third, existing capital market projects funded by USAID should be scrutinized now for clearing and settlement issues and B-D regulatory adequacy. The literature review of on-going and completed capital market projects in other countries that was conducted for this evaluation identified (a) a virtual inability of such projects to improve clearing and settlement systems, (b) a lack of analysis of the causes of this inability, and (c) numerous indications from market participants of the importance of clearance and settlement risk. The insights provided in this evaluation could be applied immediately to define and suggest solutions for this problem in other on-going USAID projects.

The Mid-term evaluation of a USAID funded capital market project in Indonesia indicates that progress stalled completely on the proposed clearing and settlement system. The final evaluation of a similar project in Kenya also indicates that no progress was made with a clearing and settlement system. The Kenya study states that:

...the clearing and settlement issue has to be dealt with as an institutional priority: it may be the most important matter which will have to be correctly addressed in the next year...

In both the Kenya and Indonesian evaluations, evaluators make vague suggestions that the problems with progress are political. No indication is made that the barriers may be technical and regulatory - technical control of risk through regulation of B-Ds and all other market participants.³

The mid-term evaluation of USAID's capital market project in Sri Lanka fails completely to discuss clearing and settlement issues or regulatory activities of the SEC or the stock exchange, even though the first and second goals of the project are to improve the operations of the SEC and Colombo Stock Exchange, respectively. Moreover, Sri Lanka has no clearance guarantee fund, nor do reports surveyed mention any plans to develop one.

³/ Midterm Evaluation, Financial Markets Project (497-0360), IQC contract No. PCE-0001-I-00-2051-00, Delivery Order No. 10, Prepared for USAID, Jakarta, Indonesia by Chemonics, October 1993, p. IV-13; and Final Report, Kenya: Evaluation of Capital Markets Authority, USAID, September 1994, p. 18.

The Sri Lanka evaluation report gives the most prominence to the third goal of the project, that is, improved public awareness of the securities market.⁴ Though not addressed in the evaluation report, positive public awareness probably will not develop until investors believe the transaction system is fair. Moreover, investors seem to have an uncanny ability to detect unfairness, spread word of its existence and solve the problem in a personal way by avoiding transactions.

Yet B-D malpractice and investor concern with B-D risk are alluded to in reports on the Sri Lanka stock market before and after USAID's mid-term evaluation. A report prepared for USAID in 1990 on a proposed regulatory role of the Securities Council (SEC) of Sri Lanka notes an increasing number of allegations concerning market malpractice and conduct of stock brokers including B-D trading using bogus names, settlement delays due to administrative backlog or malpractice of B-Ds or investors, use of banned short-selling practices, creation of false markets and false B-D statements to investors.⁵ The report confirms the urgent need to address these issues by noting that "the existence of such allegations affects the confidence of investors and is detrimental to the development of the market".⁶

A 1994 comparison of security market regulations and practices in thirteen countries also suggests that investors are acutely aware of unfair trading practices and the pervasiveness of lack of adequate regulatory practices. It states that:

In terms of overall regulatory effectiveness, Singapore, with its strong government influence, is generally viewed to be one of the best. Hong Kong is also viewed as very effective. The Philippines and Indonesia have hitherto been viewed as less effective. Thailand was viewed initially as ineffective, but has improved its performance in the last few months essentially by improved enforcement. The new Malaysian regulator is too new to allow a judgement. India's new regulator, SEBI, suffered a blow to its reputation during the 'scam' incidents.... One could say that the best test of effectiveness is whether the market judges it to be so, and

⁴/ Evaluation of The Private Sector Policy Support Project (No. 383-0100), Prepared for USAID/Colombo by Price Waterhouse International Privatization Group, December 1991, pp. 19-36.

⁵/ Sri Lanka Capital Markets Development Project, "The Role of the Securities Council in the Regulation of Market Intermediaries", Prepared for The Securities Council Sri Lanka and USAID/Sri Lanka, December, 1990, p. 3-10.

⁶/ Ibid., p. 3-10.

the international market is probably a keener judge of standards than the domestic market⁷.

Neither this report nor any of the others reviewed discuss clearing guarantee funds in relation to B-D risk, but this one does note that capital adequacy rules have been the subject of worldwide debate among regulatory bodies and exchanges. It notes that only one of the thirteen developing countries included in the study, Hong Kong, had a capital rule for B-Ds that met all of the standards cited in the report for the net capital rules used in the USA and the UK.⁸

The 1992 review of the Sri Lankan central depository also notes the need to address clearing and settlement risk. The report states that:

From the Clearing Bank's perspective, the Central Depository System was a much needed improvement and they are pleased to be working with the Colombo Stock Exchange and the Central depository System. Their observations are: ...

- Legal procedures may need tightening,
- Overall risk issues need to be competently addressed.

... The issues of risk are of vital interest to the clearing bank (and to nearly everyone else as well). They are refining a proposed 'Articles of Association' to provide a well-defined settlement guarantee mechanism... The issue is how to provide appropriate safeguards for the funds being extended and for the market's overall safety and stability.⁹

A study of the financial sector of Hungary in 1990 applauds the country's progress in moving toward book-entry with a central depository, but it expresses concern over the lack of attention to financial risk arising from clearing and settlement weaknesses. The report states that:

... the stock Exchange may not be paying enough attention to the financial exposure of the Exchange and its members. We believe that the Exchange should monitor and perhaps regulate the extent to which members borrow to finance their

⁷/ Discussion Paper, Securities Market Regulation & Supervision, Prepared by The Aries Group, LTD for the Asian Development Bank's Asia-Pacific Forum on Securities Market Regulation and Supervision, Manila, Philippines, July 11-13, 1994, p. 16.

⁸/ Ibid., p. 25-6 and Appendix III.

⁹/ A System Review of the Colombo Stock Exchange's Central Depository System, by Bill Gorman, June, 1992, partially funded by Quotron Systems, Inc. and their parent, Citibank, NA, pp. 33-4.

securities activities. If, and when, credit becomes available, consideration should be given to limiting the extent to which customers may borrow from dealers, banks or other professional lenders to finance their securities activities.... Clearance and settlement discipline should be rigorously enforced from the beginning.\¹⁰

To summarize this second lesson to be learned from this evaluation, security market success depends critically on fair treatment of issuers and investors. Such fair treatment requires clearance and settlement procedures, together with a clearing guarantee fund. These elements are perhaps a market's strongest form of internal validation that this fair treatment is occurring. As a consequence, USAID should use its leverage to insure that clearance guarantee funds are established in all of its projects. The existence of a fully-funded clearance guarantee fund in any market expresses market fairness by those stakeholders in the market who have the most in-depth knowledge of its operations and risks for all parties.

Third, start-up efforts on private sector components of USAID's capital market projects should focus quickly on well-defined projects that ensure rapid progress toward sustainability. Commencement of capital market activities in a non-profit organization such as FINEX, which is an industry-based membership association, requires radical adjustment of its activities. Such an adjustment is perhaps worthwhile, but can be made more efficient if consultants design, install and train staff to work on the required systems during Stage One of the project.

#35. Does the preliminary data lend itself to a determination of whether the Project should be continued after PACD? If so, how might it be extended or modified in subsequent phase(s)?

With regard to the Public Sector Component, it appears from the preliminary data that the Project should be continued after the PACD. The recommendations of the Project to reengineer the SEC from a Corporation Code administrative agency to a market-oriented disclosure agency are numerous and complex. It cannot reasonably be expected that such a change can be accomplished with finality by 1996. We see a need for on-the-job training after 1996, particularly in the area of enforcement, full disclosure operations, SRO oversight, B-D oversight, accounting policy formulation and audit oversight, and support staff coordination and systems implementation.

^{10/} Mission to Hungary, Observations, Findings and Recommendations, United States Financial Services Volunteer Corps, October, 1990, pp. II-10-11.

