



Capital Market Development Project
USAID/Philippines
FSDP PIO/T 492-0432-3-10064

Draft Final Report
September 1991

11

Price Waterhouse



September 27, 1991

Mr. Bruno Cornelio
Chief, Private Enterprise Support Office
U.S. Agency for International Development
Manila, Philippines

Dear Mr. Cornelio:

Re: AID/PRE Financial Sector Development Project (FSDP)
Contract No. PDC-2206-Z-00-8191-00
USAID/Philippines - Capital Market Development Project
PIO/T No. 492-0432-3-10064
FSDP Activity No. 61

Enclosed please find ten (10) copies of the Draft Final Report for the above-referenced project, which I believe reflects the guidance you and Gerry Carranceja provided me on the Preliminary Draft report. As contained in the Scope of Work, we will await any written comments the Mission may have on the enclosed document, which would then be incorporated into the Final Report, as appropriate.

On behalf of the Design Team, I would like to thank you for your guidance and assistance in carrying out this project. It has been a privilege to have the opportunity to assist you and Gerry on this important and very interesting assignment. I hope that this report provides you with a number of the inputs you require to move forward with the project design process.

I will be in Jakarta for the next 2 to 3 weeks. If you require any additional assistance, I can be contacted at our Jakarta office (phone/fax 62-21-366437), or at the Borobudur Intercontinental Hotel (phone 62-21-370333; fax 380-9595). If you require assistance from Manila or Washington, please do not hesitate to contact Rene Banez, Dick Breen or Marguerite Kirst.

Sincerely,

Mark Camstra
Senior Manager
International Consulting Practice Unit
Office of Government Services

enclosure (as stated)

cc: S. Frydman, PRE/FSDP Project Officer
D. Breen, PW/FSDP Project Director
R. Banez, PW/Manila

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I. INTRODUCTION

A. Background and Objective

USAID/Manila's Financial Resources Mobilization Project, authorized by AID/W in August 1987 but subsequently never obligated, had a two-fold purpose:

- o To enhance the environment to mobilize private term financial resources for investment in productive private enterprises (the Capital Markets Development Component)
- o To reduce the burden of the acquired assets and public corporations on the national budget (the Privatization Component).

The Privatization Component became the Privatization Project (492-0428), which began implementation in FY 1988. The Capital Markets Development Component, however, remained stalled for a number of factors, and was never implemented as originally envisioned.

The objective of this engagement is to assess the continuing validity of the original Capital Markets Development Component, and make recommendations for updating the Mission's program based on a high level of private sector participation. Additional objectives include:

- o Develop revised project design inputs for use by the Private Enterprise Support Office (PESO) personnel in re-designing/updating the original Capital Markets Development Component
- o Identify discrete short-term technical assistance activities with which the Mission can proceed during project design prior to project implementation
- o Determine areas of commodity procurement based on an assessment of the automation needs of the stock exchanges and selected areas of the Securities and Exchange Commission (SEC)
- o Identify potential non-governmental organizations (NGOs) which could act as the private sector implementor of selected components of the overall project.

B. Scope of Work and Methodology

A design team was contracted by USAID through PRE's Financial Sector Development Project (FSDP) to carry out the following scope of work:

- o Legal and regulatory framework: Review principal elements of the legal and regulatory framework to update problem areas and identify possible assistance needs.
- o Securities and Exchange Commission: Review the SEC's current responsibilities, rules, regulations and procedures as well as the organizational structure and staffing to update problem areas and identify possible technical assistance, training and commodity procurement needs.
- o Capital market private sector participants: Survey the current state of private sector participation in the capital markets and define a possible program of action to stimulate the supply and demand for securities.
- o Stock market management and operations: Review the stock exchanges current organization, operations, and computer technology base to update problem areas and define technical assistance, training and commodity procurement needs with a view to enhancing the professional management of the exchanges, and modernizing the trading capability and structure of the market.
- o Training needs assessment: Survey private capital market participants and the SEC to identify/update key training needs areas with a view to strengthening their technical skills, as well as to identify an appropriate private sector institution to serve as USAID's counterpart under the project.

The design team was also expected to develop preliminary terms of reference for long-term advisors under the revised project design, and review other donor activities in the area of capital market development as part of the process of developing revised project design elements. For further details on the scope of work, please refer to Appendix A.

The methodology employed by the design team included a program of interviews and a literature review. Interviews were conducted with over twenty top private sector managers, the leadership and staff of the SEC, and various members of the Boards of the Manila and Makati Stock Exchanges. The literature review included a number of previous studies; training, rules and procedures

manuals; and numerous reports and proceedings about the capital market and pertinent groups (see Appendices B and C.)

C. Design Team Composition

The design team was composed of a multidisciplinary blend of specialists from Price Waterhouse's Office of Government Services in Washington D.C. and Price Waterhouse's office in Manila. The team was composed of the following labor categories and personnel:

- o Team Leader/Design Specialist (Mark Camstra)
- o Legal/Regulatory Specialists (Rene Banez/John Evans)
- o Securities Industry Operations and Management Specialist (John Schroy)
- o Automation Specialists (Leo Mascarinas/John Ruckrich)
- o Training/New Financial Instruments Specialist (David Brunell)
- o Technical and Research Support (Juvy Roman/Marguerite Kirst).

D. Report Contents

The report contains the following Chapters and Appendices:

- o Chapter II summarizes the design teams' key findings and conclusions, and suggests a possible USAID role in the various potential program areas as outlined in the Scope of Work which form the basis for a revised/updated project design.
- o Chapter III presents a revised overall project description specifying project goals, components, purposes and objectives, end of project status, inputs, and key assumptions.
- o Appendices A, B and C contains the Scope of Work, List of Interviewees, and Index on Background Reports and Materials, respectively.
- o Appendix D contains the individual specialist reports prepared by the various design team members in accordance with the Scope of Work.

- o Appendix E contains a Preliminary Logical Framework
- o Appendix F presents preliminary terms of reference for six potential long-term advisory positions under the project
- o Appendix G details a Scope of Work for a package of short-term, pre-project technical assistance to assist the exchanges and the SEC to develop a new automated securities market system.

II. SUMMARY OF KEY FINDINGS, CONCLUSIONS AND RECOMMENDED USAID ROLE

The findings and conclusions below are based on a program of interviews and a review of background reports and other materials. Based on the findings and conclusions, we also suggest ways in which USAID might be involved for its consideration in making project design judgments.

A. Economic Overview

1. Stock markets can provide invaluable finance for economic development.

Many developing countries have gotten into serious difficulties through an excessive build-up of debt, both domestic and foreign. In many cases, a lot of debt has been owed by the domestic industrial sector. Equity markets provide a market mechanism for enterprises to finance investment without the creation of the fixed payment commitments associated with debt. Instead, payments are dependent on the profitability of the enterprise. If the venture is profitable, the investors may be well rewarded with both dividends and capital gains. If it is not profitable or if profits fall over a certain period of time, the enterprise is not liable for making payments.

Equity finance may be either foreign or domestic. If it is foreign, the country also gains valuable foreign exchange assets without increasing its international indebtedness. In the case of domestic finance, equity markets provide the people of the country with an opportunity to participate in the ownership and profitability of the country's development. Because of this, the existence of a fair and efficient equity market can also encourage higher national savings. It can also help achieve a more efficient distribution of resources for investment.

2. Debt financing has been the primary capital market activity in the Philippines.

In the past few decades, the Philippine capital markets have been hampered by a focus on debt financing rather than equity financing to spur economic growth. In addition, short-term interest rates have been high in real terms for an extended period of time. As a result, much of the country's savings has gone into short-term assets rather than being available to finance long-term investment.

3. The Philippine equity market environment is stagnant.

The stagnation of the Philippine stock market in recent years stands in sharp contrast to the strong growth of emerging stock markets worldwide. Emerging markets are also rapidly gaining in sophistication. Numerous markets are in the process of implementing more effective regulatory systems, better information systems, advanced trading systems, and streamlined clearing and settlement systems.

In addition to innovative changes in the regulation and operation of stock exchanges, emerging markets are also experimenting with new financial instruments to offset the impact of stock price fluctuations. Because of this, country funds continued to attract investors, with over three dozen new funds offered in 1990, despite the existence of generally steep discounts of share prices to net asset value, and despite sharp decline in prices from 1989 levels.

In the IFC publication, Emerging Markets Factbook 1991, the Philippine capital market ranked second-to-last in market performance in the world, a sharp decline considering that the development of the Philippine stock market in 1970s provided an example for and encouraged the development of other Asian markets. Every economic reason exists to strengthen the equity market as a yet undeveloped source of capital growth in the coming years. The Philippines must take the economic message seriously if it is going to be a serious competitor for the investment dollars of both its own citizens and foreign investors.

B. SEC: Legal/Regulatory Framework and Organizational Structure

1. There appear to be problems on the part of the SEC and the exchanges in making the self-regulatory system work.

A primary area that does not appear to be functioning well is the concept of self-regulation by the exchanges, other securities market organizations and individuals. The SEC's responsibility is to oversee the entire securities market. This is sometimes done directly (e.g., licensing and delicensing, review of disclosures provided in registration statements for public offerings). In most activities, however, the SEC's oversight should be indirect to the maximum extent possible, applying the principle of self-regulation. For the system to work, exchanges must be active and responsive to needs. The SEC must also respond in a timely manner to proposals made or actions taken by exchanges. There appear to be problems both on the part of the exchanges and the

SEC in making the self-regulatory system work, highlighting an area where assistance may be beneficial.

2. The SEC may be getting overly involved in making evaluations about the soundness of investments, the suitability and pricing of new issues, among other items.

There are a number of provisions in the Revised Securities Act and SEC rules that deal with evaluations by the SEC, such as maximum commissions for public offerings, whether a security is a safe investment, whether the issuers' business is sound, clearance or approval of listed companies' news reports, and certification of financial statements. The SEC takes big risks if it determines such matters. The SEC may establish certain criteria as standards to be used, but risk and safety are evaluations that can best be made by private professionals, whose views often differ, and ultimately by investors and prospective investors. Refraining from these types of evaluations is an important part of realizing self-regulation and permitting maximum private sector decision-making, which generally results in better economic decisions than can be made by government officials, and eliminates any government responsibility for decisions taken by the private sector. The appropriateness of the SEC in engaging in these types of evaluations should be reviewed, and on the basis of that review, possibly recommend that the SEC either not use such authority or that the rules be revised to eliminate these responsibilities.

3. The SEC's regulatory strategy, responsibilities, rules, and procedures need to be reviewed and overlaps eliminated or minimized.

In the area of securities market regulation, overlap and duplication of rules, regulations and procedures are prevalent. There are a number of functions of various SEC departments which in some way overlap or duplicate some of the functions of the Brokers and Exchanges Department (BED). For example, there is overlapping responsibility for registering, licensing and regulating a number of different types of securities companies and individuals. There is also significant overlap with respect to the registration of securities for public offerings/sales, and the listing thereof on the stock exchanges for trading. A rationalization of the functions of each department may be appropriate in order to avoid such overlap/duplication on paper and, more importantly, in practice, so that the SEC may adequately address the issues affecting the securities markets, such as stock exchange operations, governance of the exchanges and the evaluation powers of the SEC.

4. The SEC's regulatory efficiency and operations are impaired by an over-extended mandate and limited resources.

In addition to many overlapping and duplicated rules, the SEC's current regulatory mandate far exceeds its ability to implement them. Also, the staff of the Brokers and Exchange Department is small and lacks the professional training necessary to efficiently administer such a wide-ranging set of rules and regulations. These two problems--expansive mandate and limited resources--combine to create a considerable supervisory "execution gap" which is beyond the SEC's current capacity to manage, and affects its image in the marketplace.

Furthermore, the SEC, which was initially entrusted to administer and enforce provisions relating to public offerings of securities and trading of securities in the secondary market, currently administers and implements 20 different laws and presidential decrees. The organizational structure of the SEC has not fully adjusted to the enactment of the different laws, so many unrelated functions lie in one department while related functions may be scattered among two or three departments. The SEC needs to review its regulatory and operational strategy in order to improve operations.

5. The SEC's overall goals and objectives are fundamentally sound, but assistance is required in order to attain them.

The overall goal of the SEC, as indicated by the Chairman, is to foment the growth of the Philippine capital market through the regulatory means by which the SEC is empowered. The Chairman's objectives include: unification of the exchanges; automated trading, clearing and settlement (preferably on an integrated basis); professional exchange management; and strengthened rules and regulations to permit the SEC to more effectively regulate the market.

These goals and objectives are fundamentally sound, and coincide in principle with those of the exchanges and other securities industry participants. There has, however, been little to no progress in working toward these objectives over the past several years due, in large part, to a lack of hard, state-of-the-art information about automation options, system capabilities and associated costs upon which to make sound and economically viable decision of long-term importance. For example, serious consideration is being given to a number of issues, which are cause for concern:

- o Imposing a strictly physical unification which merges antiquated and highly inefficient trading and settlement methods

- o Considering outside software without first taking into account the other pieces and overall achitecture of the automation puzzle
- o Considering partial automation options which are likely to be more costly and significantly less efficient than full automation.

