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SUMMARY OF FINANCIAL MARKETS IN PHILIPPINES: SECONDARY SOURCE SURVEY

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NOTE

This document was prepared by Arthur Young and summarizes existing literature describing the country. Secondary sources were obtained from the International Monetary Fund, the World Bank, the Inter-American Development Bank, the African Development Bank, the Asian Development Bank, the United Nations, and other relevant commercial sources.

PHILIPPINES

SUMMARY OF FINANCIAL MARKETS SURVEY

A. ENVIRONMENT

1. Unstable political climate - the ruling political party, the New Society Movement, which has ruled since 1978 under President Ferdinand E. Marcos is now facing a unified opposition in the upcoming elections. There is also a strong communist party - Maoist Communistic Party of the Philippines-Marxist Leninist is the strongest communist party. It controls an army of approximately 10,000 soldiers and is considered a threat to the national security.

2. Unstable economic climate - since 1979 the country's economy has been deteriorating. The country has not recovered from the global recession of the early 1980s. It now faces depressed commodity prices, a significant external debt burden and a sizable trade deficit. The current political uncertainties have precipitated the departure of many corporations and foreign investors.

3. Social groups - Filippinos are basically of Malay stock but mixed with Chinese, Spanish and American strains. An estimated 85% of the population is Roman Catholic and the remainder belong to other Christian sects. The country faces a problem with the Muslim minority (the Moros) in the southern part of the archipelago who would like to secede.

4. National languages - English and Tagalog are the official languages. English is widely used in commerce, government and international relations.

5. Business community - most businesses in the Philippines are family owned and managed. The estimates for the number of families controlling the nation's wealth vary from 25 to 90 families.

6. International assistance

a) multilateral lenders:	World Bank International Development Association International Finance Corporation Asian Development Bank
b) country donors:	Japan United States Germany
c) IMF Stand-by Agreement:	Effective period is 12/04/84 through 06/13/86

B. ECONOMY

1) Non-bank financial institutions

a) these institutions accounts for 21% of the country's financial assets.

b) The different types of institutions and their estimated share of total country assets are:

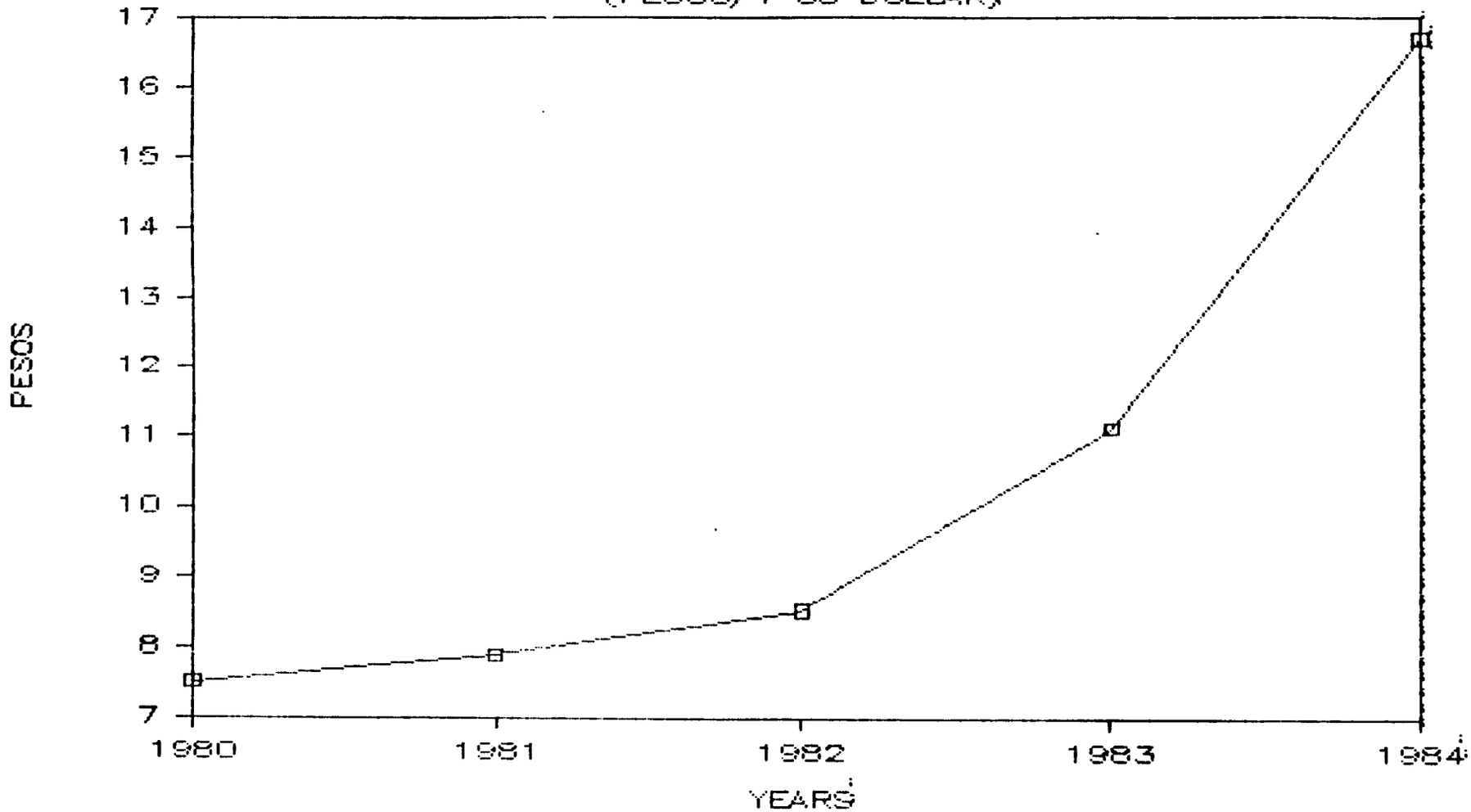
type of institution	number of companies	% of assets
investment houses	11	2.1
financing companies (includes leasing companies)	369	4.2
securities dealers/brokers	142	0.3
investment companies	63	1.9
fund managers	9	0.3
lending investors	74	*
pawnshops	574	0.1
gov't runned institutions	4	8.3
venture capital companies	8	*
building & loan associations	7	*
non-stock S & L associations	73	0.1
insurance companies (life and non-life)	135	3.9