In order to enhance the prospects for successful training outcomes, any OJT program should be required to provide a structure which will include quantifiable measurements of progress. This will avoid a common failure to structure training and measure results. Structured OJT would be the preferable approach. The need to train staff at all levels in the Philippine SEC adds to the importance of a carefully structured training program that involves exposure to work situations in the PSE and relevant organizations. Such exposure may be needed to compensate for the Commission staff's lack of such experience now.

The total amount of budgeted funds will not likely be expended before the end of the PACD, principally due to delays in Project implementation attributed to inaction at the SEC. Such unexpended funds can very profitably be used for training at the SEC Commissioner and staff level.

#36. How should USAID/Manila manage the Project subsequent to this evaluation?

USAID Manila should manage the Project subsequent to this evaluation by:

- Continuing to coordinate with the Secretary of Finance at the highest level to ensure that the SEC Chairwoman does not handicap the project;
- Continuing to coordinate at a high level with the ADB to ensure that the Project's goals, as reflected in the PP and ADB-MOU, are carried out;
- Maintaining a hands on management approach to ensure that the clearing and settlement system is adequately funded in an accelerated manner and that the SEC adopts and enforces a net capital rule applicable to B-Ds; and
- Continuing involvement with FINEX management to support completion of Project activities in training and TA.

IV. CONCLUSIONS

The Project is well designed. Substantial progress has been made to date in achieving the stated goals of the Project. The Components of the Project are interdependent. Completion of the Project is crucial to the economic well-being of the Philippines. Unfortunately, it appears that a single person at the SEC presents a significant impediment to continuation of the Project. If the DOF is successful in having the decisions made by the SEC en banc carried out, the Project should show success in 1995 with the implementation of the SAP.

The SAP for 1995 is designed to successfully implement a fully functional SEC which will oversee a disclosure-based regulatory system with active enforcement and substantial reliance on the PSE as an SRO. In this respect, the SEC should play a pivotal role in

ensuring the viability of the clearing and settlement system to be developed on a cost-effective, risk-averse basis. While the primary work will be at the SRO, the SEC must effectively play an enforcement role. For these goals to be accomplished, the present Chairwoman of the SEC must accept the SEC's changing and extremely important mandates.

As regulations are drafted by the AA consultants, a continuing important need is apparent. SEC staff must be trained to fully understand and become able to implement a reorganized SEC mandate. The evaluation team believes that the reeducation of the SEC staff is a large undertaking that can be underestimated or inadequately addressed by placing ultimate reliance on the PSE as an SRO.

V. RECOMMENDATIONS

The evaluation team's full set of recommendations are:

1. Implement a full disclosure system completely. Both the Private and Public Sectors should realize the necessity of this for a viable debt and equities market and should cooperate fully to achieve this goal. In this regard, the current position of the SEC Chairwoman must be addressed.
2. Reorient FINEX training to focus on creating businesses that create reflows. These businesses include:
 - CFA training,
 - Security sales and office manager training,
 - Issuer and investor workshops/seminars,
 - Evaluation services for mutual funds and other third-party investors, and
 - Evaluation services for debt securities.
3. Create a corporation to use FINEX's reflows when the Project Management Organization (PMO) terminates at the end of the Project. Investors in the PCDI could have first refusal to become stockholders in the corporation. An executive director for the PMO would be easier to recruit if he/she would look forward to becoming president of the corporation. The corporation would own FINEX's share of the PCDI and should receive the reflows generated from that ownership interest. It would continue to provide training and other services that contribute reflows to the corporation. Such a corporation was specified in the original PP.
4. The AA component of the project should assist with the development of the guarantee fund. The guarantee fund is very important as is set forth in the letter from Keith Williams, Acting Chief Operating Officer of the Depository (See Annex J). Project policy implementation, which can reduce the risk the fund must bear, is just beginning. The AA team should

accelerate work on clearance and settlement and net capital requirements with short-term advisors.

The SEC should be encouraged to take a more aggressive role in ensuring that the clearing and settlement funding corporation is adequately capitalized. A sensitivity analysis of alternative net capital requirements for broker-dealers should be part of the planning process for this role. The evaluation team does not believe that any person interviewed had developed a clear understanding of the actual capital requirements of the clearing guarantee fund or levels of existing broker-dealer risk.

5. Study the broker-dealer allotment system as soon as possible, because it appears to restrict access of new issuers to the PSE and to the capital markets as a whole. Even Petron executives were required to negotiate with the brokers who, at first, wanted their standard allotment of 50 percent of the stock, then reduced their request to 10 percent. Before they conceded for no allotment, they threatened to prevent the listing if their allotment request was not honored.

The Petron offering was for a billion shares and raised approximately \$490 million in equity. A smaller company would not have been excused from the allotment system. The system can raise the price of offerings to the public because the brokers hold inventory in their own accounts until the share price rises, then they sell. It is also unfair to underwriters who are forced to take back stock from offerings that do not sell well.

This will be controversial, but the effort will be worthwhile. The ADB supports revising the current distribution system. The current allocation system results in delayed distribution of securities and provides opportunities for brokers to manipulate the market to gain unfair advantage. A Task Order is recommended as means to begin the required analysis.

6. Authorize a Task Order to make recommendations concerning the issuance of Class A and Class B stock. Class B stock has historically been issued to track foreign investment in certain industries. The practice originates from a constitutional provision prohibiting foreign investors from owning more than 40 per cent of publicly held companies. Relatively high foreign demand for Class B stock often results in it selling at a premium over Class A stock.

The constitutional provision is not likely to change. Hence, without A and B designation of stock the law could be violated, placing some investors and issuers at risk. At the same time, the price of some securities may be artificially increased due to foreign investor demand even in the face of that risk. A Task Order would be helpful in coming to grips with the issue.

Perhaps the SEC should issue tracking guidelines to ensure compliance with the constitutional provision without A and B stock. The Task Order should also study the price implications of removing the A and B classes in the absence of revision of the constitutional provision. Finally, the Task Order might study whether issuers are discouraged from going public if they do not have the ability to issue differential voting stock. This is not a high priority task, but it should be accomplished within the next year.

7. The SEC should release to the public the annual financial statements that corporations are required to make each year. Currently, the Chairwoman of the SEC reportedly has a relationship with the firm CIBI to publish for commercial sale an annual report - "The Philippine 5,000" - which contains extracts of data from the corporate submissions to the SEC. Production of this publication means that for three to twelve weeks after the peak report submission period, the public does not have access to these statements. Internally, it means the SEC cannot control the registry and distribution of these submissions. In addition, USAID's PP specified that FINEX should disseminate SEC public information. As a consequence, this possibility should be carefully reviewed.

ANNEXES

- A. List of Persons Contacted
- B. Schemata of Project Components and Activities
- C. Project Budget and Expenditures Through March 31, 1995
- D. Bibliography
- E. List of Task Orders of Public Sector Contractors
- F. Comparison of Philippine CMDP With Other Projects
- G. Summary of Training Activities, Public Sector
- H. Task Order Structure and Schedule, Public Sector
- I. Training Accomplishments, Public Sector
- J. Comments on Draft Report, CMDP Mid-Term Evaluation

Annex A - List of Persons Contacted

CAPITAL MARKETS DEVELOPMENT PROJECT

Private Sector Component:

Capital Markets Development Council

Roman A. Azanza
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Voluntary Executive Director of FINEX PMO
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Angie V. Salanio
Manager, Training, Education & Research

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Teodoro B. Montecillo
President

Keith Williams
Acting Chief Operations Officer

Public Sector Component:

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Ambassador Linda Tsao Yang
U.S. Executive Director

Bankers Association of the Philippines

Leonilo G. Coronel
Executive Director

Cebu International Finance Corporation

Ruben D. Almendras
Executive Vice President - Treasurer

Citibank, N.A. Manila

Anabelle Lim-Chua
Vice President, Corporate Finance

Flor Gozon Tarriela
Vice President & Managing Partner

Citibank, N.A. New York

David Anderson
Vice President

Citisecurities Inc.