There is also an extraordinary misconception regarding the type of infrastructure and levels of financing required to effect a solution. The above examples highlight the need for objective information about how best to proceed with unification and automation, and point to an area of opportunity for USAID involvement in developing this market.

6. The discrepancy between the SEC's professional skill level and its mandated responsibilities is considerable, complicated by its limited access to human and other resources.

The SEC's mandate is broad and very technical in nature; however, it does not have access to the full range of resources needed to implement its mandate. The supply of professional staff is low, attributable to very low payscales and a civil service environment which poses serious disincentives to attracting and keeping top talent. Resources for training, staff planning, and team building have been severely reduced, leaving professionals and staff with little opportunity to develop or implement the mandate of the SEC.

7. There is "crisis of confidence" within the private sector regarding the SEC's ability to regulate the market, as well as supervise/manage the process of reorganizing and automating the marketplace.

A common theme of all people and organizations who interface with the SEC is a pervasive lack of confidence in its ability to execute and follow through. This "crisis of confidence" involves a major gap between good intentions and operations, between policies and their execution, and between a mandate and timely action. This has resulted in serious reservations in the marketplace regarding the SEC's ability to carry out the unification and automation process.

8. Role for USAID

The SEC has exhibited a strong desire for assistance from USAID, including technical assistance (both long and short term), training (local and overseas) and commodities (including a building and computer equipment for the planned Philippine Stock Exchange). In making judgments regarding its role in the areas of SEC regulation and organization, USAID may wish to take into account the following considerations:

- (1) While there are a number of issues impinging on the SEC that require legislative and policy change to resolve, much can be tangibly accomplished to improve the SEC's capacity to regulate the securities industry by making improvements at the operational, rule-making level.
- (2) Rules and regulations should be reviewed, rationalized and implemented in a manner consistent with a regulatory approach based on disclosure and self-regulation. The SEC's involvement in making evaluations should be carefully reviewed.
- (3) USAID should focus its assistance efforts under its proposed capital market project to those areas associated with the regulation of the securities industry. The only possible exception may be in the area of Information Technology (I.T.), which by its nature must encompass the entity as a whole.
- (4) USAID should consider providing interim technical assistance to the exchanges and the SEC in generating the information required to make sound decisions regarding unification and automation.
- (5) In view of the findings above, we suggest the following configuration of assistance:

Technical Assistance

- a. Regulatory Specialist to assist in the area of implementing rules and regulations
- b. Organization & Methods/Automation Specialist to assist with organizational, procedures and automation issues
- c. Information Technology (I.T.) Advisor to develop and implement an overall I.T. strategy.

Training

- d. Human Resource/Training Specialist to develop in-house training programs and capabilities, as well as to interface with private sector-provided training activities.

Commodities

- e. Computer equipment for surveillance purposes under a new automated and integrated stock market trading, clearing and settlement system
- f. Computer equipment to enhance linkages with regional offices.

C. Stock Market Management, Operations and Automation

Key findings, conclusions and recommended USAID role include:

1. A debilitating "crisis of confidence" is evident in the marketplace

The Philippines finds itself falling further behind other emerging countries that at one time looked to its stock markets for leadership and example. Many private sector participants feel like victims of the status quo, at the mercy of the problems and limitations of the SEC and the exchanges. An often-voiced desire of the private sector is to have one clear set of rules and regulations that are fair, and more open communication and dialogue with the SEC and the exchanges. The current lack of dialogue and cooperation has resulted in this "crisis of confidence."

2. A primary problem is a lack of liquidity in the marketplace.

The Manila and Makati Stock Exchanges have a reasonable number of securities listed, well-defined exchange structures, a basic level of available information, and an adequate number of broker-dealers. However, the average trading volume per listed security is too low. It is important to recognize that there are good companies worth investing in, but the volumes still remain low. The primary problem, then, is one of poor liquidity in the marketplace. The following seem prime areas to direct attention in order to address the liquidity problem:

- o Inefficiency in order execution (i.e., a high ratio of unexecuted offers)

- o Excessive turn-around time (i.e., delay in the registry of securities; settlement in certificate form; inefficient registrars)
- o High transaction costs (commission of 1.5%, 0.25% tax on transactions; registry taxes)
- o Lack of convincingly safe, efficiently managed securities accounts available at brokers
- o Public perception that brokers do not deal fairly with clients in executing orders.

All of these problems, with the exception of the tax on transactions, can be resolved by installing a fully automated, integrated single trading, settlement and back-office service focused on a central custodian, specifically designed for the Philippine marketplace.

3. The inefficiencies in current trading, clearing and settlement procedures are a major factor holding back the development of the market.

Current trading procedures are entirely manual, based on a two-way auction and open-outcry system, using white boards to mark up offers and deals. The procedures are arcane and do not contribute to efficiency in order execution, fair trading, or the development of a liquid market. Execution and priority of clients' orders under the current system is inefficient and subject to inaccuracies and misuse that are hard to detect when the market becomes busy. The current system is appropriate only for an inactive market. Due to the complex nature of trading rules, it is understandable why the public is distrustful of the current system.

Settlement and clearing procedures are conducted independently for each exchange, are paper-based and partially automated, utilizing antiquated batch processing systems. The systems are decades behind the times, both in technology and in terms of exchange practices. There is no compliance with Group of Thirty recommendations regarding: book-entry settlement, central custody, and delivery against payment. Activities of transfer agents have a three-week standard, already far too long, but still frequently not met. The inefficiencies in the settlement process are a major factor holding back the development of the Philippine market, and contribute to the market being unable to compete for foreign investment.

4. Exchange self-regulation and enforcement efforts require improvement.

The exchanges do regulate themselves. However, the question is: to what end? Supervision of rowdy conduct on the exchange floor and competing members' advertisements and recruiting practices would not seem to qualify as matters of prime interest to the public. Furthermore, the paucity of independent professional managers in the administration of the exchanges casts serious doubts on the willingness of the exchanges to rigorously inspect and severely discipline their membership, should this prove necessary.

5. The key parties are moving toward making the necessary significant changes to develop the market.

The Manila Stock Exchange (MSE) and Makati Stock Exchange (MKSE) revealed a strong disinclination to merge, particularly if such a merger were to be decreed by the SEC. However, the SEC, the MSE, and the MKSE all agree on the need to automate and modernize, and that some integration between the markets is necessary. The SEC appears to favor a merger and the acquisition of a new building. Both of the exchanges appear willing to incorporate the other, but not to be incorporated, and both are wary of the costs involved with automation and a new building. All parties seem to be misinformed regarding the costs of automation and the need for a new building. The exchanges have informed the SEC that they would be amenable to some form of association, provided that the a study was commissioned showing the commercial and technical advantages of doing so. In parallel, progressive people in the exchanges appear to be opening up to the necessities and opportunities of change. In fact, the exchanges are already in the early stages of studying and acting on the various components of change, and have asked for professional guidance and assistance in the process. These actors not only want good information, but are seeking professional assistance in considering what changes to make and how to implement them.

6. There are misconceptions regarding the cost and requirements of a breakthrough.

There are serious misconceptions both by the exchanges and the SEC with regards to the need for substantial investments in a building and the cost and difficulty of financing full automation. There are also misconceptions regarding the need for an exchange floor, the value of the open-outcry system, and the value of actually merging the current exchange organizations. Regarding actual costs, the acquisition of a fully automated system for both markets is estimated as costing approximately

US\$ 10 million, based on prior studies. Based on the current volume of the exchanges, this might be financed as follows:

- o Fifteen percent of the broker's commission, in payment of all back-office services (current costs are about 40 percent)
- o Vendor financing of \$6 million in three years
- o Investment by each exchange of \$2 million in the service company (alternatively, other investors could capitalize the service company, such as the custodian banks, since the proposal represents a profitable business proposition that should stand on its own.)

There are many alternate forms of financing, but all can probably be worked out on a normal commercial basis because the income to finance the operation already exists in the form of commissions and fees on transactions.

7. There is a wide range of automation options requiring careful analysis in order to select the most appropriate configuration for the Philippine marketplace.

There are many options for automation, and just as many pitfalls. The Taiwan stock exchange has offered its system free of charge, as it has done to other markets. However, this system is outdated and has major design flaws. The Midwest Stock Exchange, the Australian Stock Exchange, OM International of Sweden, the Toronto Stock Exchange and the Vancouver Stock Exchange (VSE) all offer systems. The most modern of these systems is that of the Vancouver Exchange, but this needs to be integrated with central clearings and custody services to provide state-of-the-art services at least cost for the Philippines. The specification of the required system would have to be carefully analyzed prior to making an appropriate selection. The adapted VSE system would offer the best facilities for surveillance by the SEC.

8. Role for USAID

The following suggestions are made to USAID in defining its role in the area of stock market operations and automation:

- (1) Support the development of an automated stock market system which promotes competition and permits free entry to any broker-dealer who meets established competency requirements (i.e., broker-dealers should not be artificially excluded by high capital requirements).

- (2) Support that the exchanges move toward a fully automated system, as opposed to settling for a partial-automation solution. Full automation is best achieved by uniting trading, settlement, and back-office services by means of an integrated automation through a single service company. This is the fastest, simplest and least expensive course of action.
- (3) Support the definition and installation of a system that is financed by the private sector on a commercial, stand-alone basis.
- (4) Do not contribute commodities to the automation effort (e.g., a "challenge grant" to develop an automated clearing and settlement capability) if these will be used to support the selection of a sub-optimal system design, or otherwise subsidize inefficiencies in the system.
- (5) In the near-term, consider assisting the exchanges and the SEC to develop and obtain a consensus on a professionally-designed plan for integrated and automated trading, settlement, and back-office services, fully describing the system and the method of financing and organization.
- (6) Within the framework of the project, consider providing assistance as follows:
 - a. Technical Assistance: A Securities Market Institution Specialist to assist on an ongoing basis in designing, planning, organizing and implementing the new Philippine automated stock market system.
 - b. Training: To promote a more professional exchange management by means of training programs implemented by a private sector implementing organization, or NGO.
 - c. Commodities: Issue a "challenge grant" to support the development of an automated clearing and settlement capability within the framework of the overall system design, subject to point (4) above.

D. SEC Automation

Based on a review of the 1987 MIS plan and extensive discussions with the EDP personnel, the following findings and conclusions were formulated:

1. The SEC has yet to obtain and develop the capability to manage computerized systems on its own.

At the SEC, there is a general misconception that powerful hardware and software systems are the only ingredients needed for successful automation. However, the SEC fails to recognize its own problems with readiness and capacity to manage these information technology resources. Making a set of entirely new applications systems operational is a formidable task, especially when one considers that the SEC has yet to acquire and/or develop the requisite information technology resources needed at this stage. Any system for a new application area, as in the case of most of the SEC systems, can be expected to undergo evolutionary modifications.

2. The upcoming year is important with respect to the SEC's automation efforts.

The upcoming fiscal year 1992 will be a crucial year for the SEC's automation efforts. Most of the systems being developed by an outside contractor will be delivered to the SEC by the end of this year. The Electronic Data Processing (EDP) Unit will be elevated to a departmental level with the approval of ten new key information technology positions, subject to budget approval. Although the current structure is limiting, the proposed future internal structure will provide vital services needed in supporting the implementation of the new systems developed by the contractor.

3. There are scarce resources with which to implement the new Information Technology (I.T.) plan.

Although 32 positions are officially attached to the EDP unit, most of them have been reassigned to other departments, thereby reducing the EDP staff to about half. The remaining EDP staff mainly function as data transcribers and data entry operators. Systems development expertise is practically non-existent.

4. Only one application in the MIS plan can be considered fully operational.

Of the eight systems planned in 1987, only the Corporate Name Verification System can be considered fully operational. The other seven are still in the design or development phase without definite schedules for completion.

5. The systems architecture and development approach is vertical, or departmental, and does not factor in clear functional areas.

A vertical approach was adopted in defining the application systems. Thus, each system follows departmental boundaries. The systems development approach calls for a module development phase followed by an integration phase. The integration phase is not clearly expounded. The systems specifications, as defined in the terms of reference, were based on existing operational procedures which had been "literally translated" into a computerized mode.

6. No plans exist for automation linkage with the stock exchanges.

The SEC applications portfolio tends to target internal operational requirements only. An "inside-out" approach that identifies significant linkages with external entities, such as the stock exchanges, has not been considered.

7. Role for USAID

Although USAID foresaw a significant role for the automation of the SEC, there do not appear to be critical commodity requirements over the short to medium term. Our findings and conclusions lead us to the following recommendations for USAID assistance:

- (1) Technical Assistance: An I.T. Advisor to lead the development of the SEC's Strategic Information Systems Plan (SISP), and to develop an applications plan, a documents management plan and a technology strategy.
- (2) Training: Training requirements will be defined as a result of the SISP component. System management methodology is a candidate area for system development training.
- (3) Commodities: No critical commodity requirements are foreseen for the short to medium term. As it is, current hardware resources are substantial. With \$185,000 still available in its I.T. project budget, the SEC can enter into an agreement with a contractor to perform Facilities Management and Data Entry. Depending on developments in potential stock exchange automation, peripheral devices and data communication may be required for the SEC head office and selected regional offices.