2. Labor force analysis

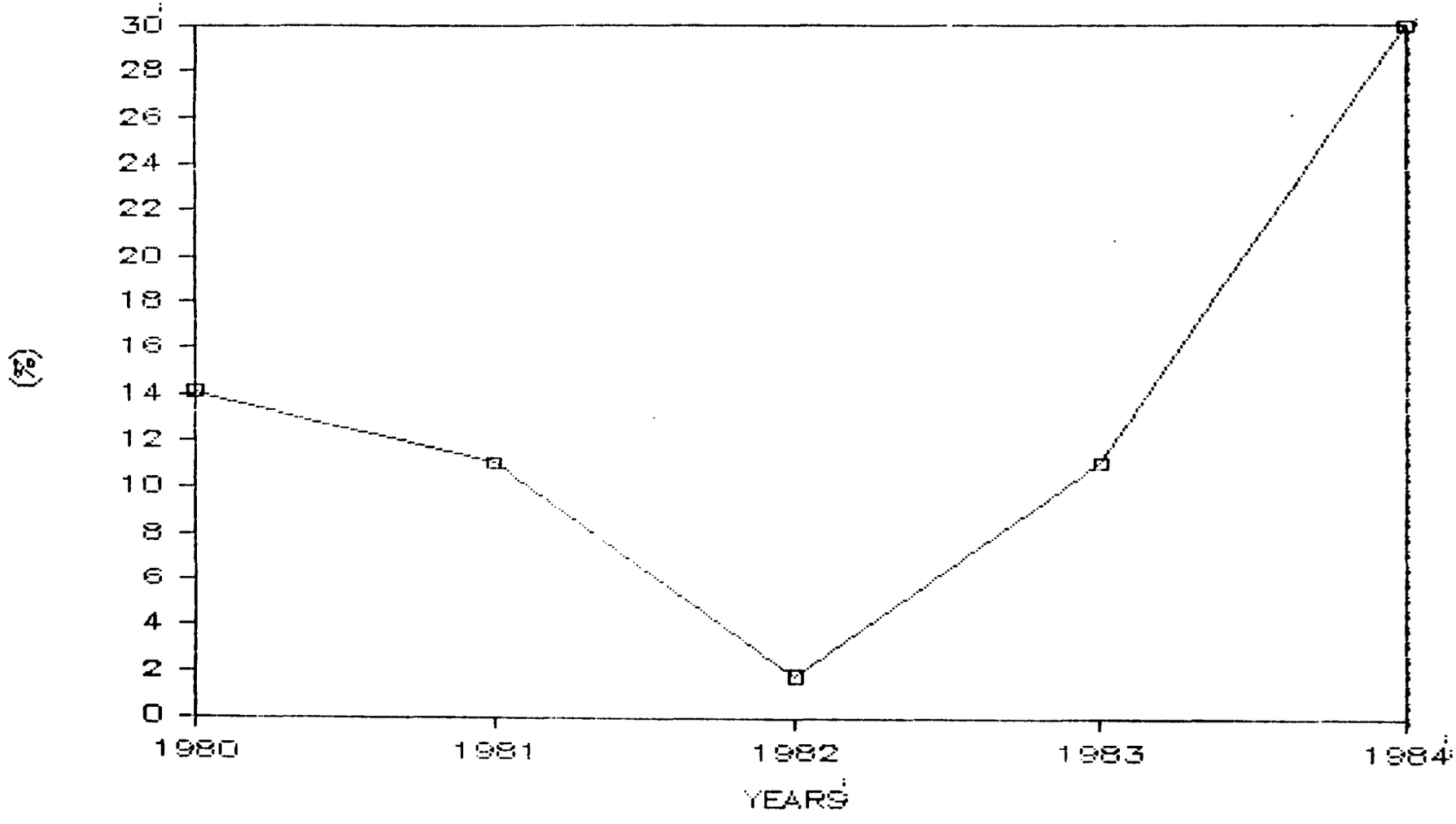
total population:	54,189,100
total labor force:	20,190,277
literacy rate:	over 80%
population growth rate:	constant 3%
percent of prcfessionals:	6.0
percent of workers in - agriculture:	52.0
- mining:	0.4
- manufacturing:	11.5
- utilities:	0.2
- construction:	2.9
- commerce:	10.5
- transportation, communications and storage:	4.1
- other services and unreported industries:	18.4

MARKET EXCHANGE RATE

(PESOS/1 US DOLLAR)