Juan G. Barredo
Research Analyst

Albert dela Cruz
Analyst

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Rene D. Almendras
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Equitable Banking Corporation

Rolando D. Esguerra
First Vice-President
Head, Trust Services Group

Adora A. Yanga
Senior Manager, Stock Transfer & Other Agency Services Dept.
Trust Services Group

Export Processing Zone Authority

Engr. Ismael H. Itass
Zone Manager Cebu

First Orient Securities Inc.

Trinidad Y. Kalaw
President

The International Securities Consultancy

Valerie McFarlane
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Monico V. Jacob
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Assistant Vice President & OIC

Philippine Stock Exchange

Irving I. Ackerman
Governor, Philippine Stock Exchange
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Enriqueta C. Caguioa
Head, Membership and Corp Affairs

Eduardo Delos Angeles
President

Romeo M. Cabinian
Member, Philippine Stock Exchange
(Vickers Ballas Securities, Inc.)

Elizabeth C. Dinoy
Head, Capital Market Studies

David Go
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(David Go Securities)

Rafael "Harley" L. Llave
Chief Operating Officer

Atty. Manuel L. Lopez
Officer in Charge (Makati)

Sergio S. Marquez
Head, Research and Market Development

Elizabeth Pasion
Director, Information Systems

Efren C. Siron
AVP Information Systems

Price Waterhouse

Robert J. Parra
Chief of Party/CCPAP

Howard Schuman

Director of Training

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Head - Trust & Investment Division

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Fe Eloisa C. Gloria
Associate Commissioner

Rosario N. Lopez
Chairwoman

Merle O. Manuel
Associate Commissioner

Josefina L. Pasay-Paz
Director

Eugenio E. Reyes
Director, Brokers and Exchanges Department

Rodolfo L. Samarista
Associate Commissioner

Aida Sta. Teresa-Gaetos
Chief, Records Division

Perfecto R. Yasay, Jr.
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Terry Barker
Chief, Office of Economic Development

Andrew H. Maliner
Auditor

Donald C. Masters, Ph.D.
Chief, Office of Portfolio Development & Implementation Support

Kenneth Schofield
Director

Brad P. Wallach
Chief, Private Enterprise Support Division

	ASIAN DEV. BANK PW Study	USAID PROJECT PAPER	IDENTIFICATION of REFORMS Annual Progress Report 1994	IMPLEMENTING REFORMS Second Annual Plan 1995	ADB PROGRAM (MOU) LOAN
SECURITIES REGISTRATION and MONITORING	Cease Merit Regulation	Review Merit Regulation and work with SEC on Changes to such Requirements	En Banc SEC agreed to delete MR as a Requirement but retain Authority --- Can eliminate entirely	A - 01: Draft Revised Securities Act; Investment Company Act; Investment Houses Act.	Opposes Merit Regulation
Full Disclosure Program Reports ¹	Efficient Market based on Disclosure				Emphasis on Self-Regulation Maximize Disclosure
S - 10	SELF-REGULATION Emphasis	- Replaces SECs purely Regulatory Approach	- En Banc Acceptance of Disclosure and Reporting Regime (CMDP Task Force) Task Orders. (S-10, S-11, S-12, S-13)	S - 16 and S - 17 Drafting of Rules regarding Registration of Securities Disclosure and periodic Reporting for Issuers of S-K & S-X (USSEC rules for narrative & accounting respectively) and Procedures for Processing and Creating A Work Environment to Implement New Procedures	Requires Adherence to Standards for Clearing & Settlement & Delivery vs Payment in the Central Depository
S - 11	SEC REORGANIZATION - Corporation Code	Automation and Transparency of Trading, Clearing and Settlement	PSE - Market Surveillance - Transparency - Centralized Clearing and Depository (C-44; C-46)	S - 19: Training of SEC Personnel to ensure understanding of New Procedures.	Strengthen SEC Enforcement.
S - 12	- Adjudicatory - Corporation Finance			F - Accounting Series. *	
S - 13 (Key Policy Issues Adopted by SEC)		SEC Reorganization - Need to rationalize overlapping function. - Market Information Service - Fully functioning sub-offices	S - 10: Work Cells Recommendations	P - Enforcement Series. *	
S - 14 Training			S - 11: Task Force Work Cells - Realign Functions in Corporate Finance - Realign Functions in Market Regulation - Centralized Registration - Equitable Distribution - Core plan Goals adopted by En Banc	* Second Year Project	
S - 16 and S - 17 Registration and Public Reporting Rules and Procedures (1995)			S - 12: Establish Model Plan Work Cells for Corporate Financial and Market Regulation		
S - 19 Training (1995)			S - 13: Key Public Issues adopted by SEC En Banc June 14, 1994		
P - 50 Enforcement			S - 14: Job Descriptions, Training Guidelines, Automation, Records Reorganization		
			P - 50: Refocusing SEC enforcement to engage violators of securities laws, including insider trading, disclosure violations, and broker-dealer compliance.		

¹/ Codes of the form (Letter, A... - Number, 1...) indicate task order reports.

Legends:

ADB - Asian Development Bank
 PW - Price Waterhouse
 MOU - Memorandum of Understanding
 MS - Market Surveillance
 MSS - Market Surveillance System
 PSE - Philippine Stock Exchange
 SEC - Securities and Exchange Commission
 MR - Merit Regulation

	ASIAN DEV. BANK PW Study	USAID PROJECT PAPER	IDENTIFICATION of REFORMS Annual Progress Report 1994	IMPLEMENTING REFORMS Second Annual Plan 1995	ADB PROGRAM (MOU) LOAN
BROKER DEALER REGULATION	SELF-REGULATION	SELF-REGULATION	Joint SEC/PSE Task Force	B - 23: DRAFT RULE CHANGES for SEC/PSE Task Force for SEC Broker-Dealer Regulation	- Require PSE to be subject to SEC Oversight
Task Order Closing Reports Published	Basic Rules provided by SEC:	- Maximum Use of Expertise of Private Sector	B - 21: Review of Broker-Dealer Regulation SEC/PSE Task Force Review Recommendations	B - 24: WRITE PROCEDURES for Broker-Dealer Regulation PSE Oversight by SEC	- PSE required to enforce its Rules of Just Trade
B - 21	- Register Exchanges - Register Investment Houses	- Improved Compliance with Standards	PSE to assume Regulatory Responsibilities as it grows	B - 25: IMPLEMENT WORK UNITS for Market Surveillance SRO Oversight and Broker-Dealer Regulation	- Prohibit Brokers from withholding Hot Issues to Public
B - 22	- Register Brokers-Dealers - Register Sales Persons	- Broker-Dealer Firms must regulate activities of their Employees	Recommendations:	B - 75: TRAINING for Broker-Dealer Regulation and PSE Oversight	- Require Disclosure of Fees
B - 24	-----	- SEC Oversight, not inconsistent with Self-Regulation	- Net Capital Rules	B - 76: DEVELOP EXAMINATION for Broker-Dealer Sales Persons and Supervisors	- Establish a Compliance and Surveillance Department
P - 50	- Exchanges monitor their Broker-Dealer Members	- Broker-Dealers monitor Employees	- Books and Records Rules	B - 77: REVIEW and VALIDATE B - 76	- Code of Conduct for Brokers - Require Penalties as Deterrants
	-----		- Unify Broker-Dealer/Investment Houses Registration	B - 78: DEVELOP A STUDY GUIDE for Persons taking the Sales Persons and Super- visory Exams.	- Require Broker-Dealer to adhere to Rules.
			- Require Securities to be distributed at Offering Price-----No Broker-Dealer Withholding of Shares	P - 50: ENFORCEMENT	Grounds for Revoking License - Non-compliance with Rules.
			- Suitability Rules		
			- Broker-Dealer Registration		
			- Overhaul Broker-Dealer Examinations primarily by PSE, SEC as Supervisor		
			- SEC to concentrate on Insider Trading and Market Manipulation		
			- PSE to establish Rules and do Rule-Writing and Rule Enforcement		
			B - 22: - MARKET SURVEILLANCE - Broker-Dealer Regulation		
			B - 24: (B-21 IMPLEMENTATION) Plan approved by SEC/PSE Task Force.		