E. Training Needs Assessment

Findings and conclusions in the training area are presented below:

1. The Stock Exchanges

- 1.1 The exchanges have previously been operated more like "clubs" than as independent professionally-managed businesses. Also, the prevalence of ethnic networks and family firms has slowed the emergence of systematic professionalization and training initiatives.
- 1.2 Resources are not a serious limitation. The larger limitation has been an "investment in the way things are." Until now things have worked well enough for the "club" members to have favored the existing arrangements over new approaches or major system changes.
- 1.3 However, for a variety of reasons including economics and competition, the exchanges are (in varying degrees) considering serious changes that will drive the need for training.
- 1.4 In the area of improving the professional management of the exchange, specific areas of training need include:
 - New technical and task skills
 - Professional and management skills required for modern exchanges, and the building of "the business"
 - Case-specific learning: problems, issues, projects, new models
 - Organization, system and institution development (intra-organization)
 - Industry development: market and investor orientation, consensus building, consultative dialogue with the SEC and the private sector (inter group relations).
- 1.5 For broker-dealers, specific areas of training need include:
 - Technical skills involving new systems, rules, automation, etc.
 - Professional research and analytic skills for serving their market

- Business development, marketing and selling skills to expand their business
- Case-specific: issues, problems, projects
- Industry development: higher vision, expectations, relationships with other players.

2. Private Sector Intermediaries

- 2.1 This group feels at the mercy of the problems and limitations of the SEC and the exchanges. Their first desire is to have one clear set of rules and regulations that are fair, out in the open, predictable, and consistently administered. This means clearer communication and dialogue with the SEC and the exchanges, as well as more participation in policy development, and new systems relying on compliance and self regulation.
- 2.2 These are already well-schooled professionals with profitable businesses, but are nevertheless participants in the system as it is today. While they do not need technical, professional or management training, they will need to develop new strategies for their own market and business development as well as for capital market and industry development.
- 2.3 In today's capital market, there are a relatively limited number of participants, most of whom are established and sophisticated. However, if the securities market and the SEC move into a new era that invites much higher confidence and trading volume, then there will be an opening for new participants and new products to enter the market. This will create a longer-term private sector training opportunity.
- 2.4 Specific training needs of private sector intermediaries include:
- Rules, regulation, new systems
 - Case-specific: issues, problem, project, new models
 - Industry development: market development, policy development and advocacy, consensus building
 - New frontiers of business, product and market development.

3. Sector-Wide Findings

There are a number of observations, attitudes, and conditions that are common to the whole sector rather than a particular organization or interest group. They each carry implications regarding the development of a training program and strategy.

- 3.1 Attitudes which limit the vision of what is possible, such as:
- Crisis of confidence in the system and its ability to change
 - Perception that self interest precludes a higher common interest
 - Unclear vision of higher business possibilities that could benefit every participant.
- 3.2 Insufficient "market information" about problems and opportunities (how everyone can make more money), investor perceptions of the players, the system, needs and wants, barriers to participation, etc.
- 3.3 Lack of any cumulative focal point for policy development and advocacy.
- 3.4 Very fragmented leadership, distribution of power, and spheres of self interest which leaves the marketplace without a strong consensus-building capability and an organized pattern of relationships which contribute to the growth of the capital market.
- 3.5 Numerous examples of ad hoc and piecemeal training initiatives and pockets of capability without any common infrastructure or support center that contributes to sharing, continuity, synergy, and cumulative impact and learning.
- 3.7 A real appetite for hands-on exposure to practical and real-world case examples of new technologies, new approaches to problems or opportunities, new developments in capital markets and regulation, state-of-the-art techniques, people and organizations who have "done it" before.

4. The Securities and Exchange Commission

- 4.1 The SEC has the full array of human resource problems and limitations of a government agency including low pay scales and a civil service environment are serious disincentives to attracting and keeping top talent.

- 4.2 Turnover and problems of discontinuity and re-training are prevalent.
- 4.3 While many structural limitations are unlikely to change without major policy and political reform, the availability of good training is one way to provide some offsetting benefits.
- 4.4 Resources for training, staff planning, and team building have been drastically reduced. Budgets for training had been a paltry \$10,000 per year for an agency with over 900 people.
- 4.5 Ad hoc, unconnected and intermittent training activities are the norm rather than the exception.
- 4.6 Staff members concerned with training are overloaded with administrative duties and have neither the time nor exposure to up-to-date training experience. They have motivation, interest and professional desire to address the needs, but lack the time, resources, and administrative priorities for any kind of breakthrough.
- 4.7 There is a consensus that some policy, rules, regulations, and structural changes are needed for the SEC to adequately promote and regulate the capital markets. However, there is an equally clear consensus that more effective execution of existing responsibilities could achieve quantum leaps of improvement.
- 4.8 The Chairman seems to have the instincts, vision and goals in mind for effective growth and regulation of the capital markets. She herself has benefitted from exposure to other markets and methods of operation. Consequently, she recognizes that many of the present limitations could be addressed through training and technical assistance.
- 4.9 SEC staff may not have a clear or useful understanding of how they are perceived by their "marketplace." Certain kinds of training processes involving "market surveys" of SEC services and relationships with its "clients" could be very helpful.
- 4.10 At the technical levels, the types of training required include:
- Front line service: contact with "clients or customers"
 - Specific task/function/system oriented: emphasis on competencies, procedures and techniques (what to do and how to do it)

- Professional and analytical (as well as analyst) skills, prospectus review/analysis, monitoring and enforcement
 - Team building.
- 4.11 At the management level (from mid-level to top), the types of training required include:
- Professional growth, skills
 - Management skills, analytical techniques, and development of group performance
 - Case-specific learning: project, problem, issue (exposure to counterparts and "pioneers" in other places and markets)
 - Organization and institutional development: leadership, systems development, people development, strategic planning
 - Industry and sector development: vision, "marketplace" orientation, policy development and implementation, intergroup relations and consensus building (dialogue and consultative relationships with other capital market players).

4.12 Institutionally, the SEC needs:

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

5. Existing Private Sector Entities and Resources

- 5.1 On the positive side, there is a network of private sector institutions and individuals representing considerable talent, energy, vision, and capability.
- 5.2 On the negative side, there are some critical limiting factors that inhibit these private sector entities from achieving a common approach including efforts that:
- Are ad hoc, intermittent, unconnected

- Are without adequate institutional memory, continuity or follow-through
- Are lacking in "critical mass," insufficient synergy, multiplier effect, and cumulative impact
- Do not foster and nurture the ongoing patterns of dialogue and working relationships between all the key players necessary to create proactive momentum in the capital market (information for problem/opportunity definition, strategies and options, policy and program development, advocacy and change)
- Do not create a powerful enough vision of a larger community of common business interests within which everyone's self interest can be more advantageously pursued
- Are conducted with fragments of time (off-the-job, or secondary-to-the-job) without any full-time professional person or driving force to push things ahead all day/every day on an equal priority with day-to-day professional and business challenges.

6. Role of USAID

The convergence of forces, needs, challenges and interests relating to capital market development over the next few years presents USAID with an opportunity to make a significant difference in what happens, how things happen, and when (how fast) things happen. Suggested criteria and objectives to guide USAID's project design process in training-related matters include:

- (1) The primary focus is to create a long-term, private-sector based training capability for the capital market.
- (2) The purpose of a capability development program is to assist selected private sector organizations in collaboratively building a self-sustaining training, policy development, and advocacy capability which serves private and public sector people and organizations in the progressive development of the Philippine capital market.
- (3) Designate an appropriate private sector implementing organization to receive, allocate and monitor program assistance (technical assistance, training and financial), and to conduct capability-building programs of its own in professional education, policy

development, and advocacy. Based on these criteria, the Financial Executive Institute (FINEX) is the leading candidate.

- (4) Assist in establishing a Center or Institute for Capital Market Management Research and Policy which will be an institutionalized focal point for sector-wide incentives and programs in management education, training development and delivery, policy dialogue and development and research. AIM is very well suited for this role and very interested in making an entrepreneurial commitment.
- (5) Build the capacity of other selected private sector organizations who through their own agenda and effort can bring a "niche" capability in the training, policy and advocacy are; and multiply the talent, resources, and energy available through the private sector.
- (6) Assist the stock exchanges in their efforts to professionalize at the Board and staff levels, as well in the professional, business and market development activities of broker-dealers and members.
- (7) Provide direct assistance to the SEC in building its in-house training and professional development capabilities.
- (8) Provide indirect and third-party assistance to the SEC through the private sector training sector capabilities to further supplement the resources available to it.
- (9) Provide near-term training services in the areas of systems/rules/regulations and automation within the stock exchanges and the SEC.

Additional details on findings, conclusions and recommendations regarding USAID's role can be found contained in individual Specialist Reports contained in Appendix D.

III. PROJECT DESIGN ELEMENTS

A. Introduction

1. Basic Project Design Structure and Components

The Exhibits presented in the following pages portray the basic nature and elements of the project design:

- Exhibit 1a & 1b: Project Design Concept
- Exhibit 2: Summary of Project Purposes
- Exhibit 3: Overall Summary of Project Outputs
- Exhibit 4: Summary of Project Inputs
- Exhibit 5a: Illustrative Project Implementation Organizational Structure - Overall
- Exhibit 5b: Illustrative Project Implementation Organizational Structure - Private Sector Component
- Exhibit 5c: Illustrative Project Implementation Organizational Structure - Public Sector Component.

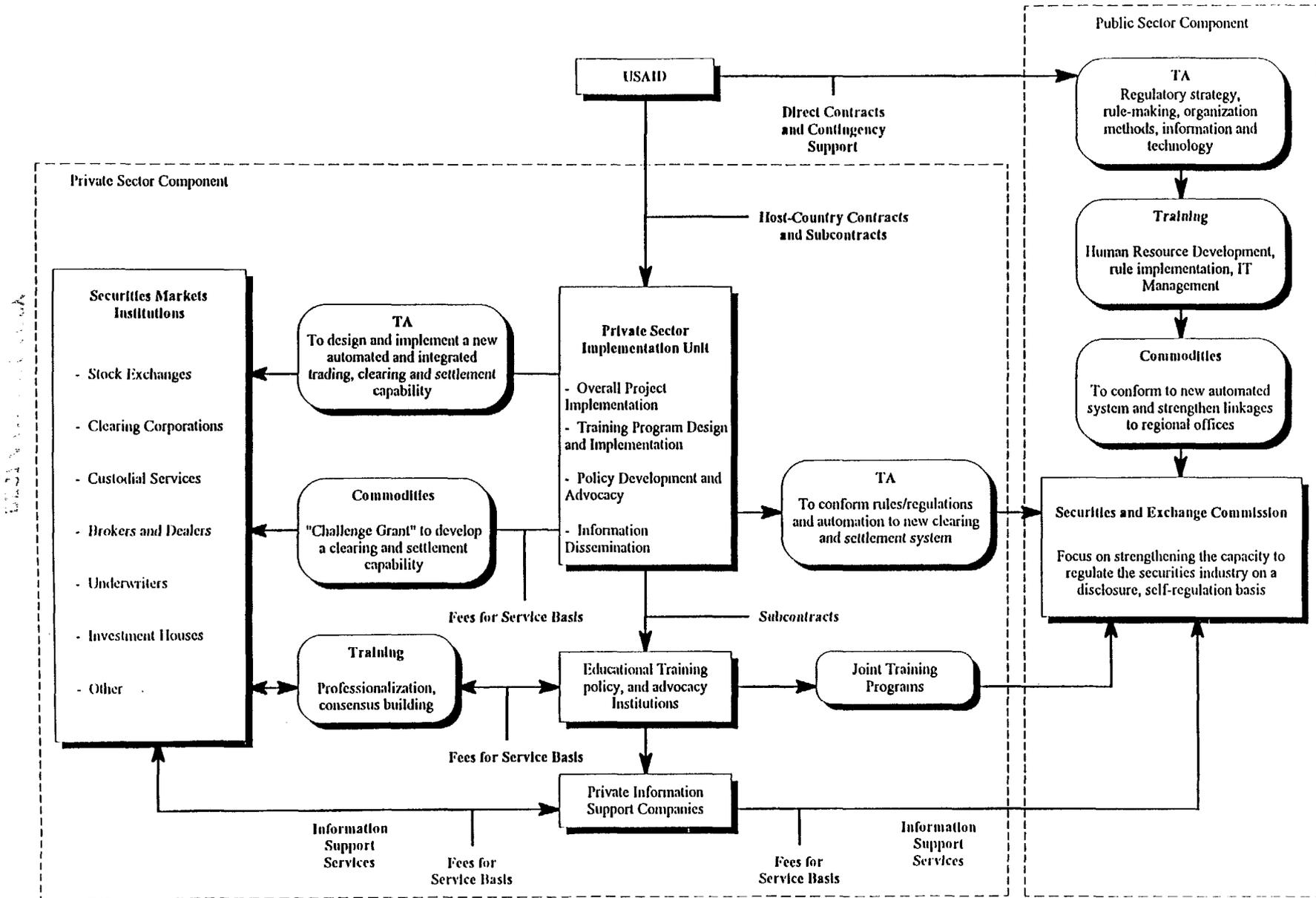
a. Private Sector Component

The overall project is composed of a Private Sector Component and a Public Sector Component. The Private Sector Component is made up of two sub-components:

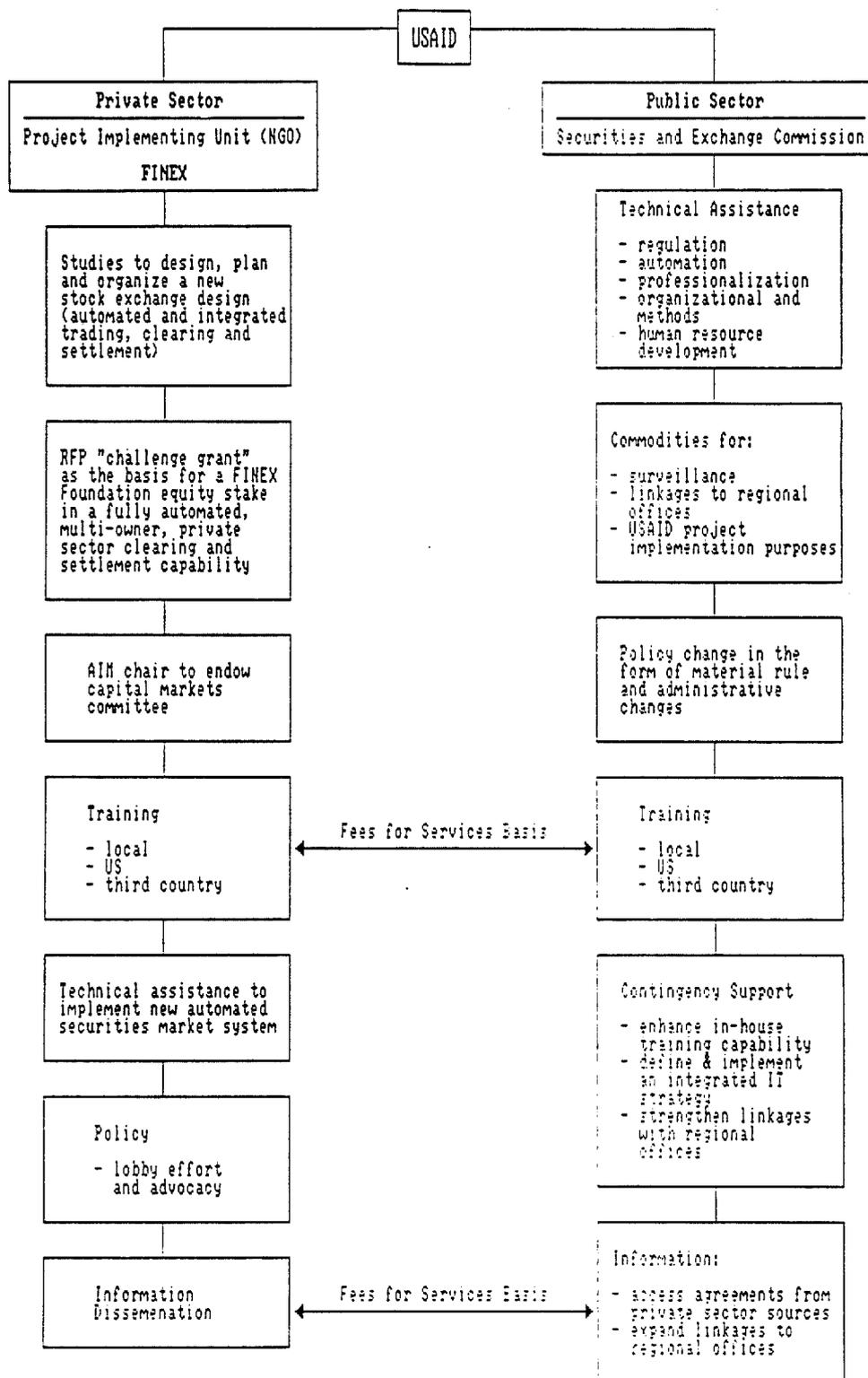
- o A private sector implementing unit, or NGO (hereafter referred to as "the NGO"), through which USAID's assistance to the private sector under the project is to be channeled, and which will be responsible for orchestrating overall project implementation, including organizing the design and implementation of education, training, policy development and advocacy programs under the project. USAID has identified the Financial Executive Institute (FINEX) as the most appropriate Philippine NGO to carry out these responsibilities.
- o Securities market institutions comprised of stock exchanges, broker-dealers and other private intermediaries such as underwriters, investment houses,

Project Design Concept

Exhibit 1a



Project Design Concept



SUMMARY OF PROJECT PURPOSES

Overall	Purposes
OVERALL GOALS AND PURPOSES	<ol style="list-style-type: none"><li data-bbox="562 695 1850 764">1. To improve the trading, clearing and settlement capacity of the market in order to increase the number and types of debt and equity securities available to investors, as well as the liquidity and/or trading volume of these instruments.<li data-bbox="562 789 1755 859">2. To improve the quality and transparency of information available to the investing public and other participants in order to instill renewed confidence in the investor community, both domestic and international.<li data-bbox="562 883 1755 930">3. To enhance the regulatory and operational environment necessary to mobilize private term financial resources for investment into productive private enterprises<li data-bbox="562 954 1367 976">4. To increase employment and incomes through private sector means

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SUMMARY OF PROJECT PURPOSES	
Private Sector	Purposes
PRIVATE SECTOR IMPLEMENTING UNIT (NGO)	<ol style="list-style-type: none"> 1. <u>Create a capability.</u> Create a long-term, private sector-based, self-sustaining and economically-viable training, policy development and advocacy <u>capability</u> which serves both the private and public sectors in the progressive development of the Philippine capital market. 2. <u>Primary recipient.</u> Designate and build the capacity of an appropriate private sector implementing organization to (a) receive, allocate and monitor program assistance; (b) conduct capability-building programs of its own in professional education, policy development and advocacy; and (c) work collaboratively with other private and public sector organizations to build this capability. 3. <u>Secondary recipients.</u> Support a Center or Institute for Capital Market Management, Research and Policy to serve as the institutionalized focal point for sector-wide incentives and programs in management education, training development and delivery, policy dialogue and development, and research. 4. <u>Professionalization of the private sector.</u> Assist capital market institutions and participants to professionalize operations and business and market development practices. 5. <u>Professionalization of the public sector.</u> Assist the SEC directly and indirectly to (a) enhance its internal capacity building and (b) attain desirable levels of interaction and dialogue between the SEC and private capital market participants.
SECURITIES MARKET INSTITUTIONS	<ol style="list-style-type: none"> 1. Assist in designing, planning, organizing and implementing a new, fully automated and integrated system for trading, clearing and settlement appropriate to Philippine circumstances, linked to an enhanced SEC regulatory capability based on disclosure and self-regulation. 2. Assist in professionalizing the operations as well as business and market development practices (working through the private sector implementing unit, or NGO). 3. Assist securities market institutions and participants to promote a collaborative, interactive and professional relationship with the SEC (working through the private sector implementing unit, or NGO).

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SUMMARY OF PROJECT PURPOSES	
Public Sector	Purposes
<p>SECURITIES AND EXCHANGE COMMISSION</p>	<ol style="list-style-type: none"> 1. Enhance the SEC's institutional capacity to regulate the securities industry on a disclosure, self-regulation basis by means of a revised regulatory strategy, enhanced rule-making capability, strengthened methods and procedures, enhanced human resource development/training capability, and a fully elaborated information technology (I.T.) strategy which encompasses regional offices. 2. Assist the SEC attain compatibility with a new automated system of integrated trading, clearing and settlement, including the installation of a computerized surveillance capability. 3. Assist the SEC to promote a collaborative, interactive and professional relationship with securities industry institutions and participants (working through the private sector implementing unit, or NGO).

OVERALL SUMMARY OF PROJECT OUTPUTS	
Private Sector	OUTPUTS
PRIVATE SECTOR IMPLEMENTING UNIT (NGO)	<ol style="list-style-type: none"> 1. Implementing Unit (NGO) fully operational 2. A well-established, self-sustaining institutional center and capability for capital market education, training, research and policy development 3. Institutionalized private sector capability for policy dialogue and advocacy with a successful track record 4. Established patterns of dialogue and collaboration among private and public sector participants in the capital market 5. Economically viable, highly professional training and organizational support capability for the private and public sectors 6. Securities market institutions functioning with internationally- accepted professional standards and practices.
SECURITIES MARKET INSTITUTIONS	<ol style="list-style-type: none"> 1. A new single integrated system (trading, clearing and settlement) designed and specified 2. Private-public sector consensus on the new system established 3. Operational/financial/business plan to implement the new system developed 4. Privately-financed service company to provide trading, clearing and/or settlement services created 5. New system procured and operationalized.

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OVERALL SUMMARY OF PROJECT OUTPUTS	
Public Sector	OUTPUTS
SECURITIES AND EXCHANGE COMMISSION	<ol style="list-style-type: none">1. Revised regulatory strategy based on disclosure, self-regulation and new system requirements defined2. Revised rules and procedures to implement revised regulatory strategy in place3. Enhanced organizational capacity to revise and implement rules on an ongoing basis in response to market needs4. Internal capacity for well-planned, ongoing education and training programs in place5. An ongoing, integrated SEC-wide I.T. plan and strategy in place.

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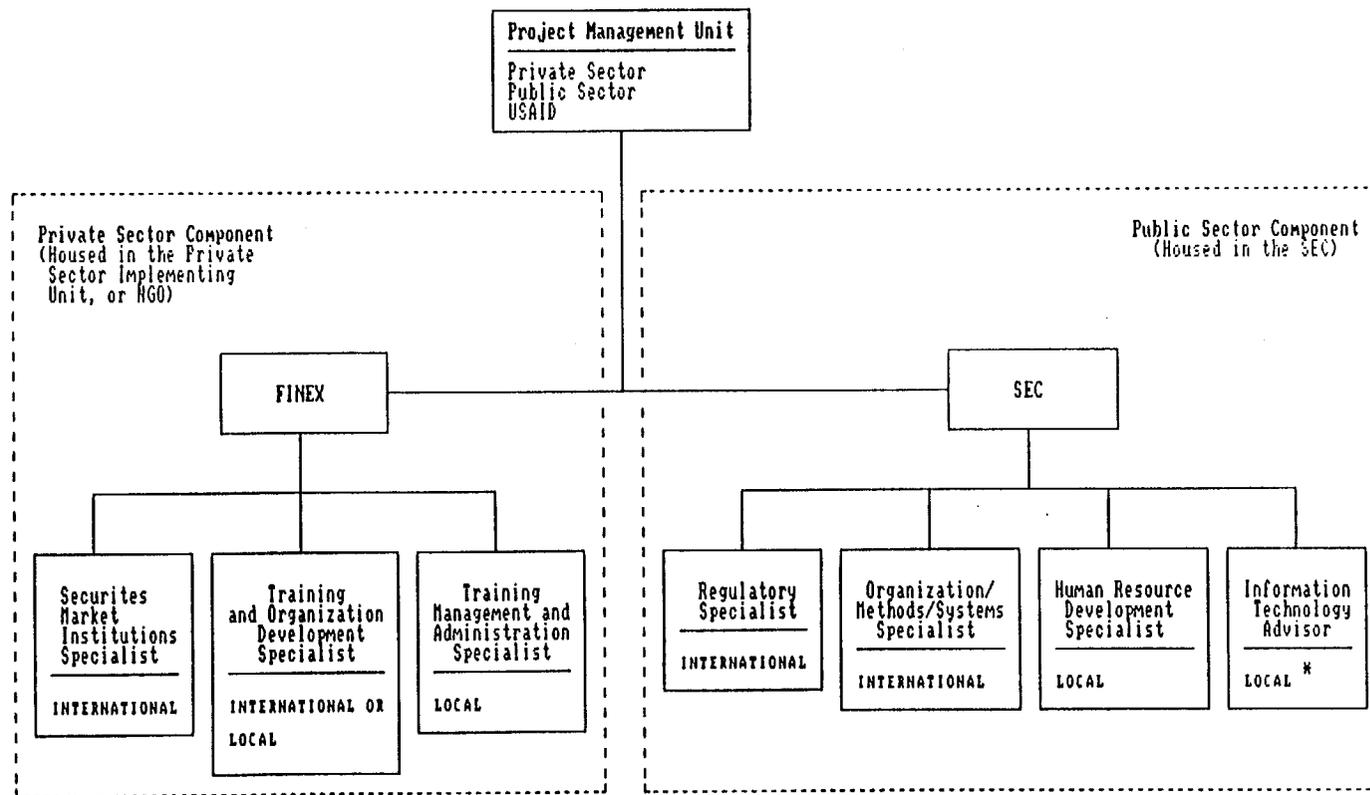
SUMMARY OF PROJECT INPUTS			
	Private Sector		Public Sector
	Market Institutions	Implementing Unit	SEC
<u>Technical Assistance</u>			
Long-term	1) Securities Market Institutions Specialist (International)	1) Training and Organization Development Specialist (International) 2) Training Management and Administration Specialist (Local)	1) Regulatory Specialist (International) 2) Organization and Management/ Systems Specialist (International) 3) Human Resources/ Training Specialist (Local) 4) Information Technology Advisor (Local)*
Short-term	1) New System (Trading, Clearing, Settlement) Design 2) Stock exchange financial/ operational planning 3) System implementation	1) Subject matter experts 2) Sub-contractors to execute seminars and workshops	1) Rule-writing Specialists 2) Procedures Specialists 3) Records Management Specialists 4) Subject matter Specialists 5) Data Modelling Specialist*
Training (Combination of local, regional, and US-based)	1) Consensus-building seminars 2) Professionalization programs 3) Advocacy programs (policy change)	1) Participant training programs	1) Internal capacity-building programs and strategies 2) Professionalization programs (joint with private sector via NGO)
Commodities	1) "Challenge grant" as the basis for a private sector equity stake in developing a clearing and settlement capability	1) For project implementation/ administration purposes	1) Surveillance as part of new stock market system 2) Strengthen linkages to regional offices 3) Project implementation/ administration