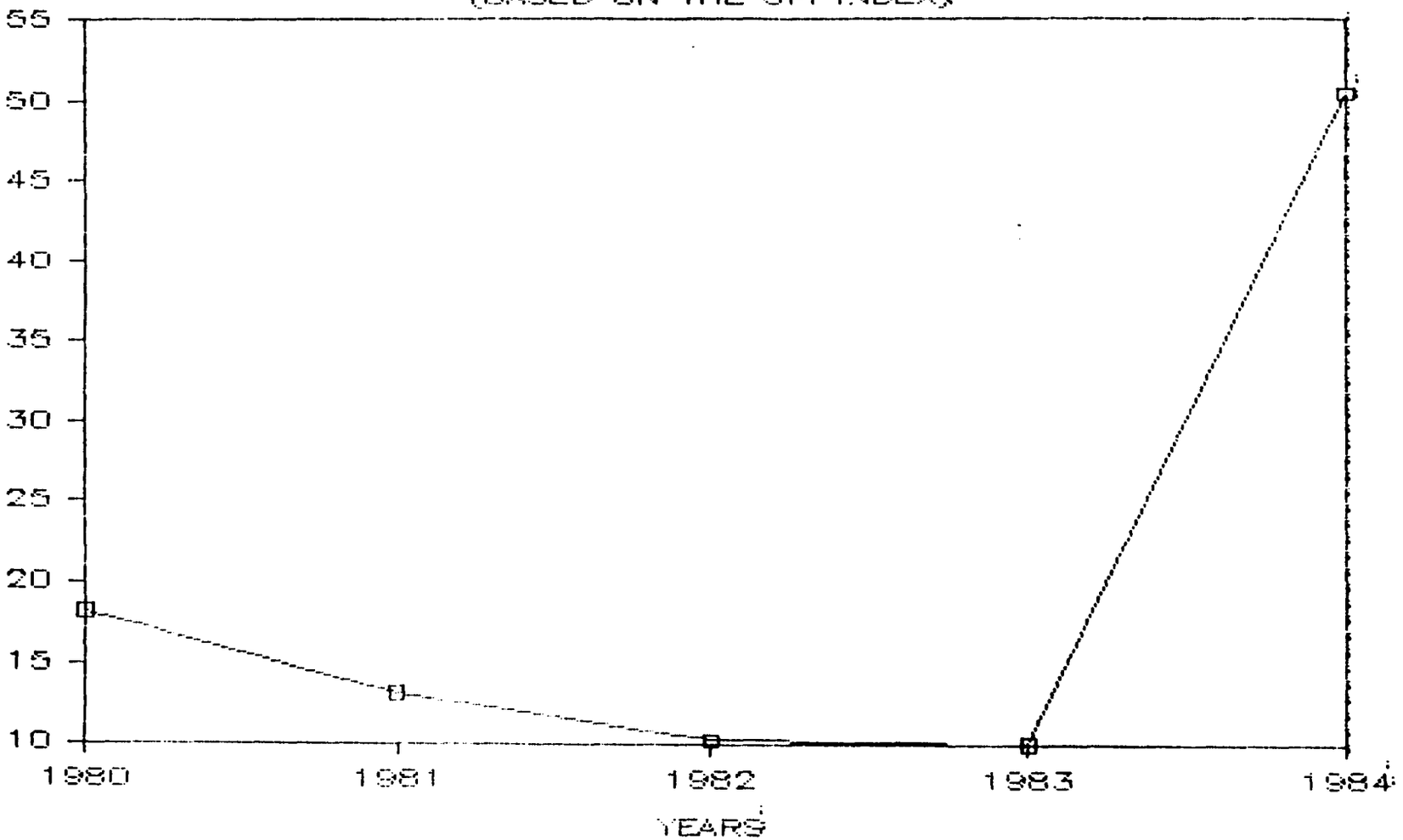


PERCENT CHANGE IN MONEY SUPPLY



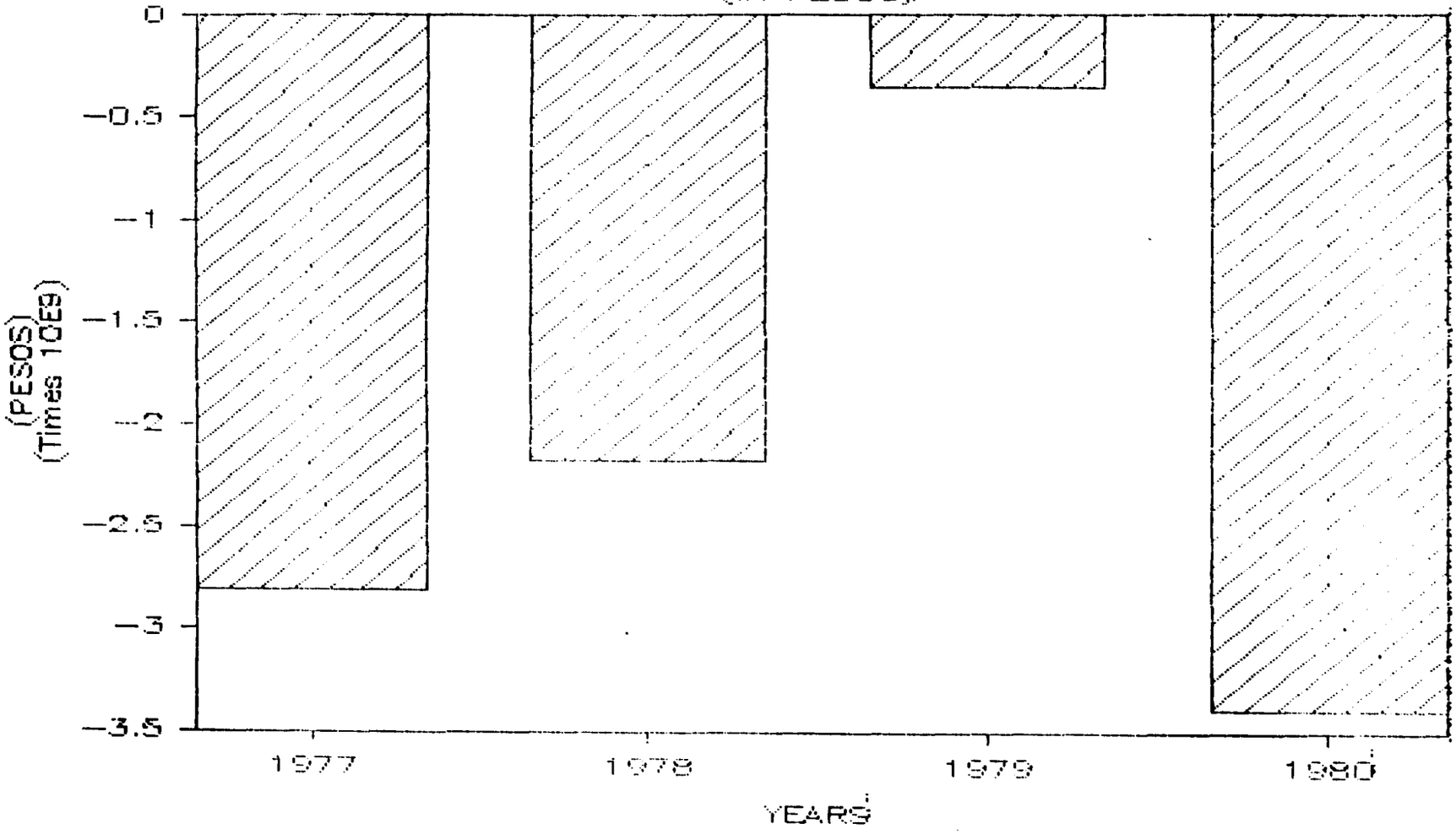
PHILLIPINE'S INFLATION RATE

(BASED ON THE CPI INDEX)



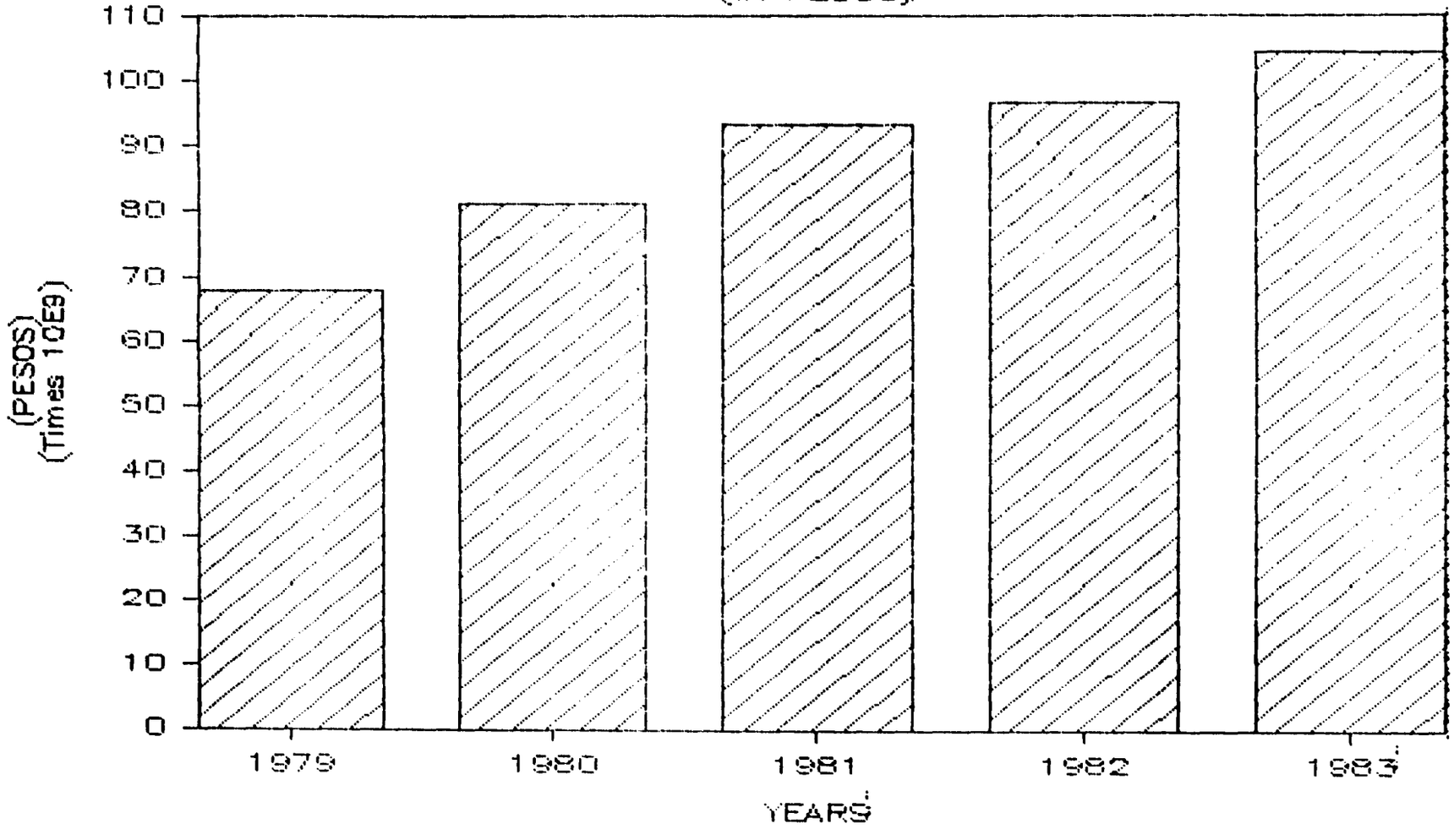
OVERALL DEFICIT/SURPLUS

(IN PESOS)