Legends:

- ADB - Asian Development Bank
- PW - Price Waterhouse
- MOU - Memorandum of Understanding
- MS - Market Surveillance
- MSS - Market Surveillance System
- PSE - Philippine Stock Exchange
- SEC - Securities and Exchange Commission
- MR - Merit Regulation

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	ASIAN DEV. BANK PW Study	USAID PROJECT PAPER	IDENTIFICATION of REFORMS Annual Progress Report 1994	IMPLEMENTING REFORMS Second Annual Plan 1995	ADB PROGRAM (MOU) LOAN
MARKET SURVEILLANCE	Require Exchanges to have Written Programs for Monitoring Trading Activities	Automated Trading System permits Transparency, to achieve a Fair Market where Price/Time is strictly observed	M - 26: MARKET SURVEILLANCE does not exist at PSE as of March 24, 1994. Recommends MS System separate from Trading Floors. Clear-cut division of responsibility between SEC and PSE. PSE to be MSS Operator.	M - 30: DEVELOP TIMETABLE for MSS Implementation. Establish written procedures.	PSE to establish a Compliance Department Prevent Insider Trading
Task Order Closing Reports Published	-----	-----	-----	-----	-----
M - 26					
M - 27					
M - 28	Commitment to self-regulation	Increase Market Confidence by Transparency	-----		
M - 31	Concept that Regulation is best accomplished by SRO	-----	M - 27: SEC/PSE TASK FORCE organized to determine how to establish effective Market Surveillance System		
P - 50		Need to Automate SEC to enhance its ability to carry out Surveillance. Information access facility linked to Private Sector - and Regional Offices.	Recommendations: - separate System from Trading Floors - attack Insider Trading and Manipulation - PSE Primary Operator		

			M - 28: DRAFT RULES for MSS		
			M - 31: TWO WEEK PSEC/PSE TRAINING in MS	P - 50: ENFORCEMENT	

Legends:

- ADB - Asian Development Bank
- PW - Price Waterhouse
- MOU - Memorandum of Understanding
- MS - Market Surveillance
- MSS - Market Surveillance System
- PSE - Philippine Stock Exchange
- SEC - Securities and Exchange Commission
- MR - Merit Regulation

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Annex C

PROJECT BUDGET and EXPENDITURE

1. FINEX Foundation Private Sector Funds through March 31, 1995:

	Approved Budget	Advances to date	Disbursements to date	Undisbursed Balance from Advances
a. Technical Studies	\$1,091,862.03	\$745,805	\$698,123	\$393,739
b. Investor Information Services	\$167,617.02	\$0	\$0	\$167,617
c. Exchange Automation	\$1,000,000.00	\$0	\$0	\$1,000,000
d. Training, Education, Research	\$975,641.76	\$1,357	\$1,313	\$974,284
e. Policy Reform	\$422,051.19	\$0	\$0	\$422,051
f. Institution Building	\$1,281,914.96	\$0	\$0	\$1,281,915
g. Audits	\$53,913.04	\$0	\$0	\$53,913
Sub-Total	\$4,993,000	\$747,162	\$699,436	\$4,293,519

2. PSEC Public Sector Funds through February 28, 1995

	Budget ²	Total Cost Incurred to Date	Total Funds Remaining
a. Commodity Procurement	\$1,646,193	\$108,792	\$1,537,400
b. Information Access	\$748,000	\$65,011	\$682,988
c. Policy Reform	\$316,000	\$137,804	\$178,195
d. Training & Education	\$794,669	\$82,345	\$712,323
e. Institutional Support	\$1,298,812	\$367,675	\$931,137
Sub-Total	\$4,803,674	\$761,627	\$4,042,043
f. Fixed Fee	\$0	\$30,543	(\$30,543)
TOTAL	\$4,803,674	\$792,170	\$4,011,500

1/Information from FINEX quarterly report for the period ending 31 March 1995.

2/Information from Arthur Andersen & CO. Voucher No.17 for the period ending 31 March 1995

Annex D - Bibliography

Task Order Deliverables and Other Project-Related Reports

A. Public Sector:

See Annex E

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B. Private Sector:

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Petron Corporation: Prospectus for 1,000,000,000 Shares. Issue Managers and Lead Underwriters, Development Bank of the Philippines and Philippine National Bank; July 4, 1994.

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1. Current Status Assessment Report
Information Planning Study
Deliverable for Task Order A02 (August 15, 1994)
By Arthur Andersen & Co.
USAID Contract No. 492-0447-C-00-3119-00 (Public Sector Component), CMDP
Securities and Exchange Commission - Philippines
(Part 1 of 3)

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Information Planning Study
Deliverable for Task Order A02 (September 30, 1994)
By Arthur Andersen & Co.
USAID Contract No. 492-0447-C-00-3119-00 (Public Sector Component), CMDP
Securities and Exchange Commission - Philippines
(Part 2 of 3)

Information Plan Report
Information Planning Study
Deliverable for Task Order A02 (October 20, 1994)
By Arthur Andersen & Co.
USAID Contract No. 492-0447-C-00-3119-00 (Public Sector Component), CMDP
Securities and Exchange Commission - Philippines
(Part 3 of 3)
2. Office Automation Strategy Report
Deliverable for Task Order A04 (July 1994)
By Arthur Andersen & Co.
USAID Contract No. 492-0447-C-00-3119-00 (Public Sector Component), CMDP
Securities and Exchange Commission - Philippines
3. Office Automation Implementation
Closing Report for Task Order A04 (October 5, 1994)
By Arthur Andersen LLP
USAID Contract No. 492-0447-C-00-3119-00 (Public Sector Component), CMDP
Securities and Exchange Commission - Philippines
4. The Existing SEC Contracts
Closing Report for Task Order A05 (March 3, 1994)
By Frank Holz and Nonie Arboleda, Andersen Consulting
USAID Contract No. 492-0447-C-00-3119-00 (Public Sector Component), CMDP
Securities and Exchange Commission - Philippines
5. Review of the Financial and Administrative Systems

- Closing Report for Task Order AO7 (April 21, 1994)
By Arthur Andersen & Co.
USAID Contract No. 492-0447-C-00-3119-00 (Public Sector
Component), CMDP
Securities and Exchange Commission - Philippines
6. Corporate and Partnership Registration System and Name
Verification System Review
Closing Report for Task Order AO8 (April 25, 1994)
By Arthur Andersen & Co.
USAID Contract No. 492-0447-C-00-3119-00 (Public Sector
Component), CMDP
Securities and Exchange Commission - Philippines
7. Review Office Environment and Strength Level
Closing Report for Task Order AO9 (April 22, 1994)
By Arthur Andersen & Co.
USAID Contract No. 492-0447-C-00-3119-00 (Public Sector
Component), CMDP
Securities and Exchange Commission - Philippines
8. NVS Data Conversion
Closing Report for Task Order A10 (November 14, 1994)
By Arthur Andersen & Co.
USAID Contract No. 492-0447-C-00-3119-00 (Public Sector
Component), CMDP
Securities and Exchange Commission - Philippines
- Broker/Dealer Licensing and Regulation: Program Review
Closing Report for Task Order B21 (June 20, 1994)
By Arthur Andersen & Co.
USAID Contract No. 492-0447-C-00-3119-00 (Public Sector
Component), CMDP
Securities and Exchange Commission - Philippines
10. Broker/Dealer Licensing and Regulation: Convene Special Tasks
Force
Closing Report for Task Order B22 (June 20, 1994)
By Arthur Andersen & Co.
USAID Contract No. 492-0447-C-00-3119-00 (Public Sector
Component), CMDP
Securities and Exchange Commission - Philippines
11. Broker/Dealer Licensing Regulation: Implement Transition Plan
Closing Report for Task Order B24 (March 30, 1995)
By Arthur Andersen & Co.
USAID Contract No. 492-0447-C-00-3119-00 (Public Sector
Component), CMDP
Securities and Exchange Commission - Philippines
12. Securities Licensing and Monitoring: Identify Civil Service
Context