* Optional

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Illustrative
Project Implementation
Organizational Structure

OVERALL

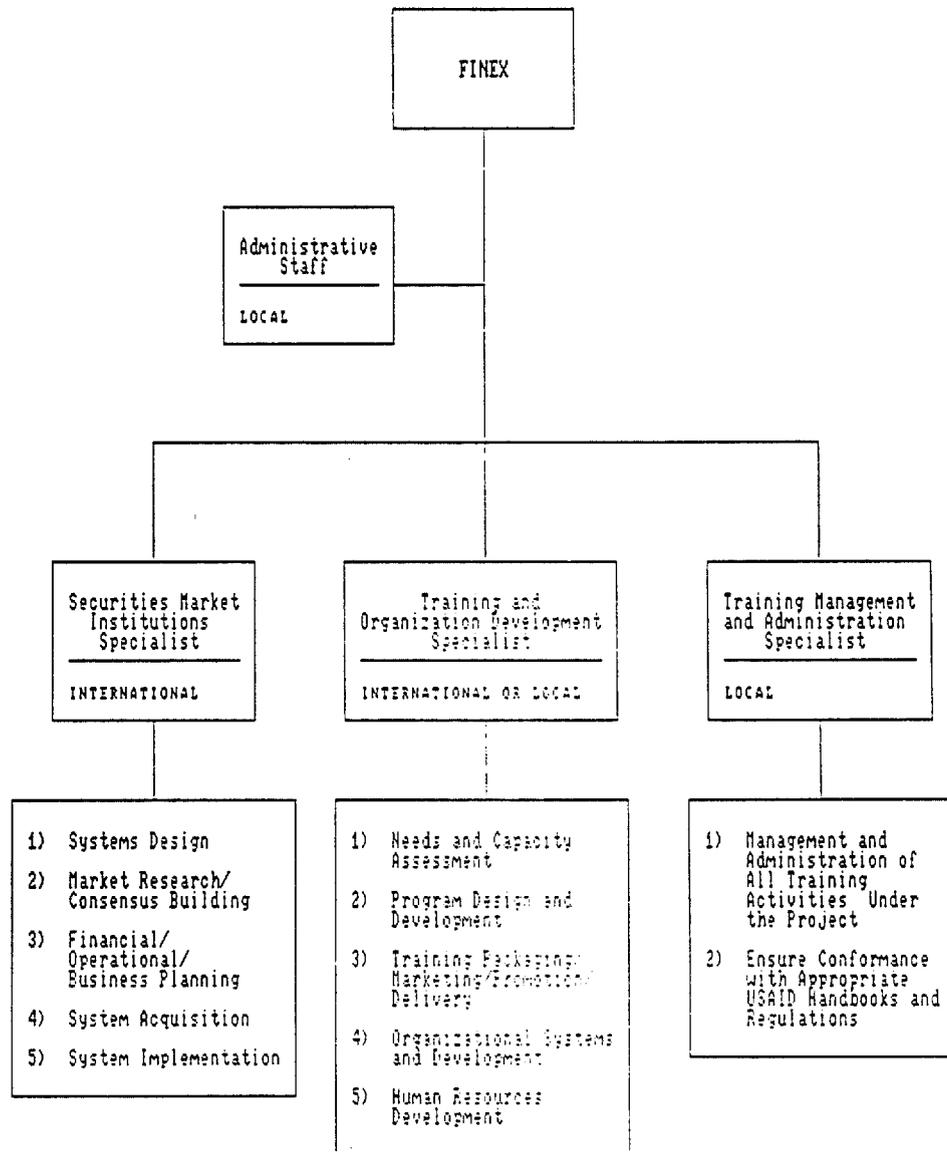


* Optional, as it expands beyond the SEC's regulatory oversight of the securities industry

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Illustrative
Project Implementation
Organizational Structure

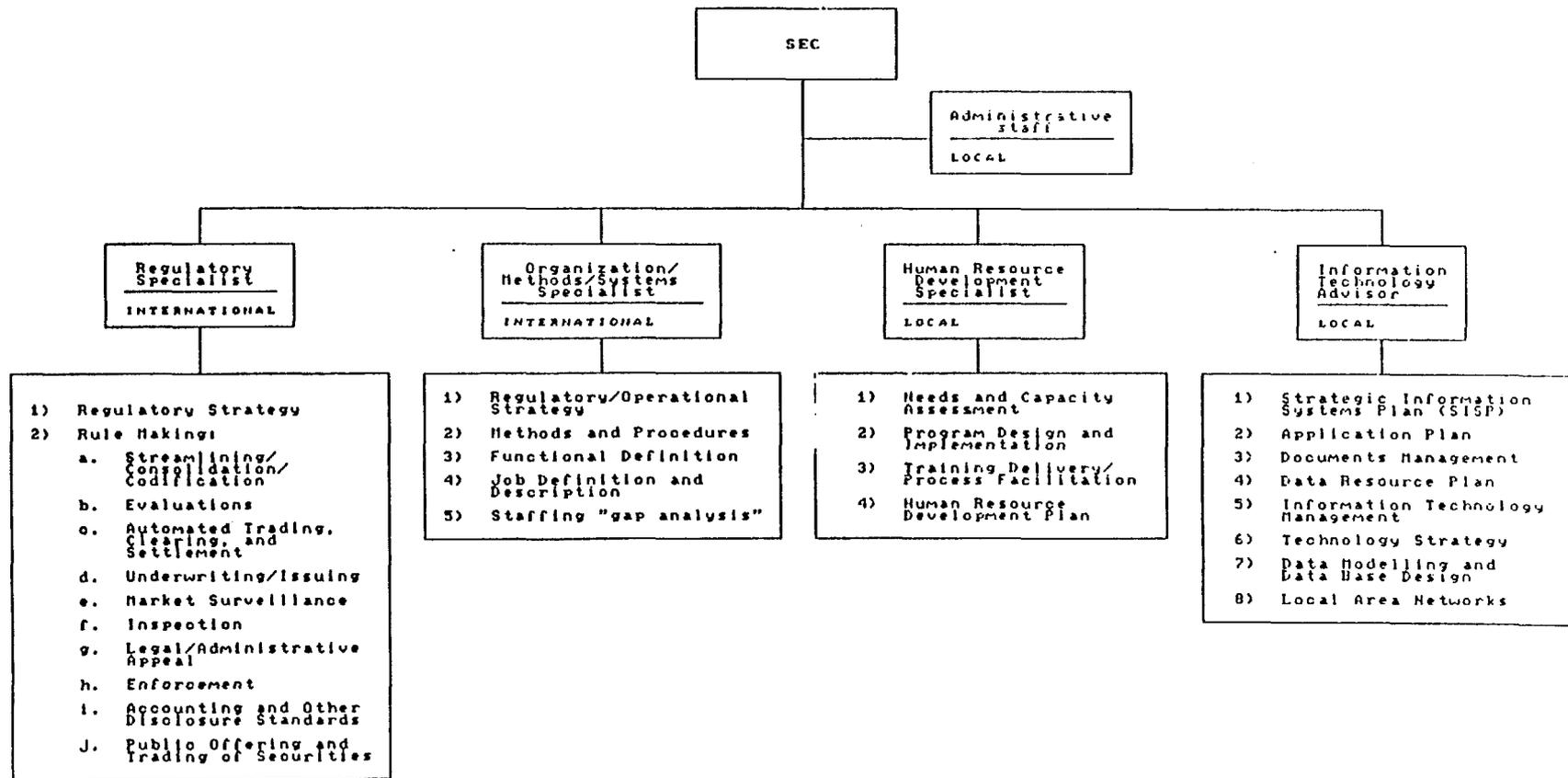
Private Sector Component



Note: One long-term specialist to serve as Chief of Party of private sector component

Illustrative
Project Implementation
Organizational Structure

Public Sector Component



Note: One long-term specialist to serve as Chief of Party for the public sector component

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clearing corporations, central custodian, among others. USAID technical, training and financial assistance provided to securities market institutions will be channeled through the NGO.

The project will provide funding for a package of technical assistance, training and commodities for the securities industry as indicated in the various Exhibits. USAID intends to channel the funding to the NGO, or primary recipient, by means of a host-country contracting arrangement. The NGO would then issue subcontracts to secondary recipient organizations in order to implement specific elements of the project's private sector component, as appropriate. Additionally, USAID intends to facilitate an equity investment by the NGO in a private provider of automated clearing and settlement services. The return on investment generated by this equity stake will underpin the NGO's ability to become a financially self-sufficient provider of capital market development services.

b. Public Sector Component

The Public Sector Component is comprised of the Securities and Exchange Commission (SEC). The project will focus on strengthening the capacity of those Departments and other organizational units of the SEC responsible for regulating the securities industry. Assistance under the Public Sector Component will be channelled directly to the SEC by means of direct contracts and other forms of budgetary support. The SEC will also have access to training and other services as provided under initiatives developed under the Private Sector Component.

Section III.B. Project Description elaborates on the project's goal, purposes, outputs, end of project status, inputs and underlying assumptions.

2. Relation to Mission Private Sector Strategy

The Capital Market Development Project is an integral part of the Mission's private sector strategy, which stresses an increased role for the private sector in economic development. The relationship between the capital market and the private sector is symbiotic, because an active and competitive capital market is an important channel for private sector contributions to economic growth, and private sector growth contributes directly to capital market development.

The Mission's private sector strategy is centered on maximizing private sector participation in the Philippines' economic development activities, as well as in the execution of USAID programs. The strategy emphasizes operational, effectiveness,

and performance improvements within the private sector, without necessarily considering policy change as a pre-requisite, since policy-making is a public sector activity. The development of private-sector self-regulation initiatives, with public sector standards and exception-monitoring capabilities, is an important focus. In addition, the USAID strategy emphasizes capability- and capacity-building in the areas of automation, intra- and inter-organizational performance, and private sector policy and advocacy.

USAID's private sector strategy is coordinated through the Private Enterprise Support Office (PESO). PESO ensures that specific private sector development programs adhere to the global Mission strategy of encouraging economic growth through heavy private sector involvement. PESO's programs are leading towards more rapid development of export-oriented businesses and are aimed at reducing government intervention in private sector activities. The USAID strategy and PESO programs aim to leverage limited resources and to achieve large outputs and pay-offs with relatively modest inputs. Cash requirements for technical assistance, cost-sharing and challenge grants, and the possibility of dollar-to-dollar funding ratios from donors and private sector institutions, are emphasized as potential means of achieving that leverage. The strategy seeks to build through and around credible private sector leaders and entrepreneurs, allowing these leaders to be the champions of growth and change.

3. Interface With Other Donor Programs

In addition to USAID, the Asian Development Bank (ADB) and the World Bank (WB) are interested in fostering capital market development and have been conducting studies and developing programs on the subject. These institutions share USAID's desire to assist in the development of the the Philippine capital market. The opportunities which exist for interaction and coordination between these donor agencies should be maximized.

As can be noted in its "policy matrix," the ADB's program in particular overlaps significantly with USAID's program for capital market development. A number of factors, however, provide a basis for developing complementing programs:

- o A principal ADB focus is to effect policy change; a principal USAID focus is to strengthen the operational capacity of private and public sector capital market institutions to implement policy change.
- o The ADB's technical assistance, while targetted at similar areas as that of USAID, is predominantly short-term in nature; USAID's technical assistance is primarily long-term in nature.

- o USAID's activities in training and commodities supplement and are complementary to the ADB's program as currently defined.

USAID will work closely with the ADB to ensure that their strategies, assistance programs, and resources are coordinated and complementary.