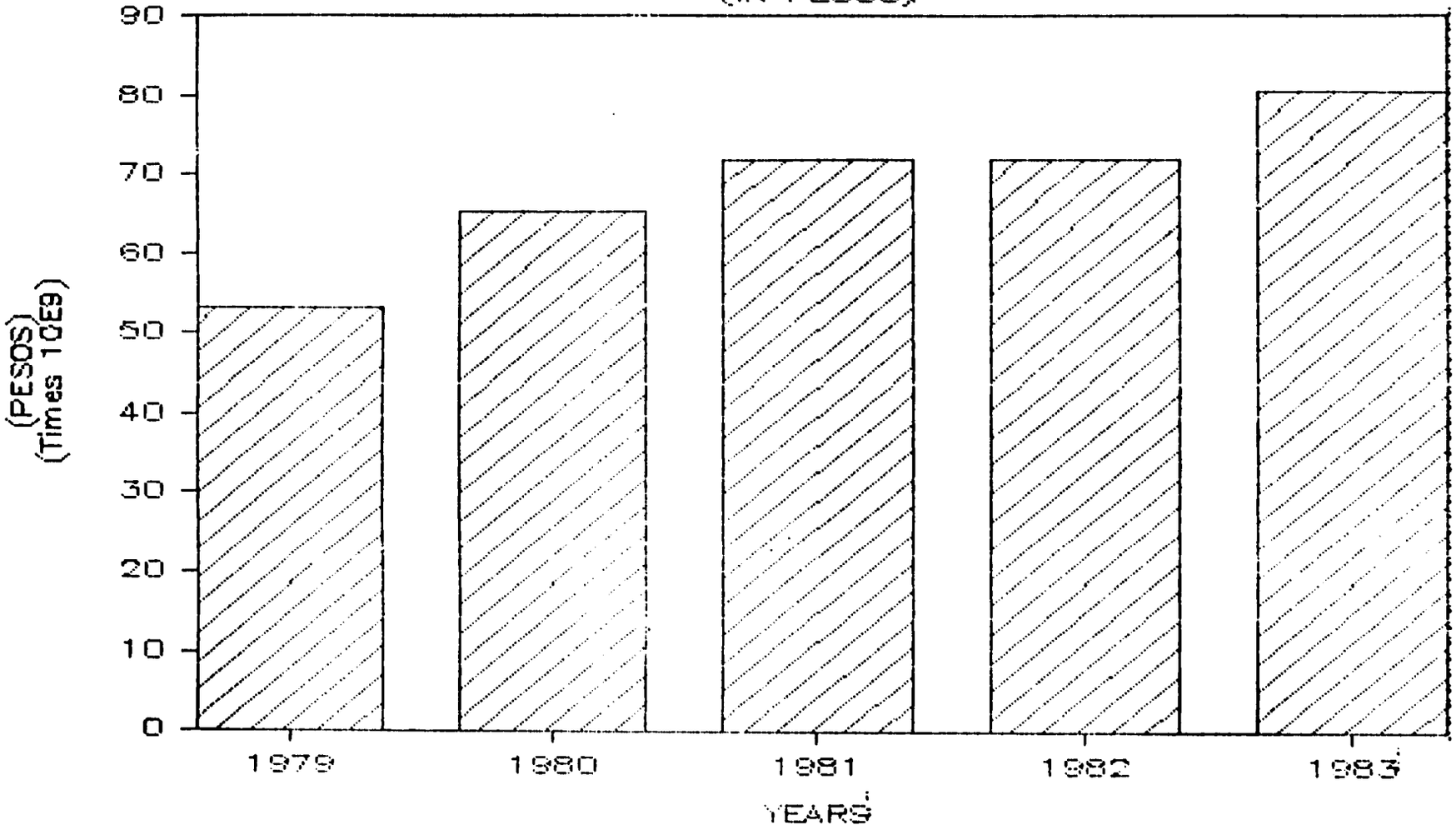
GROSS DOMESTIC INVESTMENT

(IN PESOS)