- Closing Report for Task Order CIV (April 15, 1994)
 By Arthur Andersen & Co.
 USAID Contract No. 492-0447-C-00-3119-00 (Public Sector
 Component), CMDP
 Securities and Exchange Commission - Philippines
13. Clearing & Settlement Depository: Program Review
 Closing Report For Task Order C44 (Dec, 1994)
 USAID Contract No. 492-044-c-00-3119-00
 Securities and Exchange Commission - Philippines)
14. Clearing Settlement Depository: Program Review
 Closing Report for Task Order C44 (Dec. 31, 1994)
 USAID Contract No. 492-044-C-00-3119-00 (Public Sector
 Component), CMDP
 Securities and Exchange Commission - Philippines
15. Clearing/Settlement/Depository: Working Group
 Closing Report for Task Order C46 (March 22, 1995)
 By Arthur Andersen & Co.
 USAID Contract No. 492-0447-C-00-3119-00 (Public Sector
 Component), CMDP
 Securities and Exchange Commission - Philippines
16. Linking Extension Offices: Evaluate Current Linkage
 Closing Report for Task Order E32 (April 25, 1994)
 By Arthur Andersen & Co.
 USAID Contract No. 492-0447-C-00-3119-00 (Public Sector
 Component), CMDP
 Securities and Exchange Commission - Philippines
17. Linking Extension Offices: Establish New Linkages
 Closing Report for Task Order E33 (July 14, 1994)
 By Arthur Andersen & Co.
 USAID Contract No. 492-0447-C-00-3119-00 (Public Sector
 Component), CMDP
 Securities and Exchange Commission - Philippines
18. Market Surveillance: Program Review
 Closing Report for Task Order M26 (March 25, 1994)
 By Arthur Andersen & Co.
 USAID Contract No. 492-0447-C-00-3119-00 (Public Sector
 Component), CMDP
 Securities and Exchange Commission - Philippines
- 1 Market Surveillance: SEC/PSE Task Force
 Closing Report for Task Order M27 (April 8, 1994)
 By Arthur Andersen & Co.
 USAID Contract No. 492-0447-C-00-3119-00 (Public Sector
 Component), CMDP
 Securities and Exchange Commission - Philippines

20. Market Surveillance: Draft Rules
Closing Report for Task Order M28 (June 10, 1994)
By Arthur Andersen & Co.
USAID Contract No. 492-0447-C-00-3119-00 (Public Sector Component), CMDP
Securities and Exchange Commission - Philippines
21. Market Surveillance: Provide Training
Closing Report for Task Order M31 (January 16, 1995)
By Arthur Andersen LLP
USAID Contract No. 492-0447-C-00-3119-00 (Public Sector Component), CMDP
Securities and Exchange Commission - Philippines
22. Enforcement: Program Review
Closing Report for Task Order P50 (April 21, 1995)
By Arthur Andersen LLP
USAID Contract No. 492-0447-C-00-3119-00 (Public Sector Component), CMDP
Securities and Exchange Commission - Philippines
23. Records Management Activity Review
Closing Report for Task Order R34 (March 25, 1994)
By Arthur Andersen & Co.
USAID Contract No. 492-0447-C-00-3119-00 (Public Sector Component), CMDP
Securities and Exchange Commission - Philippines
24. Establish RMTF and Project Group
Closing Report for Task Order R35 (April 6, 1994)
By Arthur Andersen & Co.
USAID Contract No. 492-0447-C-00-3119-00 (Public Sector Component), CMDP
Securities and Exchange Commission - Philippines
25. Records Management: Develop Integrated Plans/Organization
Closing Report for Task Order R36 (May 27, 1994)
By Arthur Andersen & Co.
USAID Contract No. 492-0447-C-00-3119-00 (Public Sector Component), CMDP
Securities and Exchange Commission - Philippines
26. Records Management: Support to the RMTF
Closing Report for Task Order R37 (November 29, 1994)
By Arthur Andersen & Co.
USAID Contract No. 492-0447-C-00-3119-00 (Public Sector Component), CMDP
Securities and Exchange Commission - Philippines
27. Securities Licensing and Monitoring: Program Review
Closing Report for Task Order S10 (April 29, 1994)
By Arthur Andersen & Co.

USAID Contract No. 492-0447-C-00-3119-00 (Public Sector Component), CMDP
Securities and Exchange Commission - Philippines

28. Securities Licensing and Monitoring: Establish LMTF Closing Report for Task Order S11 (August 15, 1994)
By Arthur Andersen & Co.
USAID Contract No. 492-0447-C-00-3119-00 (Public Sector Component), CMDP
Securities and Exchange Commission - Philippines
29. Securities Licensing and Monitoring: Experimental Working Groups
Closing Report for Task Order S12 (August 22, 1994)
By Arthur Andersen & Co.
USAID Contract No. 492-0447-C-00-3119-00 (Public Sector Component), CMDP
Securities and Exchange Commission - Philippines
30. Securities Licensing and Monitoring: Policy Discussions by LMTF Closing Report for Task Order S13 (June 27, 1994)
By Arthur Andersen & Co.
USAID Contract No. 492-0447-C-00-3119-00 (Public Sector Component), CMDP
Securities and Exchange Commission - Philippines
31. Securities Licensing and Monitoring: Form and Support Sub Task Forces
Closing Report for Task Order S14 (April 12, 1995)
By Arthur Andersen & Co.
USAID Contract No. 492-0447-C-00-311-00, CMDP
Securities and Exchange Commission - Philippines

Annex F

**Comparison of Philippine CMDP With
Other Projects**

I. DESIGN OBJECTIVES	ADB	INDO- NESIA	KENYA	SRI LANKA	CMDP PHIL	UNIQUE	INNO- VATIVE	COM- MENT
1. Central Depository	Yes	Yes	No	Yes	Yes	X		Depository
2. Counterpart Funding	No	Yes	No	No	Yes	X	X	In arrears
3. Regulation and Policy (AA)	Yes	Yes	Yes	Yes	Yes		X	Law revision
4. Organization (AA)	Yes	Yes	Yes	Yes	Yes	X	X	Work cell
5. Human Resources (AA)	No	Yes	No	No	Yes			
6. Technical Assistance (Finex)	No	No	No	Yes	Yes			CDS
7. Challenge Grant (Finex)	No	No	No	Yes	Yes	X	X	Seed Money
8. Investor Information Service (Finex)	No	No	No	No	Yes	X	X	For Investors
9. Training, Education and Research (Finex)	Yes	Yes	Yes	Yes	Yes	X	X	CFA
10. Institutional Support (Finex)	Yes	Yes	Yes	Yes	Yes			Expense
II. Features								
Stock Exchange/Trading	Yes	Yes	No	Yes	Yes			Surveillance
Guaranty Fund	No	No	No	No	No			Broker Deposit
Commodities (Computers)	No	No	No	Yes	Yes			Equipment
Privatization Program	Yes	Yes	Yes	Yes	No			
Task Orders	No	Yes	No	No	Yes		X	Consultants
Reflows					Yes			Sustainability
Local Consultants	No	Yes	Yes	Yes	Yes			Mgt. Consultants
Expatriate Consultants	No	Yes	No	Yes	Yes	X	X	Short-term
Long-term Advisers	No	Yes	Yes (1)	Yes(4)	Yes(3)	X	X	Qualified
Task Forces Format	No	Yes	No	No	Yes	X	X	Tracking
National Program	Yes	Yes	Yes	Yes	Yes			Capital City
Regional Program	No	No	No	Yes	Yes			Outstation

Annex G

Summary of Training Activities, Public Sector

SUMMARY OF TRAINING ACTIVITIES

Below is a summary of the training courses and conferences that were attended by SEC officials from January 1994 to May 1995.