B. Project Description

1. Project Goal and Purposes

The overall program or sector goal of the project is to increase employment and incomes through private sector means. The purposes of the project include:

- o Improving the quality and transparency of information available to the investing public and other capital market participants in order to instill renewed confidence in the investor community, both domestic and international.
- o Improving the operational capacity of the market in order to increase the number and types of debt and equity securities available to investors, and to deepen the liquidity and/or trading volume of these instruments.

2. Project Components

a. Private Sector Component

(1) Private Sector Implementing Unit (the NGO)

(a) Perceived Areas for Improvement

There are a number of factors inhibiting the ability of the private sector to play a determining role in improving the transparency and quality of information in the marketplace, and otherwise promote the development of the market:

- o Attitudes which limit the vision of what is possible in developing the market including a crisis of confidence in the current marketplace and its ability to change, a

perception that self-interest precludes a higher common interest, and an unclear vision of higher business possibilities that could benefit all participants

- o Insufficient market information about problems and opportunities associated with reorganizing the Philippine capital market
- o Lack of any cumulative focal point for policy development and advocacy
- o Very fragmented leadership, distribution of power and spheres of self interest which leaves the marketplace without strong consensus-building capacity and an organized pattern of relationships which contribute to the growth of the market
- o Numerous examples of adhoc and piecemeal training initiatives and pockets of capability without any common infrastructure or support center that contributes to sharing, continuity, synergy and cumulative impact and learning.

These problem areas point to the need for a private sector implementing organization responsible for designing and implementing capital market-related policy, advocacy, training programs that:

- o Provides an ongoing, sustainable capability that will best leverage, multiply and "add value" to the currently available, yet fragmented and ad hoc private sector training related assets and resources
- o Establishes a full-time mechanism for marshalling, marketing, distributing and deploying training resources to achieve synergy, continuity and cumulative impact
- o Addresses the needs of the marketplace as a whole and the patterns of communication/working relationships among the various participants. This should foster a new, ongoing and more progressive "community of interests" that can drive (1) performance and execution, (2) vision and policy development, and (3) advocacy.
- o Provides ongoing resources to develop institutional memory, networking and linkages that will benefit all the constituent parts
- o Can accelerate the development of the capital market by making it a more interactive, consultative process

APPENDIX A

Scope of Work

Financial Markets Development Program

Program Assistance Development

Statement of Work

Overall SOW Structure

- A. Objective**
- B. Background and Current Status**
 - 1. The Financial Resources Mobilization Project
 - 2. Other Donor Activity
 - 3. Updated Design Premises
- C. Scope of Work**
 - 1. Legal and Regulatory Framework
 - 2. Securities and Exchange Commission
 - 3. Capital Market Private Sector Participants
 - 4. Stock Market Management and Operations
 - 5. Training Needs Assessment
 - 6. Long-Term Technical Assistance
 - 7. Donor Coordination
 - 8. PESO Portfolio Integration
- D. Specialist Requirements and Team Composition**
- E. Duration and Schedule**
- F. Deliverable Requirements**
- G. Level of Effort**

A. Objective

The objectives for carrying out the PAIP development for the Financial Markets Development Program include:

1. Review and update the Mission's program related to promoting capital market development in the Philippines based on a high level of private sector participation.
2. Develop inputs for the PAIP-based on the Capital Markets Development Component of USAID/Manila's Financial Resources Mobilization Project (492-0377), the updating exercise and the ongoing activities of other donors.
3. Identify discrete short-term technical assistance (TA) activities with which the Mission can proceed during project design and prior to project implementation.
4. As the basis for a commodity procurement component of the project, carry out an automation assessment of the stock exchanges and selected areas of the SEC to determine computer-related requirements.
5. Identify potential NGOs to act as the private sector implementor of selected components of projectized assistance.

B. Background and Current Status

1. The Financial Resources Mobilization Project

USAID's Financial Resources Mobilization Project, authorized by AID/W in August 1987 (but subsequently never obligated), had a two-fold purpose:

- o To enhance the environment to mobilize private term financial resources for investment in productive private enterprises (the Capital Markets Development Component).
- o Reduce the burden of the acquired assets and public corporations on the national budget (the Privatization Component).

The Privatization Component became the Privatization Project (492-0428), which began implementation in FY 1988. However, the Capital Markets Development Component remained stalled due to a number of factors. The original expected outputs of the Capital Markets Development Component included proposals for revised legislation and regulations to be submitted to the Philippine Congress and an improved Securities and Exchange Commission (SEC) serving in both developmental and regulatory capacities. The Capital Markets Development Working Group--with the Secretariat in the Department of Trade and Industry--was intended to serve as the primary implementing entity for the legal/regulatory and institutional development activities of the Capital Markets Development Component. An Investor's Promotion Group to be formed under the project was envisioned as the counterpart, coordinating directly with USAID to implement activities for the development of a private investment company. The project planned to procure technical assistance through a combination of host-country and AID-direct contracts.

The Mission identified a number of project elements and TA requirements for each element. Proposed project elements included the legal and regulatory framework, the SEC, the stock exchanges, accounting and auditing activities, a capital markets conference and a media campaign. The objective of the present assignment is to assess the continuing validity of the original Capital Markets Development elements and to make recommendations for updating TA/training areas accordingly.

2. Other Donor Activity

The most active donor in the area of capital market development in the Philippines is the Asian Development Bank (ADB). The ADB is currently negotiating a US\$200 million program loan with the GOP to promote capital market development. While details regarding the nature of the program are not currently available, preliminary indications

are that the main thrust of the loan is to encourage the GOP to (a) unify the Manila and Makati stock exchanges and (b) update capital market regulations. Preliminary indications are that, though funds for TA do form part of the loan package, they may be somewhat limited, particularly in view of the scope of the problems facing the Philippine capital market. Hence, the capital market development program that USAID intends to design, building on the original project, could contain TA, training, and commodity procurement elements to complement the efforts of the ADB in this area. The program assistance development contractor should take into account those policy areas to which the ADB is allocating resources so that USAID's program may build upon ADB efforts in new policy conditionality.

3. Updated Design Premises

The output of this engagement should take into consideration a number of design premises as set forth recently by the Private Enterprise Support Office (PESO), including:

- o Maximize the use of private sector counterparts who can serve as mechanisms to reach the private sector directly as well as voices for continued reform by the GOP.
- o Leverage the use of private sector funds to the maximum extent possible.
- o Develop project design inputs in a manner consistent with an innovative, "hybrid" project design methodology that includes both public and private sector counterparts as well as project and program (resource transfer with conditionality) elements.
- o Integrate the new Financial Markets Development Program into the current PESO portfolio to maximize the internal leverage of USAID private sector resources.

- o Define the role for a U.S. long-term institutional contractor and/or personal services contractors (PSC) to oversee the GOP-implemented component.

Additional instruction regarding design inputs will be provided by the PESCO Chief during project design.

C. Scope of Work

In close coordination with USAID, the Contractor, through a literature review and a program of interviews, shall:

- o Reassess the problems being experienced by, and update the TA and training needs of, private sector capital market participants and pertinent GOP bodies in the areas of capital market regulation and stock market management and operations (as specified in more detail below).
- o Specify program areas in which USAID intervention could be useful and appropriate, taking into account the current needs of the private sector and the GOP, other donor activities, the Mission's past program designs, and comparative advantages.
- o Develop a PID-level "logical framework" using the standard AID format, which outlines preliminary project outputs, inputs and possible areas of USAID intervention (including project goals, objectives, outputs, end of project status, counterparts, inputs, etc.).

More specifically, the Contractor should address areas and issues such as, but not necessarily limited to, the following:

1. Legal and Regulatory Framework: Review principal elements of the legal and regulatory framework (acts, codes, regulations, rules, etc.) to update problem areas and identify possible TA needs. Some issues to address include the extent to which the legal and regulatory framework is too

fragmented, whether the SEC has too many responsibilities, and whether the current regulatory framework is fully consistent with a market "self-regulation" approach. A review of the Investment Company Act should be included to determine its suitability for stimulating supply and demand for securities.

2. Securities and Exchange Commission: Review SEC's current: (a) responsibilities, rules, regulations and procedures; and (b) organizational structure and staffing to update problem areas and identify possible TA/training needs. Include:
 - o A comparison of the SEC's responsibilities, rules, regulations and organizational structure with those of regulatory bodies in more developed countries (e.g., the U.S. SEC), as well as those in countries in comparable stages of development.
 - o A review of the procedures for companies to go public, including disclosure requirements.
 - o A review of the extent to which the SEC may possess an overly legal, quasi-judicial orientation--resulting in a tendency to define and apply more direct forms of regulatory oversight--as opposed to an orientation which is broader-based and hence possibly more conducive to a balanced emphasis on a capital market development role and investor protection.
 - o Define areas of institutional support for the SEC in areas that will directly strengthen its ability to support its private sector clientele.
3. Capital Market Private Sector Participants: Survey the current state of private sector (brokers, dealers, investment houses, underwriters, pension funds, etc.) participation in the capital markets and define a possible program of action intended to stimulate the supply and demand for securities (both debt and equity).

Include an assessment of possible new financial instruments which may be of interest to the private sector (e.g., debt securities, venture capital, rights trading).

4. Stock Market Management and Operations: Review the stock exchanges' current organization, operations, and computer systems technology base to update problem areas and identify possible TA, training and commodity needs with a view to enhancing/professionalizing the trading capability and structure of the capital markets. Include a review of:

a. Organizations:

- (1) The current status of the possible merger of the two exchanges.
- (2) The organizational and management structure of the exchanges from the point of view of how the self-regulatory mode can best be made operational.
- (3) The nature of membership arrangements and member responsibilities.

b. Operations:

- (1) Current trading and clearing/settlement procedures.
- (2) The capacity of the exchanges to detect and eliminate improper trading activity.
- (3) The capacity of the exchanges to act as self-regulatory organizations and to enforce members' compliance with rules of the exchanges and the SEC.

c. Automation:

- (1) The current state of automation of trading, clearing/settlement procedures, etc.

means by which USAID's Financial Markets Development Program remains free-standing, yet is complementary to and honors the conditionality of other donors' programs.

8. PESO Portfolio Integration: Develop a project design that is fully integrated with PESO's current and projected project portfolio. For example, take into account the linkages between capital market development and privatization (privatizations require both access to viable means of financing and represent a way to increase the supply of securities issued and trade in the capital markets, thereby enhancing their development).
9. Policy Matrix: The Mission intends on using a hybrid program/project approach. Though funding for policy change will be limited (approximately \$10 million), the design team should identify approximate niches for AID intervention, through review of other donors' efforts in this area (e.g., ADB Program Loan for Improving Capital Markets).

D. Specialist Requirements and Team Composition

The following specialist areas are required to carry-out this SOW:

- o Capital market law and regulation.
- o Capital market regulatory agency organization and management.
- o Capital market private sector institution operations (traders, brokers, investment houses, underwriters, pension funds, etc.).
- o Stock exchange organization, management and operations.
- o Stock exchange automation (trading, clearing and settlement, real-time integration with SEC supervisory computer systems).

(2) A range of automation options for trading and clearing/settlement which maximize the ability of the SEC to monitor trading activity on a real-time basis.

(3) The systems requirements of the SEC to develop a Central Depository System to streamline information storage and retrieval.

5. Training Needs Assessment: Survey private institutions' participating in capital market activity and the GOP/SEC to identify/update key training needs areas with a view to strengthening their technical capital market skills. Include:
- o A review of Philippine private institutions that might best serve as a counterpart to USAID through which training programs could be designed and implemented, and in which a capital market training capacity could be institutionalized.
 - o Discussions with the Philippine Accounting Standards Council (PASC) and the Philippine Institute of Certified Public Accountants (PICPA) to assess the current training needs in the areas of accounting and audit, that pertain to the preparation of prospects and other financial disclosure information.
6. Long-Term Technical Assistance: Develop preliminary terms of reference for three long-term, advisory positions to assist: (a) the SEC in regulatory and organizational reform; (b) the stock exchange(s) in unification, organizational and procedural restructuring, automation, etc.; and (c) the NGO selected to oversee the private sector component of the overall capital market program.
7. Donor Coordination: Review other donor activities in the area of financial/capital market development, and integrate into the program design

- o Capital market institution training design and implementation.
- o New financial instruments development (e.g. debt instruments, venture capital, rights trading).
- o AID project design (PAIP-level).

In view of these specialist requirements, the following team composition/labor categories are required to carry out the SOW:

1. Program Design Specialist/Team Leader
2. Capital Market Regulations Specialist
3. Capital Market Private Institutions Specialist
4. Stock Market Automation Specialist
5. Financial Markets Training/New Financial Instruments Specialist
6. Technical Support/Research Analyst (junior level)

It is anticipated that some categories may be staffed by either foreign or domestic consultants, as appropriate. The contractor will be expected to source domestic consultants through subcontracting with a Philippine firm.

E. Duration and Schedule

The elapsed time needed to carry out this engagement is estimated at twelve weeks, with approximately seven to eight weeks spent in country. Anticipated start and end dates are July 30, 1991 and October 19, 1991, respectively. Six day work-weeks are authorized for work carried out in-country without premium compensation.