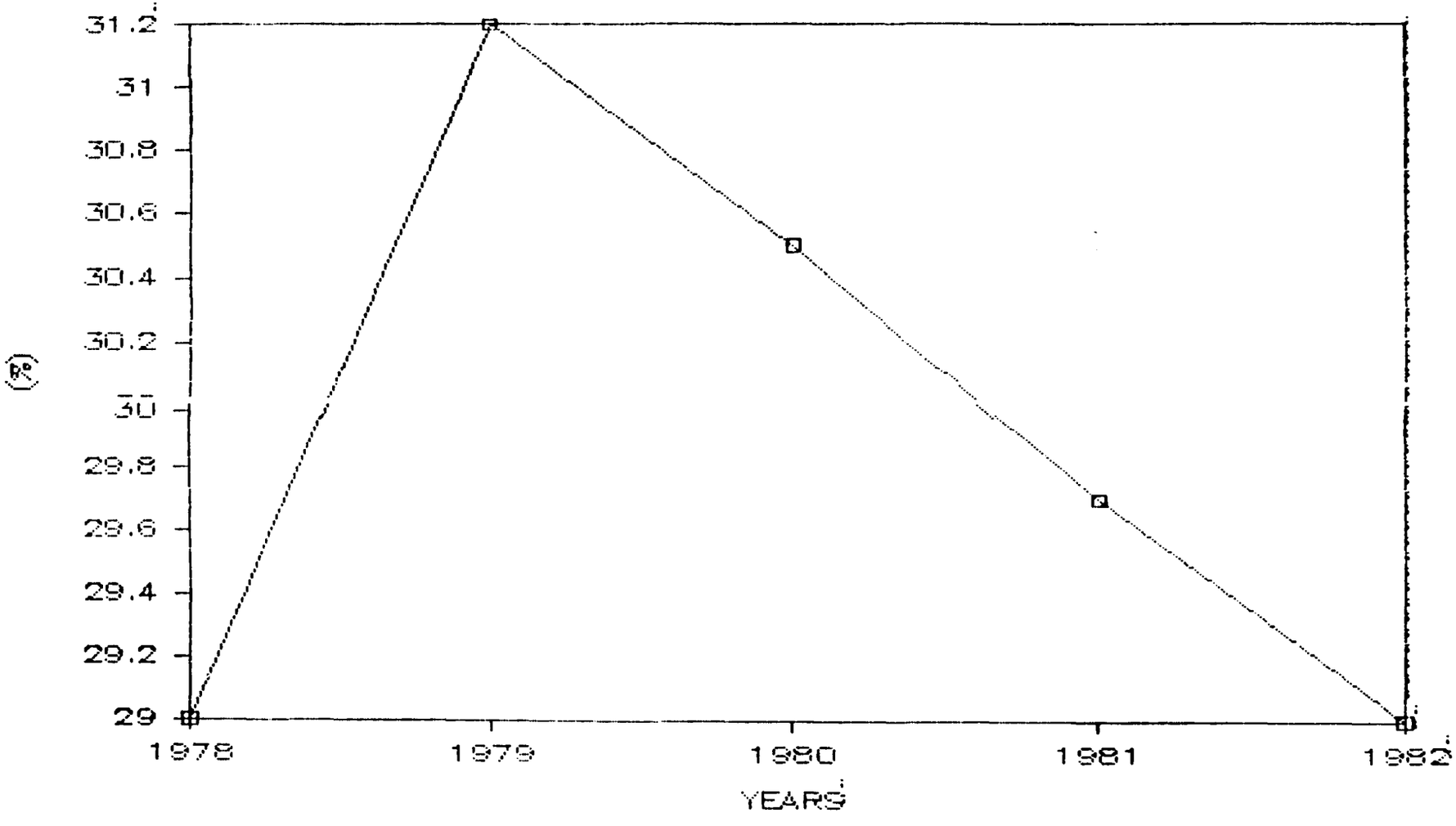


GROSS NATIONAL SAVINGS

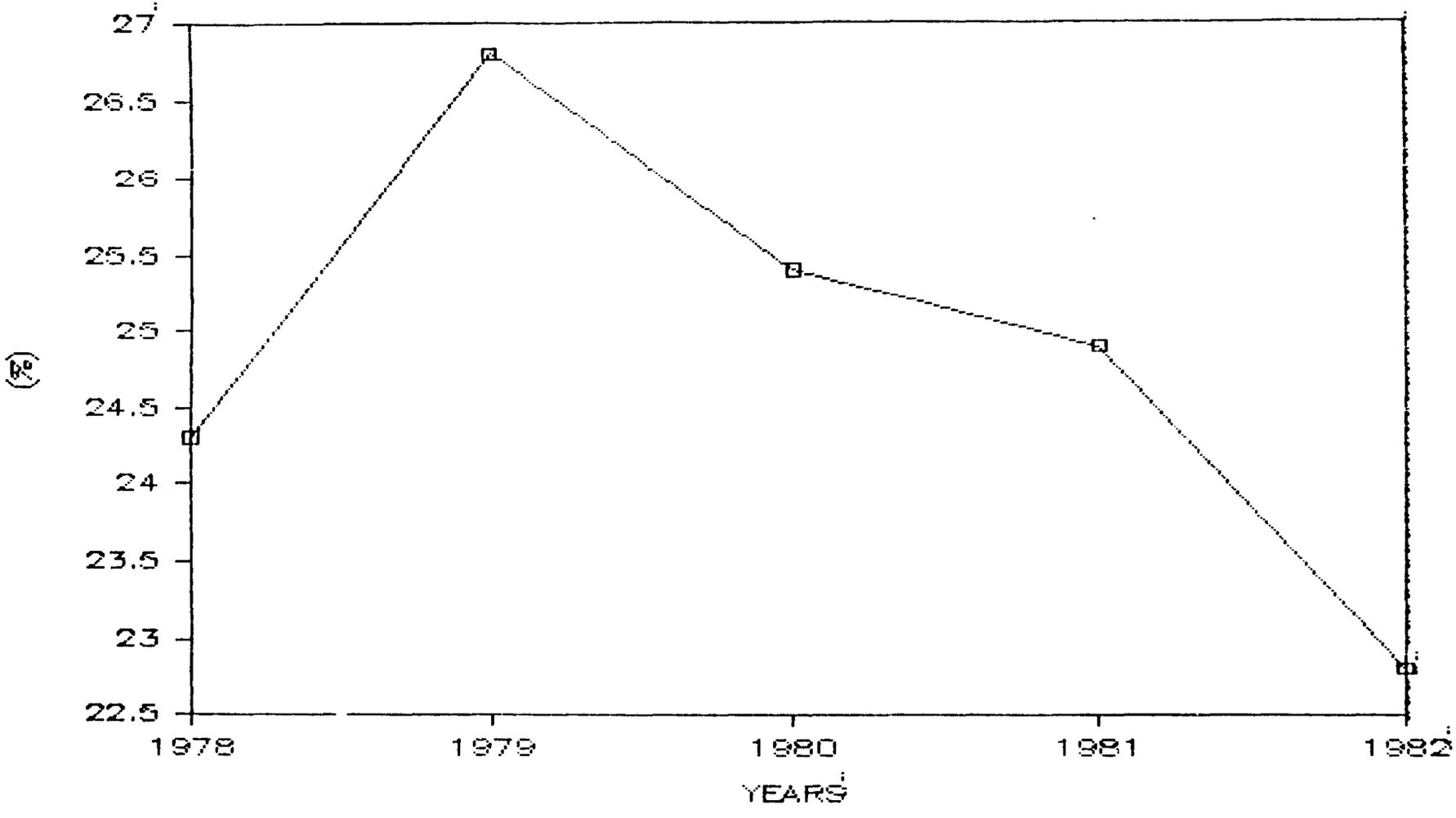
(IN PESOS)