DATE	COURSE/CONFERENCE TITLE	PLACE	SEC OFFICIALS INVOLVED
January 1994	IOSCC Conference	Bangkok & Hongkong	Rosario Lopez
February & March 1994	Office Automation (Initial CMDP Training)	Philippines (SEC Computer Training Center)	40 SEC staff
April 1994	Fourth Annual SEC International Institute for Securities Market Development	USA	Perfecto Yasay Olga Pacana
May 1994	Study Tour to Various Exchanges, the NASD and SEC	USA	Eugene Reyes Rodolfo Samarista Merle Manuel Perfecto Yasay
June 1994	Seminar on Investment Company Regulation	USA	Fe Eloisa Gloria Elizabeth Martin
August 1994	Conference for Regional Directors on Enforcement	Malaysia	Eligio Almojera
October 1994	XIXth Annual Conference of the IOSCO	Japan	Rosario Lopez Rodolfo Samarista Perfecto Yasay
November 1994	International Training Institute: Program on Securities Enforcement	Washington, USA	Myrna Go Emily dela Cruz
November 1994	Market Surveillance	Philippines	Martin Lauron Lita Dulfo Flora Togonon Rommel Oliva Reynaldo Sun Myrna Go
December 1994	Training Program for Certified Financial Analyst	Philippines	Linda Daoang Merle Pascual Teresita Rivera
January 1995	Regional Regulations Workshop	Malaysia	James Abugan Menardo Devera
January to December 1995	Office Automation (On-going CMDP Training)	Philippines (SEC Computer Training Center)	189 SEC staff (As of April 1995)
February 1995	Post Trade Operations	Philippines	16 SEC staff
March 1995	Self Regulatory Organizations and Broker-Dealer Surveillance	Philippines	48 SEC staff
April 1995	US SEC Fifth Annual International Institute for Securities Market Development	USA	Daisy Besa De Asis Merle Cunanan
April to May 1995	US-ASEAN Council for Business and Technology invitational Trip - PSE Delegation to the US	USA	Linda Daoang

Annex H

**Task Order Structure and Schedule,
Public Sector**

TASK ORDER STRUCTURE AND SCHEDULE

Capital Markets Development Project, Public Sector Component

Contract No. 492-0447-C-00-3119-00

As of May 22, 1995

Annex H

Stages and Task Orders	Year 1 Activities (10/93 - 9/94)					Year 2 Activities (10/94 - 9/95)					Year 3 Activities (10/95 - 9/96)				
	Reg	HR	IT	Start Date	End Date	Reg	HR	IT	Start Date	End Date	Reg	HR	IT	Start Date	End Date
Stage One - Conceptualizing and developing policy goals and institutional improvements															
A. Policy Goals and Legislation															
A01 - Legislation	X			21-Feb-94		X							15-Feb-95		
Securities Licensing and Monitoring															
S13 - Policy Discussions by LMTF	X	X		3-Jun-94	14-Jun-94										
Corplan 1994 - Planning Session and Action Priorities	X			May-94	Jul-94										
Corplan 1995 - Planning Session and Action Priorities						X			Jul-95	Sep-95					
B. Institutions' Strengthening															
Information Technology															
A02 - Information Plan (3 segments)															
Current Status Report - Information Planning Study			X	24-Jan-94	7-Sep-94										
SEC Information Technology Strategy Report			X	24-Jan-94				X					11-Oct-94		
Information Plan Report			X	24-Jan-94				X					20-Oct-94		
A04 - Office Automation Strategy Report (A04 segment 1 of 2)			X	20-Jan-94				X					5-Oct-94		
A05 - Existing SEC Contracts			X	18-Jan-94	10-Mar-94										
A06 - Tracking Baseline Data			X	4-Apr-94				X					30-Sep-95		
A07 - Review of Financial and Administrative Systems			X	18-Jan-94	25-Mar-94										
A08 - Review of Corporation and Partnership Registration System			X	24-Jan-94	30-Apr-94										
A60 - IT Organization Study							X	X	15-Oct-94	15-Jan-95					
Securities Licensing and Monitoring															
S10 - Program Review	X	X	X	25-Jan-94	6-May-94										
A09 - Review of Office Environment and Strength Levels		X		11-Mar-94	29-Apr-94										
CIV - Identify Civil Service Context		X		9-Mar-94	6-May-94										
S11 - Establish LMTF		X		4-Apr-94	15-Jul-94										
S12 - Experimental Working Groups		X		18-May-94	2-Jun-94										
S14 - Form and Support Sub Task Forces		X		27-Jun-94	30-Sep-94										
Broker/Dealer Licensing and Regulation															
B21 - Program Review	X	X	X	18-Apr-94	25-Jun-94										
B22 - Convene Special Task Forces	X			1-Jan-94	1-Jul-94										

Stages and Task Orders	Year 1 Activities (10/93 - 9/94)					Year 2 Activities (10/94 - 9/95)					Year 3 Activities (10/95 - 9/96)				
	Reg	HR	IT	Start Date	End Date	Reg	HR	IT	Start Date	End Date	Reg	HR	IT	Start Date	End Date
Market Surveillance															
M26 - Program Review	X		X	24-Feb-94	25-Mar-94										
M27 - SEC/PSE Task Force	X		X	7-Mar-94	12-Mar-94										
Linking Extension Offices															
E32 - Evaluate Current Linkage		X	X	16-Mar-94	28-Apr-94										
Records Management															
R34 - Activity Review		X	X	1-Feb-94	6-Apr-94										
R35 - Establish RMTF and Project Group		X		21-Mar-94	6-Apr-94										
R36 - Develop Integrated Plans/Organization		X	X	7-Mar-94	10-Jun-94										
R43 - Electronic Imaging Study							X	X	20-Feb-95	16-Jun-95					
Clearing/Settlement/Depository															
C44 - Program Review						X			3-Nov-94	31-Dec-94					
C48 - Settlement Working Group						X			15-Jan-95	15-Jul-95					
Enforcement Program															
P50 - Program Review	X	X		1-Sep-94		X	X			15-Apr-95					
Qualification Examinations for Broker/Dealers															
B76 - Qualification Examinations: Write Questions						X									
B77 - Review and Validate Examination Questions						X									
Financial Disclosure and Accounting/Auditing Standards															
F85 - Program Review						X									
F86 - Task Force on Accounting and Auditing						X									
Stage Two - Implementing improvements in policy goals, rules, laws, procedures, systems and organizational structures															
Information Technology															
A04 - Office Automation Implementation (A04 Segment 2 of 2)			X	20-Jan-94				X		14-Oct-94					
A10 - Name Verification System Data Conversion			X	2-May-94	1-Jul-94										
A59 - Development of the Name/Relationship System (NRS)						X	X		13-Mar-95	30-Sep-95					
A61 - Technical Architecture/Support for the Application Development Projects								X	15-Oct-94	30-Sep-95					
A62 - Development of Corporate Information System (CIS)								X	1-Dec-94	31-Aug-95					

Stages and Task Orders	Year 1 Activities (10/93 - 9/94)					Year 2 Activities (10/94 - 9/95)					Year 3 Activities (10/95 - 9/96)				
	Reg	HR	IT	Start Date	End Date	Reg	HR	IT	Start Date	End Date	Reg	HR	IT	Start Date	End Date
A63 - Development of Compliance Monitoring System (CMS)							X	X	1-Dec-94	30-Jul-95					
A64 - Programming Support								X	1-Dec-94	30-Sep-95					
A66 - Implement Commodities Procurement Plan								X	see A61						
A68 - Establish an SEC Computer Network								X	see A61						
Securities Licensing and Monitoring															
S16 - Rules and Legislation	X			20-Jun-94		X								30-Jun-95	
S17 - Structures/Procedures/Environment/Transition Plan						X	X		17-Mar-95	30-Sep-95					
Broker/Dealer Licensing and Regulation															
B23 - Draft Rules	X			3-4/94		X								15-Mar-95	
B24 - Implement Transition Plan						X	X		7-Nov-94	31-Mar-95					
B25 - Management Framework for Market Regulation Program						X	X		20-Apr-95	30-Sep-95					
Market Surveillance															
M28 - Draft Rules	X			14-Mar-94	21-Apr-94										
M30 - Implement Transition Plan						X	X								
Linking Extension Offices															
E33 - Establish New Linkage		X		18-Apr-94	22-Jul-94										
Records Management															
R37 - Support to the RMTF		X	X	18-May-94	28-Aug-94										
R39 - Structures and Procedures							X		3-Oct-94	30-Jun-95					
R40 - Development of the Records Management System (RMS)		X	X	18-Jul-94			X	X		31-Jul-95					
Clearing/Settlement/Depository															
C45 - Establish Working Group/Draft Rules						X			3-Nov-94	31-May-95					
C47 - Write and Implement Oversight Procedures						X									
Enforcement Program															
P51 - Draft Rules and Procedures						X									
P52 - Implement New Program						X	X								
SEC Rulemaking Process															
D56 - Publication of SEC Rules						X	X	X	3-Oct-94	30-Apr-95					
Human Resource Development															
H73 - Establish an SEC Code of Conduct						X	X								