F. Deliverable Requirements

The end-product of this engagement will be a draft PAIP-level document that will serve as an input to

the USAID project design team. During the course of the engagement, the project USAID design team members will give their findings, conclusions and recommendations to the Team Leader/Project Design Specialist, who will produce a Preliminary Report o/a the end of Week 6. The Preliminary Report will form the basis for a presentation to USAID and Philippine private and public sector representatives, as appropriate, prior to the consulting team's departure o/a the end of Week 6. Based on the outcome of the presentation, as well as discussions with USAID officials, the Team Leader/Project Design Specialist, working with the Consultant Team members as necessary, will produce a Final Draft Report o/a the end of Week 7, prior to departing the country. USAID will transmit a written response to the Final Draft to PRE/PD and the Contractor, as necessary, o/a the end of Week 10. The Contractor, in consultation with PRE/PD, will produce the Final Report o/a the end of Week 12.

G. Level of Effort

The following level of effort (in work-days) by labor category is envisioned:

	<u>Estimated Person-Days</u>
1. Team Leader/Project Design Specialist	42
2. Capital Market Regulation Specialist	30
3. Capital Market Private Institutions Spec(s)	30
4. Stock Market Automation Specialist(s)	30
5. Financial Markets Training/New Financial Instruments Specialist(s)	30
6. Technical Support/Research Analyst(s)	36

Labor categories 3, 4, 5, and 6 may be composed of a combination of foreign and domestic consultants, both working within the estimated level of effort set forth for that labor category.

Financial Sector Development Project
USAID/Manila - Capital Markets Development Project

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Financial Sector Development Project
USAID/Manila - Capital Markets Development Project

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- o Produces long-term benefits that can be relatively high compared to resources required.

From a strategy and design point of view, this component will stress:

- o Capability development versus ad hoc units of training
- o A long-term approach
- o Leveraging private sector assets/resources
- o Building on strong existing organizations
- o Being market responsive and revenue generating (a fees-for-services orientation)
- o Establishing operational and financial sustainability so that USAID's participation can be phased out
- o Defining joint private-public sector programs
- o Private sector networking and collaboration
- o Private and public sector working and learning together
- o Achieving a financial multiplier effect through challenge grants, cost sharing, etc.
- o Fostering of policy dialogue and advocacy
- o The maximum use of cost-country talent, supplemented by U.S. and third-country expertise where necessary and appropriate
- o Building on existing leadership, "champions" and "entrepreneurs."

(b) Specific Objectives

The objectives of this sub-component include:

1. Institutionalize a private sector-based capital market development capability: Help create a long-term, private-sector based training capability for the capital market. A capability development program will assist selected private sector organizations to collaboratively build a self-sustaining training, policy development, and advocacy capability which serves private and public sector people and organizations in the progressive development of the Philippine capital market.

2. Select and develop a primary recipient: Designate and build the institutional capacity of an appropriate the NGO to:
- o Receive, allocate and monitor program assistance (technical, training and financial assistance)
 - o Conduct capability-building programs of its own in professional education, policy development, and advocacy.

The NGO must be highly credible to private and public sector leaders in the capital market sector, well positioned across the capital market and overall financial sector, and have an impeccable track record in handling funds and conducting programs of value. It must have the vision, sense of mission and leadership to play this role.

3. Select and develop secondary recipients: Provide support for a Center or Institute for Capital Markets Management Research and Policy which will be an institutionalized focal point for sector-wide incentives and programs in management education, training development and delivery, policy dialogue and development and research. This center will:
- o Develop and conduct programs for the private and public sector
 - o Foster collaborative dialogue and participation of people and groups across the capital market
 - o Provide professional expertise and other resources such as infrastructure/office/space/support services for other groups who want to undertake worthwhile training initiatives (including information, policy, or advocacy related activities).

Additionally, the Center will build the capacity of selected other private sector organizations who through their own agenda and effort can bring a "niche" capability in the training, policy and advocacy area, as well as multiply the talent, resources, and energy available through the private sector.

4. Assist in private sector professional development: Assist the stock exchanges and other private capital market participants in their efforts to professionalize at the board and staff levels, as well in the professional, business and market development activities of broker-dealers and members.
5. Assist in public sector professional development: Provide assistance to the SEC directly by building its in-house training and professional development capabilities, and

indirectly by establishing private sector training programs that supplement its resources available for:

- o The SEC's internal capacity building
 - o Attaining desirable levels of interaction, dialogue, consultation between the SEC and private sector/capital market participants.
6. Support the transition to a new system: In order to manage the transition to a new operational system for the market, provide training services to the private sector and the SEC in:
- o Quality control management of training services that will be supplied by the vendors of new computer-based systems
 - o Actual training capability/services which are needed over and above what can be derived from the system suppliers.

(c) Sub-component Output

The principal output associated with this sub-component of the project is a private sector-based institutional capability for capital market development education, training, research, policy dialogue and advocacy.

(d) End of Project Status

Conditions that will indicate that this sub-component's objectives have been met and its output achieved include:

1. The NGO is fully operational, organizationally viable, and financially self-sustaining on the basis revenues from fees-for-services activities and returns from equity investments in private companies providing automated clearing and settlement services to the market. This organization is a leading player in capital market development through its own programs as well as through an active network of other private sector organizations to which it channels funds and technical support.
2. A highly-regarded and self-sustaining institutional center for capital market education, training, research, and policy development composed of existing organizations and affiliated with a distinguished institution for higher learning is established and operational.

3. A private sector network composed of existing organizations--each in its own niche--for policy dialogue and advocacy which has successfully advanced progressive policies, strategies and programs for capital market development to the leadership in the public and private sectors is established and operational.
4. Effective patterns of dialogue and collaboration among private and public sector capital market participants are established.
5. A highly professional training and organizational support capability for private and public sector capital market organizations is in place and financially self-sustaining.
6. Securities market institutions are functioning within a framework of internationally-accepted professional standards and practices.
7. Significant additional private sector financial resources (or various financial equivalents) which reflect at least a dollar-for-dollar matching of funds contributed by USAID have been directed into capital market education/training, policy development, and advocacy efforts.

(e) Sub-component Inputs

Funding will be made available over a 3 to 4 year period to support the various kinds of people, activities and training assistance required for the effective design and implementation of the program described above. This includes funding to support the primary recipient (i.e., technical assistance and commodities for the NGO), as well as the secondary recipients (i.e., subcontractors hired to implement various elements of the overall training program, as designed and coordinated by the primary recipient).

(1) Technical Assistance

Long-Term

In addition to various administrative support personnel, the following long-term personnel are required to achieve this sub-component's objectives and output:

1. Training and Organization Development Specialist (est. 36 months)
2. Training Management and Administration Specialist (est. 36 months).

The Terms of Reference for these personnel are included in Appendix F.

Short-Term

Short-term technical assistance will also be required in a number of categories, including:

- o Needs and capacity assessment
- o Program design and development
- o Training packaging, marketing, promotion, delivery
- o Organizational systems and development
- o Human resource development
- o Capital market policy studies.

(2) Training

Funding will be provided to implement the various elements of the overall training-related program, which will involve the following types of activities:

- o Various core professional education programs
- o Periodic special focus workshop and seminars
- o Forums and conferences for the capital markets community
- o Case and learning materials development
- o Training development, consultation, and facilitation services (needs assessment, design, training of trainers, organizational development and systems change, human resource development, process facilitation)
- o Training materials development, packaging and marketing services to link users of training with providers of training or existing course materials

- o Research to support policy analysis and dialogue
- o Ongoing linkages and networking
- o Shared experiential learning among Asian counterparts
- o Infrastructure, support, and professional services for other organizations and groups (both private and public) that are involved in capital market development.

These activities will be conducted locally, regionally and in the United States, and implemented via secondary recipients on a subcontract basis.

(3) Commodities

Computer hardware and software will be required for activities:

- o Related to project administration on the part of the NGO
- o Possibly related to a "Challenge Grant" for developing a clearing and settlement system.

(4) Seed Capital

Funding and/or the utilization of USAID-organized guarantee mechanisms will be required to finance the start-up of a private company established to provide automated clearing and settlement services to the marketplace.

(f) Important Assumptions

Various assumptions and key factors will influence the execution and implementation of this sub-component's objectives and approach, and will significantly determine the nature, quality, and level of results achieved. These include:

- o FINEX or other appropriate private entity is willing and able to implement the project
- o Appropriate implementing organizations and personnel are selected and supported

- o The approach of building an institutionalized capability is accepted and utilized by market participants
- o The private sector leveraging strategy of dollar-for-dollar matching contributions is feasible
- o The nature of USAID's commitment is clear and consistent up-front, with continuous follow-through and support being provided in accordance with agreed-upon plans and courses of action
- o Within the framework of agreed-upon responsibilities and courses of action, USAID remains interested, credible, relevant and "quality conscious"
- o USAID's comparative advantage of flexibility and a private sector development philosophy is allowed to manifest itself
- o USAID is able to channel seed capital through the selected implementing unit to private companies established to provide automated clearing and settlement services to the market on a challenge grant basis
- o USAID funds are available according to the agreed-upon plan
- o Other parallel assistance inputs (e.g., technical assistance to the exchanges and the SEC to reorganize the market) proceed in a timely and satisfactory manner
- o An appropriate degree of coordination with other donors is achieved.

Exhibit 2, 3 and 4 summarize this sub-component's objectives, outputs and inputs; Appendix E also contains a preliminary logical framework matrix summarizing this sub-component's design elements.

(2) Securities Market Institutions

(a) Perceived Areas for Improvement

The Philippine capital market is characterized by a number of problem areas where improvement is necessary to develop the market, and which form the basis for the design of this sub-component:

- o Lack of confidence. There is a debilitating "crisis of confidence" on the part of market participants rooted, in large part, in a lack of dialogue and cooperation, and whereby the Philippines finds itself falling further behind other emerging countries that once looked to its stock markets for leadership and example.
- o Lack of liquidity. Despite a reasonable number of sound securities listed on the exchanges, the average trading volume per listed security is far too low. This is due in large part to inefficiency in order execution, excessive turnaround time, high transaction costs, lack of convincingly safe and efficiently managed securities accounts, and other factors-- problems which can be resolved by installing a fully automated, integrated single trading, settlement and back-office service focused on a central custodian.
- o Lack of modern trading systems. The current trading system, which is manual and based on two-way auction and open-outcry methods, is antiquated and appropriate only for an inactive market. The inefficiencies in current trading, clearing and settlement procedures are a major factor holding back the development of the Philippine market, and contribute to the market being unable to compete for foreign investment.
- o Lack of professional management. There is a paucity of independent professional managers in the administration of the exchanges which seriously limits their ability to operate as self-regulating organizations.
- o Lack of information on how to improve the market. There are serious, friction-causing misconceptions both by the exchanges and the SEC regarding the cost and requirements of making significant improvements in the management and operations of the marketplace. This is due in large part to a lack of hard, state-of-the art information about automation options, system capabilities and associated costs upon which to base joint decisions.

(b) Specific Objectives

The overall objective of this sub-component is to provide the key parties--the exchanges, other appropriate private sector intermediaries, and the SEC--with information upon which to base decisions about the soundest and most economically-viable course of action to develop a new Philippine securities market system, and to assist in the process of making the new system operational.

Specific objectives include:

- o Develop a New System: To assist in designing, planning, organizing and implementing a new, fully automated and integrated system for trading, clearing and settlement appropriate to the Philippine circumstances, linked to an enhanced SEC regulatory capability based on disclosure and self-regulation. This involves:
 - System Design: Defining the requirements and specifications of a single automated national trading system--including computer-based trading, clearing, settlement and back-office capability--that would serve the operational needs of both exchanges, and facilitate the SEC carry out its regulatory responsibilities.
 - Consensus Building: Developing a consensus in favor of the proposed system among broker-dealers, officials of the SEC, custodians, registrars and other market participants.
 - Organization: Evaluating alternative methods of organizing, financing and managing the provision of an automated system.
 - Planning: Defining the transition process (all key planning and action steps) that the exchanges and the SEC would need to undertake once they choose to convert to an automated system of their choice.
 - Contracting: Assisting in contracting the acquisition of the automated system from international vendors.
 - Contract Management: Providing contract management assistance during the implementation of the automated system.
 - Technology Transfer: Ensuring that technology transfer is effected in the process of acquiring the new system by requiring the vendor train Philippine personnel in all aspects of running, maintaining and programming the system.
- o Develop Financial Instruments: Broaden the product line of broker-dealers to include underwriting services, fund management, and trading in fixed-interest securities.
- o Build and Strengthen Relations: Assist private securities market institutions to promote a collaborative, interactive and professional relations with the SEC.

(c) Sub-component Output

The output of the Securities Market Institutions sub-component is an improved securities trading, clearing, and settlement capability rooted in a revised market organizational structure and modern automated systems and procedures.