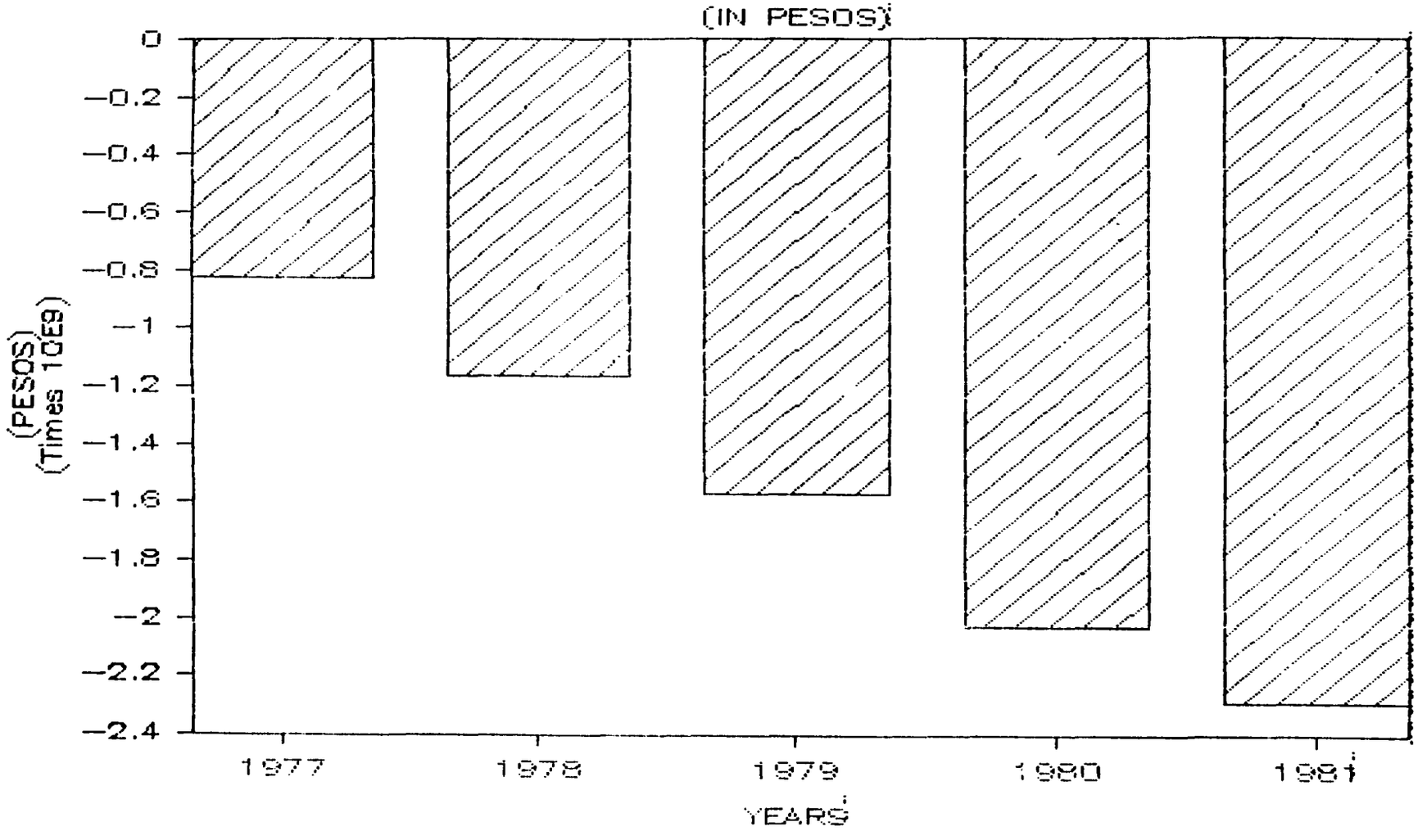
GDI AS A PERCENT OF GDP



GNS AS A PERCENT OF GDP



PHILIPPINE'S CURRENT ACCOUNT BALANCE



C. REGULATORY CLIMATE

1. Foreign exchange (FX) control - all FX transactions are controlled by the Central Bank of the Philippines. All outward remittances must be approved. FX cannot be used to import luxury consumer items. FX receipts from exports and from current earnings or income of residents must be surrendered for pesos to the commercial banking system. Foreign borrowings by residents require prior approval by the Central Bank and are restricted to those who already have access to FX. The Central Bank and a few comercial banks offer swap facilities and forward covers to preferred customers such as exporters, but only for a maximum of six months. Inward foreign investments are required to register so as to monitor remittance of profits and repatriation of capital. Outward foreign investments require prior authorization by the Central Bank and are rarely allowed.

   The Philippine peso has been allowed to float since 1970. The rate of exchange is determined by a weighted average of all interbank sales consummated during the preceeding day at the Foreign Exchange Trading Center of the Bankers' Association of the Philippines.

2. Price controls - The Price Stabilization Council has the power of pricing basic commodities such as rice, corn grits, milk, sugar, cooking oil, pork, chicken, eggs and school supplies. There has been much lobbying against these controls, and the government has been considering eliminating them. Price for transportation, utilities and fertilizers are under separate agency control.

3. Labor regulations - the labor code has been established by the National Tripartite Congress of Labor. It provides for compulsory arbitration of labor-management disputes and a limited measure of bargaining over wages.

4. Foreign investment restrictions - foreigners have very restricted ownership rights. The government has the power to force foreign enterprises to sell shares to Filippinos after it has been in operation for ten years. The government has not allowed the offshore banking units of foreign companies to open operations in local currency. Foreign nationals may purchase shares labeled class B (majority of shares), but cannot purchase Class A shares.

5. Regulatory bodies for commerce

a) The Central Bank controls not only the monetary system but the entire financial and credit system. It regulates all banking and quasi-banking activities (see Appendix) of banks and non-bank financial intermediaries. The Monetary Board is responsible for both policy and regulation. This five man Board is composed of the Bank's Governor, the Minister of Finance, the Director General of the National Economic and Development Authority, the Chairman of the Board of Investment, and a representative from the private sector.

b) The Securities Exchange Commission (SEC) supervises the securities market. The SEC is understaffed and must direct most of its attention to administrative activities related to the registration of securities and approval of the articles of incorporation. As a result, regulation and enforcement tend to be lax.

D. FINANCIAL SYSTEM

The Philippines' financial sector is highly diversified and include a wide variety of institutions and financial instruments. However, despite the number of institutions and innovative financial practices, the system is still underdeveloped in terms of financial asset accumulation and the volume of financial transactions. Financial institutions are highly vulnerable to external events. Several have folded in the last few years. The corporate sector is generally weak and poorly developed, unable to provide the support needed for strong financial markets.

1) Banking system

a) monetary system
- The Central Bank
  - issues currency;
  - administers the monetary, banking and credit system;
  - acts as a lender of last resort;
  - discharges banking services for the government and other banks;
  - manages the country's international reserves;
  - implements various laws governing the various types of financial institutions;
  - undertakes savings promotions program;
  - manages specialized guarantees and loan funds;
  - operates a security printing plant, a gold refinery and a mint.

b) institutions
- Commercial Banks

According to the recent Asian Development Bank (ADB) study of the Philippines financial markets the commercial banks are in financial distress. There are 33 institutions: 27 private banks, a government owned bank, a semi-government owned bank and the Philippine branches of four foreign owned banks (see Appendix). The government owned bank, the Philippine National Bank, is the largest commercial bank. ADB reports that this bank is practically insolvent because of its extensive holdings of non-performing assets. Private commercial banks are also facing liquidity shortages, many being virtually insolvent. Part of the problem stems from the fact that most of these banks are small, closely associated with specific business family groups. Also, many banks are stretching their resources by lending more than their deposit bases, thus making them more vulnerable to a liquidity squeeze. The major portion of commercial bank business is directed towards short-term lending because the funds available are short-term in nature as well. In order to counteract the short term bias the

government introduced the expanded commercial banking system (ECB) allowing banks with ECB licences to engage more actively in providing long term funds. There are now nine ECB banks.

- thrift banks
  There are three types of thrift banks in the country - the savings and mortgage banks; the stock savings and loans associations; and the private development banks. Although originally the three kinds of institutions were set up to meet different needs, 1980 reforms eliminated all functional distinction between them. In addition, thrift banks were allowed to become full domestic commercial banks once they had reached the minimum capital requirements. Currently, thrift banks may obtain separate authority to engage in trust operations; perform quasi-banking operations; undertake limited foreign currency deposit operations; and engage in foreign exchange dealership.

- rural banks
  The rural banks are small institutions which act as unit banks within their specifically defined regions. They are authorized to accept savings and time deposits, and with special permission from the Central Bank, even demand deposits. Some rural banks act as foreign exchange dealers, but they limit their activities to simply buying foreign currencies from tourists and residents for resale to the Central Bank or the commercial banks. Due to their involvement with the government's massive financing programs for agricultural production these banks have been burdened with substantial amounts of unpaid loans. This, in turn, has adversely affected the Development Bank of the Philippines, which has invested in preferred stock of many rural banks as counterpart capital to induce their formation.

- specialized government banks.
  The Development Bank of the Philippines (DBP), like the Philippine National Bank, is holding a significant number of non-performing assets which it acquired through foreclosures. Many of the DBP borrowers had high debt-to-equity ratios which made them very vulnerable to the high interest rates of the early 1980's and the decrease in demand for their products. In addition, DBP has taken over various government projects which have been performing poorly.
  The Land Bank of the Philippines (LBP) is a full service commercial bank which has specialized in: land transfer financing (using 25 long-term bonds); providing financial and technical aid to farmers; and assisting former landowners to shift their capital towards commercial ventures.

The Philippines Amanah Bank is a combination commercial, savings, and development bank established to serve the southern Muslim population. It relies mainly on government deposits and its own capital to finance its assets.

- foreign banks
  The four foreign commercial banks in the Philippines were established prior to the Central Bank Act and the General Banking Act of 1948. Since that time no new foreign full-service bank has been permitted although various offshore banking units (OBUs) have since started up. The OBUs are allowed to engage in all banking activities with non-residents and among themselves, using any currency other than the Philippine peso. They can engage in foreign exchange activities with commercial banks and can extend project related long-term foreign currency loans to residents with prior approval from the Central Bank. Since 1981, some OBUs have been allowed to assist resident clients in importing equipment when the value exceeded $1 million. They have also provided financial advice and related services to local businesses and receive payment in foreign currency. The 27 foreign banks which do not have OBUs have representative offices in the Philippines. These offices are limited to promoting their banks and providing information regarding services they can deliver abroad.