Stages and Task Orders	Year 1 Activities (10/93 - 9/94)					Year 2 Activities (10/94 - 9/95)					Year 3 Activities (10/95 - 9/96)				
	Reg	HR	IT	Start Date	End Date	Reg	HR	IT	Start Date	End Date	Reg	HR	IT	Start Date	End Date
Qualification Examinations for Broker/Dealers															
B78 - Examination Procedures and Study Guides						X									
Financial Disclosure and Accounting/Auditing Standards															
F87 - Draft Guidelines, Rules and Procedures						X									
F88 - Implement New Guidelines, Rules and Procedures						X	X								
Stage Three - Training to resolve skill gaps in priority areas															
Information Technology															
A03 - MIS Advisory Assistance			X	6-Jun-94				X		30-Sep-95					
Office Automation Training Contract								X	Jan-95			X		Dec-95	
Securities Licensing and Monitoring															
S19 - Training and Skill Building						X	X								
Broker/Dealer Licensing and Monitoring															
B75 - Provide Training and Skill Building						X	X								
Market Surveillance															
M31 - Provide Training						X	X		14-Nov-94	25-Nov-94					
Records Management															
R41 - Assign/Assess/Train Staff							X		4-Oct-94	30-Jun-95					
Clearing/Settlement/Depository															
C49 - Provide Training/Skill Building						X									
Enforcement Program															
P53 - Training and Skill Building						X	X								
Human Resource Development															
W80 - Workshop: SEC Mandate, Powers and Responsibilities						X	X		15-Jan-95	30-Sep-95					
Financial Disclosure and Accounting/Auditing Standards															
F89 - Training and Skill Building						X	X								
T70 - Support to Task Forces						X	X	X	2-Jan-95	30-Sep-95					

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Annex I

**Training Accomplishments,
Public Sector**

TRAINING ACCOMPLISHMENTS

Capital Markets Development Project, Public Sector Component

Contract No. 492-0447-C-00-3119-00

As of May 22, 1995

Annex 1

Stages and Task Orders	Training Accomplishment Categories				
	On-site Advice	Ad-hoc Response	Workshops/ Seminars	Skill Building	Catalytic & Monitoring
Stage One - Conceptualizing and developing policy goals and Institutional improvements					
A. Policy Goals and Legislation					
A01 - Legislation	1, 2				3, 8, 9, 10
Securities Licensing and Monitoring					
S13 - Policy Discussions by LMTF			1, 2, 3, 8, 9, 10		
Corplan 1994 - Planning Session and Action Priorities			1, 2, 3, 8, 9, 10	4	
Corplan 1995 - Planning Session and Action Priorities					
B. Institutional Strengthening					
Information Technology					
A02 - Information Plan (3 Segments)					
Current Status Report - Information Planning Study	3, 5				
SEC Information Technology Strategy Report	3, 5				
Information Plan Report	1, 3, 5				
A04 - Office Automation Strategy Report (A04 Segment 1 of 2)	4			5	
A05 - Existing SEC Contracts	3	5			
A06 - Tracking Baseline Data					2
A07 - Review of Financial and Administrative Systems	4	5			
A08 - Review of Corporation and Partnership Registration System	4	5			
A80 - IT Organization Study	1, 3, 4, 5				

Legend:

- 1 - Task force participation (Licensing and Monitoring TF, Information Technology TF, Joint PSE/SEC TF, Legislative TF, Extension Office TF, Records Management TF)
- 2 - External focus on constituents and customers (issuers, markets and participants, investors)
- 3 - Program focus across functions (operations linked by program areas and policy goals)
- 4 - SOP development and operations implementation
- 5 - System development and technical operations
- 6 - Market Surveillance oversight and investigation
- 7 - Clearing and settlement (expert presentation)
- 8 - Enforcement awareness
- 9 - Disclosure awareness
- 10 - Market regulation, SRO oversight, and compliance awareness

Stages and Task Orders	Training Accomplishment Categories				
	On-site Advice	Ad-hoc Response	Workshops/ Seminars	Skill Building	Catalytic & Monitoring
Securities Licensing and Monitoring					
S10 - Program Review	2				2, 9, 10
A09 - Review of Office Environment and Strength Levels		4			
CIV - Identify Civil Service Context	3				2
S11 - Establish LMTF	1, 2, 3	4			9, 10
S12 - Experimental Working Groups	1, 2, 3	4			9, 10
S14 - Form and Support Sub Task Forces	1, 2, 3	4			9
Broker/Dealer Licensing and Regulation					
B21 - Program Review	3				8, 10
B22 - Convene Special Task Forces	1, 3				2, 8, 10
Market Surveillance					
M26 - Program Review	2, 3				6, 8, 10
M27 - SEC/PSE Task Force	1, 2			6, 8, 10	1
Linking Extension Offices					
E32 - Evaluate Current Linkage	1, 4				3
Records Management					
R34 - Activity Review	2, 4				3
R35 - Establish RMTF and Project Group	1				3
R36 - Develop Integrated Plans/Organization	1, 2, 4				3
R43 - Electronic Imaging Study	5				
Clearing/Settlement/Depository					
C44 - Program Review	4			7	2, 3, 6, 10
C46 - Settlement Working Group	7	4		7	1, 2

Legend:

- 1 - Task force participation (Licensing and Monitoring TF, Information Technology TF, Joint PSE/SEC TF, Legislative TF, Extension Office TF, Records Management TF)
- 2 - External focus on constituents and customers (issuers, markets and participants, investors)
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Stages and Task Orders	Training Accomplishment Categories				
	On-site Advice	Ad-hoc Response	Workshops/ Seminars	Skill Building	Catalytic & Monitoring
Enforcement Program					
P50 - Program Review	4				2, 3, 8, 9, 10
Qualification Examinations for Broker/Dealers					
B76 - Qualification Examinations: Write Questions	1			4	8, 10
B77 - Review and Validate Examination Questions	1			4	8, 10
Financial Disclosure and Accounting/Auditing Standards					
F85 - Program Review	4			2, 3	8, 9
F88 - Task Force on Accounting and Auditing	1, 4			2, 3	8, 9
Stage Two - Implementing improvements in policy goals, rules, laws, procedures, systems and organizational structures					
Information Technology					
A04 - Office Automation Implementation (A04 Segment 2 of 2)	4				
A10 - Name Verification System Data Conversion	4	5		5	
A59 - Development of the Name/Relationship System (NRS)	5				2, 3, 8
A61 - Technical Architecture/Support for the Application Development Projects	5				
A62 - Development of Corporate Information System (CIS)	5	4			3
A63 - Development of Compliance Monitoring System (CMS)	5	4			3, 8
A64 - Programming Support	5			5	
A68 - Implement Commodities Procurement Plan	5				3
A88 - Establish an SEC Computer Network	5			4	3

Legend:

- 1 - Task force participation (Licensing and Monitoring TF, Information Technology TF, Joint PSE/SEC TF, Legislative TF, Extension Office TF, Records Management TF)
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Stages and Task Orders	Training Accomplishment Categories				
	On-site Advice	Ad-hoc Response	Workshops/ Seminars	Skill Building	Catalytic & Monitoring
Securities Licensing and Monitoring					
S16 - Rules and Legislation	1	2			2, 8, 9
S17 - Structures/Procedures/Environment/Transition Plan	3, 4		8, 9	1, 2	8, 9, 10
Broker/Dealer Licensing and Regulation					
B23 - Draft Rules	1, 4	2			7, 8, 10
B24 - Implement Transition Plan	3, 4	1		1, 2	7, 8, 10
B25 - Management Framework for Market Regulation Program	4		6, 7, 8, 10	4	6, 7, 8, 10
Market Surveillance					
M28 - Draft Rules	2			6	
M30 - Implement Transition Plan	1, 3, 4			6	8, 10
Linking Extension Offices					
E33 - Establish New Linkage	3	4	1, 4		2
Records Management					
R37 - Support to the RMTF	3			3, 4	2, 9
R39 - Structures and Procedures	3	4		3, 4	2, 8, 9
R40 - Development of the Records Management System (RMS)	5	1, 4		1, 4	8, 9
Clearing/Settlement/Depository					
C45 - Establish Working Group/Draft Rules	1, 3	2	7		4, 7, 10
C47 - Write and Implement Oversight Procedures	1, 3		7	4	2, 8, 10

Legend:

- 1 - Task force participation (Licensing and Monitoring TF, Information Technology TF, Joint PSE/SEC TF, Legislative TF, Extension Office TF, Records Management TF)
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Stages and Task Orders	Training Accomplishment Categories				
	On-site Advice	Ad-hoc Response	Workshops/ Seminars	Skill Building	Catalytic & Monitoring
Enforcement Program					
P51 - Draft Rules and Procedures	1, 3, 4	8			2, 8, 9, 10
P52 - Implement New Program	8		8	1	2, 8, 9, 10
SEC Rulemaking Process					
D56 - Publication of SEC Rules	4	3			2
Human Resource Development					
H73 - Establish an SEC Code of Conduct	1, 2		1, 3		8
Qualification Examinations for Broker/Dealers					
B78 - Examination Procedures and Study Guides	4		1, 2		8, 10
Financial Disclosure and Accounting/Auditing Standards					
F57 - Draft Guidelines, Rules and Procedures	4			2, 3	8, 9
F58 - Implement New Guidelines, Rules and Procedures	1, 4		1	2, 3, 4	8, 9
Stage Three - Training to resolve skill gaps in priority areas					
Information Technology					
A03 - MIS Advisory Assistance	5	5	1		3
Office Automation Training Contract			1, 3	3, 5	
Securities Licensing and Monitoring					
S19 - Training and Skill Building	1, 2, 3		1, 4	3	8, 9

Legend:

- 1 - Task force participation (Licensing and Monitoring TF, Information Technology TF, Joint PSE/SEC TF, Legislative TF, Extension Office TF, Records Management TF)
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Stages and Task Orders		Training Accomplishment Categories				
		On-site Advice	Ad-hoc Response	Workshops/ Seminars	Skill Building	Catalytic & Monitoring
	Broker/Dealer Licensing and Monitoring					
	B75 - Provide Training and Skill Building	1, 2, 3, 4		1, 4	3	6, 8, 10
	Market Surveillance					
	M31 - Provide Training	1, 2, 3, 4		1, 4, 6	6, 10	8
	Records Management					
	R41 - Assign/Assess/Train Staff	1, 2, 3		1, 4	3	2, 3, 8, 9
	Clearing/Settlement/Depository					
	C49 - Provide Training/Skill Building	1, 2, 3		1, 7	7	6, 8, 10
	Enforcement Program					
	P53 - Training and Skill Building	1, 2, 3		1, 8	6	8, 9, 10
	Human Resource Development					
	W80 - Workshop: SEC Mandate, Powers and Responsibilities	1, 2, 3	4	1, 4		6, 8, 9, 10
	Financial Disclosure and Accounting/Auditing Standards					
	F89 - Training and Skill Building	1, 2, 3	4	1, 4	4	8, 9
	T70 - Support to Task Forces	1, 2, 3, 4	4		1	6, 8, 9, 10

Legend:

- 1 - Task force participation (Licensing and Monitoring TF, Information Technology TF, Joint PSE/SEC TF, Legislative TF, Extension Office TF, Records Management TF)
- 2 - External focus on constituents and customers (issuers, markets and participants, investors)
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Annex J

**Comments on Draft Report,
CMDP Mid-Term Evaluation**

PHILIPPINE CENTRAL DEPOSITORY, INC.

**c/o FINEX PROJECT MANAGEMENT OFFICE
7TH FLR, RUFINO PLAZA 6784 AYALA AVENUE, MAKATI, METRO MANILA, PHILIPPINES
TELS.: (632) 894-2401 or 894-2402 FAX: (632) 894-2398**

18 May 1995

**USAID
PRIVATE ENTERPRISE SUPPORT OFFICE
U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT
18/F Magsaysay Center
1680 Roxas Boulevard
Manila**

Dear Sirs:

Thank you for asking me to contribute to the review of the draft report of your evaluation team.

I find no areas of major error or where I would disagree on balance with the overall judgements made. It would be inappropriate to address minor details, so the following comments only are those I would wish to make:

- i) The contribution of USAID personnel appears to be greater to one who has been "on the ground" than has been given credit for in the report. In the experience of this writer, the head of PESO (Brad Wallach) has provided a sounding board and guidance on how to make progress and how to resolve some areas of disagreement between market participants on many occasions, at least in respect of the private sector component.
- ii) The PCD will provide settlement mechanisms in addition to depository services. The focus of the report on broker-dealer risk is, of course, well-founded; however, the NSCC/DTC model is not completely the one being followed here. Therefore, the challenge grant is being used to support more than just a depository - PCDI will provide settlement and book-entry-transfer services.

The report refers to automation of trading, clearing and settlement. Trading has been successfully automated by the PSE (and its predecessors). "Clearing" in the sense of there being a structure to confirm trades/identify and resolve out-trades is also undertaken by the PSE. The part which needs to be planned-for is the reduction of the likely incidence and effect of broker default and failure. The PSE/RCBC/EBC initiative will address this (it will involve, I understand capital of USD 2.5 million - not, as stated in the report, a study which will cost this much!). The evaluation report's emphasis on the need for both the public and sector components to address this is timely and will

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undoubtedly help to ensure that broker/dealer risk is now seen as an important priority.

Certainly, high and effective net capital requirements imposed by the PSEC would materially reduce the costs of a Trade Guarantee Fund. Without such enhanced requirements, the evaluator's fear that the cost to the sponsors of a TGF would be prohibitively high is well-founded. However, "real-time" mark-to-market functionality could itself also be prohibitive. There is a need to balance these costs. It may be necessary to rely upon "haircuts" for each asset class (coupled with much more stringent and frequent inspections, without notice).

It will take time to build up all three components relating to broker/dealer risk - the capital of the TGF, the regulatory requirements and the operational capabilities to monitor exposure and to handle defaults. The PCDI is ready to offer facilities and capabilities on an "agency" (i.e., "no-risk") basis to the TGF if required.

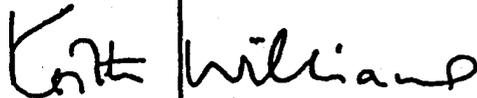
- iii) The settlement backlog remains a problem. The PCDI will not be able to meet its objectives unless further improvements are made in the way the industry manages this backlog - most importantly because no stock can be immobilized unless the majority of traded certificates are issued up-to-date. The report on P.36 ("a crisis was avoided...") may be optimistic - it could still occur. The Post-Trade Council is a recent development which the evaluation team may not have been informed about. This could be the right body to coordinate all the initiatives concerning clearing and settlement, etc.

In a few places there are logical or grammatical inconsistencies (inevitable in a time-bound draft) - these have been ignored or interpretations made which best fit the writer's own experience, under the assumption that the drafting team will correct these themselves. Thus, none of these are mentioned here.

Finally, the team should be congratulated on their thorough and penetrating work.

Sincerely yours,

PHILIPPINE CENTRAL DEPOSITORY, INC.



KEITH WILLIAMS
Acting Chief Operations Officer