2)Financial Markets

a)-money market
The money market is well developed in terms of instruments traded, the level of activities and extent of market participants. The market has recuperated slowly from the chaos created when established industrialist Dewey Dee asbconded with an unpaid debt of 635 million pesos. Many investment companies failed and many manufacturing companies were placed in the hands of NBP and DBP and other government financial institutions. The government now keeps a closer watch on the market and requires stand-by guarantees by commercial banks for commercial paper.

- types of sub-markets
  - interbank call market
  - commercial paper market
  - government securities market

- participants in the money market (1982 figures)

Type of investor	% of total transaction volume
individuals	6.3
commercial banks	50.7
other types of banks	9.7
investment houses	9.3
investment companies	0.7
finance companies	4.9
trust/pension funds	2.5
insurance companies	1.3
government corporations	1.7
private corporations	12.4
securities dealer	0.3
lending investors	0.1

Type of instrument	% of total transaction volume
interbank call loan	44.1
promissory notes	40.2
repurchase agreements	1.9
certificate of assignments	0.03
certificate of participation	-
commercial paper (non-financial)	2.2
commercial paper (financial)	4.1
CBCIs	1.8
treasury bills	0.5
DBP bonds	0.3
other gov't securities	0.3

b) capital market

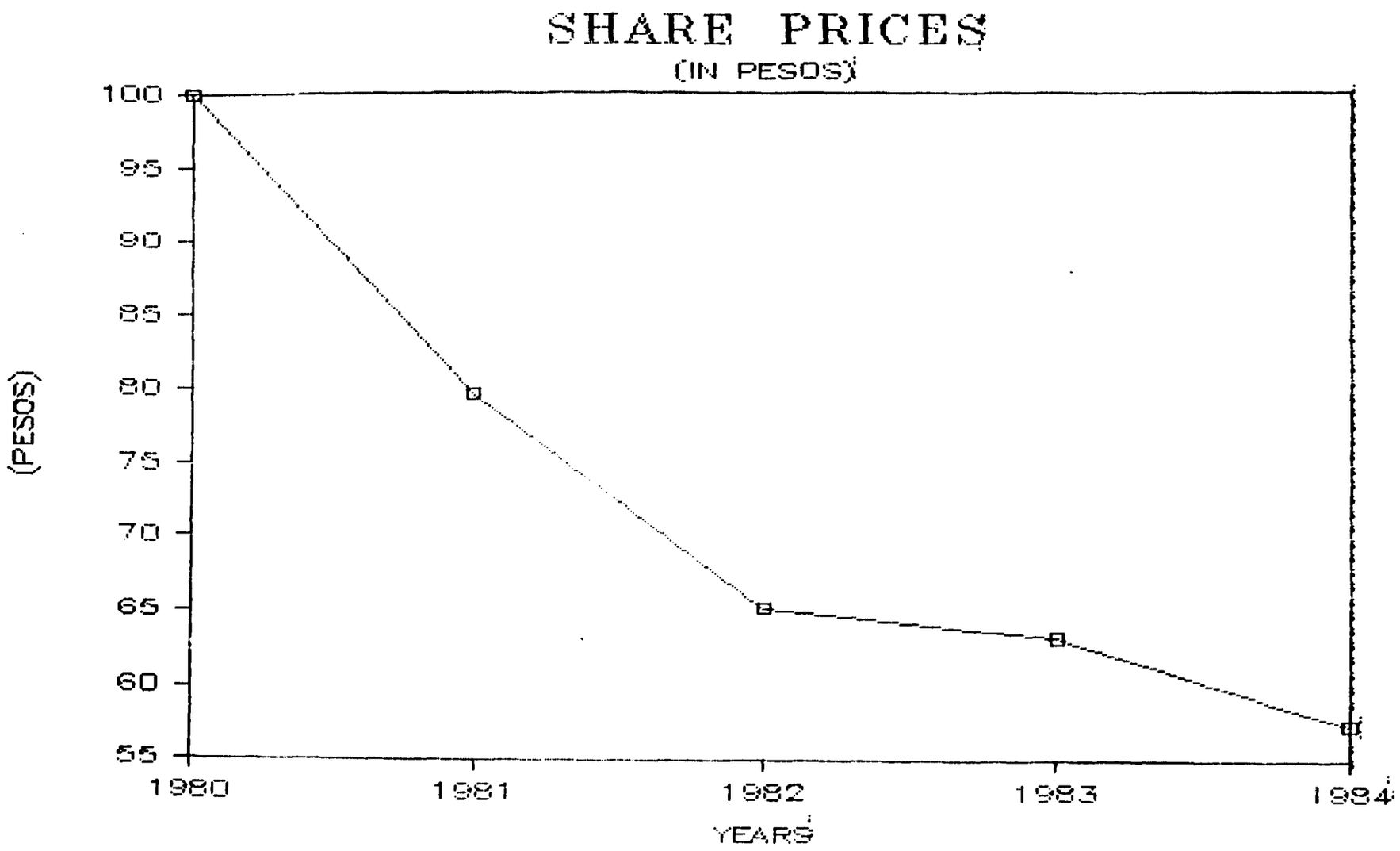
The capital market is underdeveloped in the Philippines. There are major problems in both the demand and the supply of instruments. Investors find that real assets such as real estate are preferable to long term securities in the presence of high inflation. Those who prefer financial assets opt for short-term money market instruments which are far more liquid. The secondary market for shares is thin thus greatly reducing the liquidity of long-term securities. In terms of supply, most well established companies are controlled by families which are afraid of losing control and prefer to rely on bank loans for additional funds. The government has recently been encouraging companies to go public, but as of yet there has not been great cooperation.

-corporate bonds. Few corporate bonds are publicly placed. Only PICOP convertible debentures are listed on the stock exchanges. Other corporate bonds are privately placed.

-stock markets. There are two active stock exchanges in the Philippines : the Manila Stock Exchange (MSE) and the Makati Stock Exchange. 200 issues are listed in both exchanges (1983 figure). The total market capitalization for the two exchanges equaled 18.2 billion pesos or 38% of the volume of the money market.

- stock market image
Despite the long history of MSE (1927) the public regards the market not only as volatile and speculative, but corrupt, and controlled by a few individuals. There are two types of shares: those listed on the Big Board which are considered reliable steady companies, and those listed on the Small Board which are considered speculative in nature (mostly mining and oil exploration companies). The latter dominate the exchanges, consequently, the market moves with the volatile commodity prices.

-underwriters and brokers. Investment houses, investment companies and ECB banks are eligible to be underwriters. The commission rates for common stocks are 1% of the amount, regardless of price for quantities more than 2,000 pesos. For lesser amounts there is a flat commision of 20 pesos. Brokers do not have access to credit facilities which would allow them to maintain an adequate number of securities to smooth the tradings.


SHARE PRICES
(IN PESOS)
100
95
90
85
80
75
70
65
60
55
(PESOS)
1980
1981
1982
1983
1984
YEARS

E. TAX SYSTEM

The tax system in the Philippines is based on the U.S. system and is at least as complicated. The following summary is an over-simplification of the system. More detailed information is readily available. The government office in charge of tax collection is the Bureau of Internal Revenue.

1. Income tax

   a) corporations: 25% for first 100,000 pesos;
      35% for amounts over 100,000 pesos;
      10% surcharge for closely held companies.
      10% on dividends which can be deducted by the stockholder.

   In addition, there are a variety of other taxes which apply to certain organizations and corporations (5% extra on banks, 10% extra on OBUS)

   b) individuals: 3% - lowest paying tax bracket
      70% - highest paying tax bracket

   c) other taxes:
      - estate and gift tax
      - sales tax
      - specific (excise) tax
      - property tax
      - business and occupation taxes
      - documentary stamp tax
      - mining tax
      - franchise tax
      - amusement tax
      - tobacco inspection fees
      - firearm tax
      - water rentals
      - overseas communication tax
      - charges on forest products

F. ACCOUNTING

1) Accounting standards. These standards are set by the Philippine Institute of Certified Public Accountants (PICPA) and are mainly based on American standards. The PICPA is a member of the International Accounting Standard Committee (IASC) and the International Federation of Accountants (IFA).

2) Accounting profession. In order to sit for the CPA exam all candidates must first obtain a bachelor's degree in commerce or in business administration. To practice, a person must pass the exam.

3) Licencing and ethics. The Professional Regulation Commission, through the board of Accountancy, is the licencing committee. The Board of Accountancy is responsible for enforcing the code of professional ethics. Under this code, accountants are not allowed to advertise using mass media.

APPENDIX

TABLE 1 PHILLIPINE COMMERCIAL BANKS
(figures as at end December 1981, inP million)

Bank	Total Assets
Private Domestic	
Bank of the Philippine Islands	8489.0
Allied Banking Corporation	7430.4
Metropolitan Bank & Trust Co.	6940.0
Far East Bank and Trust Co.	5355.6
Republic Planters' Bank	5060.9
Philippine Commercial & Industrial Bank	4817.7
United Coconut Planters Bank	4645.1
Rizal Commercial Banking Corporation	4589.2
International Corporate Bank Inc.	4552.2
Traders Royal Bank	4144.5
The Manila Banking Corporation	3650.1
China Banking Corporation	3473.4
Pacific Banking Corporation	3354.5
Equitable Banking Corporation	3209.0
Security Bank & Trust Co. Inc.	3129.0
Philippine Bank of Communications	3109.9
The Consolidated Bank and Trust Corp.	3096.5
Family Bank & Trust Co.	3001.2
Insular Bank of Asia & America Inc.	2974.6
Prudential Bank	2565.2
The Philippine Banking Corp.	2324.5
Associated Citizens Bank	2030.9
Cititrust Banking Corp.	1799.6
Producers Bank of the Philippines	1771.1
Philippine Trust Company	1119.6
Pilipinas Bank	1089.6
Commercial Bank of Manila	446.9
Government or Semi-Government	
Philippine National Bank	44866.0
Philippine Veterans Bank	2726.5
Foreign	
Citibank NA	12637.0
Bank of America NT and SA	3602.1
The Hongkong and Shanghai Banking Corp.	1742.8
The Chartered Bank	865.2

TABLE 2 Philippine banks and non-bank financial intermediaries performing quasi-banking functions: regulated framework for selected categories (figures in P)

	Expanded Commercial Bank	Commercial Bank	Thrift Bank	Investment House	Finance Co. with Quasi-Bank Financing
Minimum paid-in Capitalization	500 m at start	100 m (old) 300 m at start (new)	Based in metro Manila 10 m (old) 20 m (new) Based outside Metro Manila 5 m (old) 10 m (new)	50 m at start (new) 20 m (old) - to Dec. 1983	As investment house
Inherent powers	Commercial banking Investment house functions Investment in non-allied enterprises	Commercial banking	Full domestic banking including personal and mortgage loans	Investment house functions (underwriting; dealing; securities; equities)	Financing (instalment; financing, receivables; discounting; factoring) Leasing
Additional powers granted	Trust Foreign currency Deposit Unit (FCDU) Quasi-banking	As expanded commercial bank	Trust Limited FCDU operations Foreign exchange dealership Quasi-banking	Quasi-banking	
Liquidity financing from Central Bank	Available	Available	Available	Available	Available
Equity holdings permitted	30% of commercial banks 100% of financial allied enterprises 100% of non-financial allied enterprises 35% of non-allied enterprises	30% of commercial banks 100% of thrift banks 40% of other financial allied enterprises 100% of non-financial allied enterprises	As commercial bank	40% in non-banks performing quasi-banking No limitations on other non-banks Minority in non-allied enterprises	As investment house

TABLE 2 Philippine banks and non-bank financial intermediaries performing quasi-banking functions: regulated framework for selected categories (figures in P)

	Expanded Commercial Bank	Commercial Bank	Thrift Bank	Investment House	Finance Co. with Quasi-Bank Financing
Ownership restrictions	40% or less total foreign ownership	As expanded commercial bank	As expanded commercial bank	At least majority Filipino or less	At least 60% Filipino
	20% or less per family group			40% or less per individual, family or corporate group	40% or less per individual or corporate group
Upward conversion possibilities (per Central Bank policy)		To expanded commercial bank	To commercial bank, then to expanded commercial bank	No to commercial bank	No to any type of bank
				Directly to expanded commercial bank	
Net worth: risk asset ratios	10%	10%	10%	10%	10%
	8% - 500 m-693m capital 6% - 700m or more capital				
Single borrower's limit	15% of net worth	15% of net worth	15% of net worth + additional 15% if for housing of low and middle income borrowers	80% of net worth	80% of net worth
Reserve requirements	Demand - 16%	As expanded commercial bank	Demand - 16%	Deposit substitutes 730 days or less - 16%	As investment house
	Savings - 16%		Saving - 8%		
	NOW -16%		NOW - 12%	Over 730 days- 5%	
	Time 730 days or less - 16%	Time 730 days or less - 8%	Interbank - 1%		

TABLE 2 Philippine banks and non-bank financial intermediaries performing quasi-banking functions: regulated framework for selected categories (figures in P)

	Expanded Commercial Bank	Commercial Bank	Thrift Bank	Investment House	Finance Co. with Quasi-Bank Financing
	Over 730 days- 5%	Over 730 days- 5%			
	Deposit substitutes 730 days or less - 16% Over 730 days- 5%	Deposit substitutes 730 days or less - 16% Over 730 days- 5%			
	Interbank - 1%	Interbank - 1%			

Source: CBP Circulars; Enabling Acts of the respective financial intitutions.

END NOTE

We have limited the discussion of government attitudes in view of the pending elections and the uncertainties surrounding previous policies.

ADB Recommendations

(a) Non-Securities Market
1.)Rehabilitation of PNB and DBP
2.)Strengthening of capital base, improvement of efficiency and fortification of reserve positions in private commercial banks.
3.)Improvement of long-term funding and long-term lending capabilities of private commercial banks.
4.)Strengthening of project appraisal capabilities of commercial banks.

(b) Bond Market
1.)Rationalization of issuance terms of government securities corporations and organizations.
2.)Encouragement of domestic corporations whose revenue base is in domestic currency to raise long-term funds in the domestic market.
3.)Planning by the government of a comprehensive debt management program, including government guarantees.
4.)Listing of government bonds on the stock exchange to alert investors to the market prices of these securities.

(c) Equity Market
1.)Advancement of a policy encouraging more equity issues by leading, well-performing companies.
2.)Imposition by the stock exchange of increasingly strict listing requirements.
3.)Consideration by the GOP of incentives to promote individual stock ownership.
4.)Restoration by the SEC of public confidence in the equity market by enforcing regulations against fraudulent transactions.
5.) Encourage securities financing so as to stimulate secondary tradings.