(d) End of Project Status

Conditions that will indicate that this sub-component's objectives have been met and its output achieved include:

1. A modern securities market system design and specification consistent with the requirements of the Philippine marketplace and internationally-accepted standards is defined and approved for implementation
2. An appropriately reconstituted securities exchange organization with independent professional management is established
3. A privately-financed central custodian-automation service company to serve broker-dealers is established
4. A new automated system is procured and under operation
5. Participation by Broker-dealers in underwriting and fund management is permitted.

(e) Sub-component Inputs

A number of inputs will be required in order to achieve this sub-component's objectives and output.

(1) Technical AssistanceLong-Term

A Securities Market Specialist (international, 36 months) to serve as day-to-day advisor in designing and implementing the new securities market system. (See Appendix F for Terms of Reference).

Short-Term

Short-term specialists (est. 60 months) will also be required in a number of categories, including:

- o Legal specialists (domestic)
- o Securities industry specialists (domestic)
- o Stock market specialists (international)
- o Regulatory specialists (domestic, international)
- o Automation specialists (domestic, international)
- o Investment banking/finance specialists (domestic, international).

(2) Training

Training assistance will be required in the following areas:

- o Seminars/workshops to support the consensus-building process
- o Seminars/workshops to assist broker-dealers in developing business and marketing plans within the framework of the new system
- o Seminars/workshops to support vendor efforts to train broker-dealers and other personnel in the process of installing the new system.

(3) Commodities

Commodities may be required as part of USAID's "Challenge Grant" for developing a clearing and settlement system.

(f) Important Assumptions

A number of assumptions shape the sub-component's ability to attain the technical objectives and outputs, including:

- o The key parties--the exchanges and the SEC--have access to the state of the art information necessary to make sound, economically-viable decisions.

- o The key parties subscribe to and implement jointly-determined decisions on how to proceed with reorganizing and automating the marketplace.
- o Automated order-based trading and centralized clearing and settlement are legally, commercially, and technically feasible in the Philippines.
- o The new system is "financeable" on a self-financing, commercial basis.
- o Policy and regulatory changes which permit broker-dealers to participate in underwriting and fund management activities are made
- o An appropriate degree of donor coordination is achieved.

Exhibits 2-4 present a summary of this sub-component's objectives, outputs and inputs; Appendix E also contains a preliminary logical framework matrix summarizing this sub-component's design elements.

b. Public Sector Component

(1) Perceived Areas for Improvement

The SEC has a number of problem areas where improvement is necessary and which form the basis for the design of this component:

- o There are problems on the part of the SEC and the exchanges in making the self-regulatory system work, including the fact that the SEC may be getting overly involved in making evaluations about the soundness of investments, the suitability and pricing of new issues, among other areas.
- o There is significant overlap and unnecessary duplication in the SEC's rules, regulations, organizational responsibilities and procedures.
- o The SEC's regulatory efficiency and operations are impaired by an overextended mandate and limited resources.
- o There is a considerable discrepancy between the SEC's professional skill level and its mandated responsibilities, complicated by its limited access to human and other resources.

- o The SEC's overall objectives in reorganizing and automating the market are fundamentally sound, but they require information and assistance to achieve them.
- o There is a "crisis of confidence" within the private sector regarding the SEC's ability to regulate the market, as well as to supervise/manage the process of reorganizing and automating it.

(2) Specific Objectives

The objectives of the Public Sector Component include:

- o To enhance the institutional capability of the SEC to regulate the securities industry in a manner that provides appropriate investor protection and promotes fairness and efficiency without over-regulating the securities industry
- o To attain compatibility with a new automated system of integrated trading, clearing and settlement, including the installation of of a computerized surveillance capability
- o To promote a collaborative, interactive and professional relationship between the SEC as a regulator and the private securities industry as executor/promoter
- o To strengthen the technical capital market skills of SEC staff, as required for their regulatory role
- o To instill confidence in the Philippine and foreign investor community through improved regulatory and enforcement effectiveness
- o To promote linkages with the SEC regional offices.

(3) Component Output

The output for this component is an enhanced regulatory framework and SEC institutional capability consistent with disclosure and self-regulatory methods of capital market regulation.

(4) End of Project Status

Conditions that will indicate that this sub-component's objectives have been met and its output achieved include:

1. A revised regulatory strategy conforming to the principles of self-regulation and disclosure as well as to the requirements of the new automated system is approved by the SEC and implementation initiated
2. Revised rules resulting from the process of codification/streamlining are issued
3. New/revised rules consistent with the new system, and the principles of self-regulation and disclosure are issued
4. New/revised internal operational procedures consistent with the new/revised rules and the principles of self-regulation and disclosure are approved and implementation initiated
5. A plan/strategy to automate the new/revised procedures and related records and information requirements is approved and implementation initiated.
6. A human resource development plan/strategy to strengthen the technical regulation skills of SEC staff is approved and implementation initiated.

(5) Component Inputs

A number of inputs will be required to achieve the Public Sector Component's objectives and output.

(a) Technical AssistanceLong-Term

Four long-term specialists and advisors are required under the Public Sector Component:

1. Regulatory Specialist (international, 36 months)
2. Organization and Methods/Automation Specialist (international or domestic, 36 months)
3. Human Resource Development Specialist (international or domestic, 36 months)

4. Information Technology Advisor (domestic, 36 months).

Short-Term

A combination of international and domestic short-term specialists (est. 60 months) will be required to support the efforts of each long-term specialist. Appendix F contains the Terms of Reference for each long-term advisor, as well as a description of the types of short-term TA which can be expected.

(b) Training

A combination of seminars/workshops and participant training conducted locally, regionally and in the United States will be provided to SEC staff at two levels:

- o Directly, as organized by the Human Resource Specialist, to build in-house training and professional development capabilities
- o Indirectly, as organized through the NGO under the private sector component, to further supplement the resources available for the SEC's internal capacity building, as well as to attain desirable levels of interaction, dialogue, and consultation between the SEC and private sector participants.

(c) Commodities

Computer hardware and software will be required to:

- o Conform to the new automated system (particularly in the area of surveillance)
- o Automate the records and information requirements associated with new/revised organizational procedures
- o Strengthen linkages with regional offices.

(6) Important Assumptions

A number of key assumptions shape the outcome of USAID's efforts under the Public Sector Component:

- o USAID is able to provide assistance directly to the SEC and not through a government intermediary
- o Concrete steps are taken by the SEC and the exchanges to reorganize and automate the market
- o The long-term specialists are able to work directly under the Chairman, serving as "invisible aides" and support resources, and develop a relationship of trust with the Chairman and other key SEC staff
- o Proposed changes in regulations, rules and internal procedures are approved
- o A constructive working dialogue can be achieved between the SEC and key private sector participants
- o Other parallel assistance inputs under the project (e.g., technical assistance to the exchanges and the SEC to reorganize the market) proceed in a timely and satisfactory manner
- o An appropriate degree of donor coordination is achieved.

Exhibits 2-4 present a summary of this sub-component's objectives, outputs and inputs; Appendix E also contains a preliminary logical framework matrix summarizing this sub-component's design elements.

APPENDIX B

List of Interviewees

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APPENDIX C

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A. Legal and Regulatory

- o An Analysis and Commentary on House Bill No. 19782, "An Act to Develop the Philippine Securities Market, Create a Capital Market Development Commission, Define Its Powers and Duties, Amend Pertinent Provisions of Relevant Laws, and for Other Purposes." Presented to Hon. Dante Tinga of the Philippine House of Representatives by Mr. George Uy-Tioco, January 31, 1989.
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- o A.I.D. Memorandum, "Private Enterprise Policy Support Program Policy Actions," 1991.
- o PESO Profile

APPENDIX D

Specialist Reports

1. Regulation/SEC Organization (R.Banez, J. Evans)
2. Stock Market Management/Operations (J. Schroy, J. Ruckrich)
3. Stock Market and SEC Automation (L. Mascarinas, J. Ruckrich)
4. Training Needs Assessment (D. Brunell)

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M E M O R A N D U M

To: Mark Camstra, Team Leader
From: Rene Banez & John Evans, Legal and Regulatory Team
Date: September 27, 1991
Re: Specialist Report

Attached is our report on the Regulatory and SEC Components, as contained in the Scope of Work. Please advise if any additional information is required.

attachment (as stated)

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I. INTRODUCTION

The scope of work we carried out addresses the legal and regulatory actor in the capital markets of the Philippines: the Securities and Exchange Commission. We focused on identifying regulatory and structural areas where USAID could assist the SEC in its internal development. Thus, having reviewed the Revised Securities Act, the Study of Securities Market Institutions, Philippines by the Aries Group, the 1985 Discussion Report concerning Capital Market Development by Reilly, et.al., and the various other materials provided, it is our belief that USAID can be most helpful to the development of the capital market in the Philippines by providing persons with appropriate experience to work directly with the SEC and its staff to recommend and draft specific changes in the existing laws, rules and regulations, hold hearings with the purpose of causing the exchanges to meet self-regulatory obligations, combine their activities and act in the interest of developing the capital market. Although the SEC should obviously assist in developing the market, that should not be a specific mandate that can be used by market participants to oppose SEC actions to further diffuse the SEC's limited resources.

II. BACKGROUND

A. General Overview

The first Securities Act of the Philippines was enacted on October 26, 1936 by virtue of Commonwealth Act No. 83. This law was basically patterned from the U.S. Securities Act of 1933 and the U.S. Securities Exchange Act of 1934. This law created the first Securities and Exchange Commission.

The SEC started operation on November 11, 1936, under the executive supervision of the Department of Justice. The SEC's main responsibilities were to do a thorough analysis of every registered security, a scrutiny of the financial condition and operations of every applicant for security issue, strict screening of every application for a broker's or a dealer's license, and to provide close supervision of stock and bond brokers and stock exchanges.

The role of the SEC continued to change over the years, through the enactment of four acts.

- o On September 27, 1979, the SEC was reorganized into a collegial body consisting of one Chairman and two Associate Commissioners.
- o On March 21, 1976, Presidential Decree (P.D.) No. 902-A was passed, expanding the powers of the SEC to include quasi-judicial powers. The orders or decisions of the SEC en banc were made appealable to the Supreme Court for review. Administrative supervision of the SEC was placed under the Office of the President.
- o On January 2, 1981, the P.D. No. 1758 was passed expanding the number of commissioners to five.
- o On February 23, 1982, the Batasang Pamhansa (Philippine Congress) passed Batas Pamhansa Blg. 178, otherwise known as the Revised Securities Act.

The SEC, which was initially entrusted to administer and enforce provisions relating to public offerings of securities and trading of securities in the secondary market, currently administers and implements 20 different laws and presidential decrees.

B. SEC Rules and Regulations

The SEC has encountered many problems in the implementation of its numerous responsibilities. Many overlapping and duplicating rules exist, and the current regulatory mandate of the SEC far exceeds its ability to implement or its effectiveness in the marketplace.

To the extent problem areas can be resolved through SEC rulemaking, rule changes would be recommended. Following are details of the primary problems found.

1. Stock Exchange Operations

A primary area that does not appear to be functioning well is the concept of self-regulation by exchanges, other securities market organizations and individuals. The concept is that investment firms, brokerage firms, and investment advisory firms have the main responsibility to oversee their employees and agents, and assure that their activities conform to standards of operation, integrity and fairness established by law, SEC rules and regulations, exchange rules and regulations, ethical codes and standards established by applicable professional associations, and by the firms themselves.

Exchanges are responsible for establishing appropriate rules and regulations to assure fair and efficient trading in securities on the exchange, free entry of members who qualify with reasonable requirements, settlement of differences between members and enforcement of securities laws, rules and regulations applying to their members.

The SEC's responsibility is to oversee the entire securities market. This is done directly in some instances, such as licensing and delicensing of exchanges, broker/dealers, approving exchange rules and any changes in such rules, and, if necessary, requiring specific actions by exchanges and others. It is also done by reviewing disclosures provided in registration statements for public offerings of securities and declaring such registration statements to be effective.

In all other activities, the SEC's oversight should be indirect to the maximum extent possible. Self-regulation requires coordination and cooperation between the SEC and an exchange. The exchange must take the initiative to fulfill its direct responsibility over its members and listed companies as well as continually improving its trading and after-trading systems.

The SEC encourages these activities by suggesting actions it believes to be important, and then giving the exchange a reasonable period of time to respond in the manner deemed appropriate by the exchange, rather than by directly requiring an exchange to take a specific action, or mandating such things as number of seats, seat price, automation, name of exchange, sources of funds, approval of listing, etc. Moreover, except in unusual cases, the SEC should not discipline or order an exchange member to do something without first discussing the matter with the exchange and permitting the exchanges to provide appropriate discipline or require the problem to be resolved. For the system to work, the exchange must be active and responsive to needs. The SEC must also respond in a timely manner to proposals made or actions taken by an exchange.

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There appear to be problems both on the part of the exchanges and the SEC in making the self-regulatory system work. The self-regulatory system is operating successfully in a number of securities markets, the largest of which are in the United States and Great Britain.

The primary benefits of a properly operating self-regulatory structure are that it makes maximum use of the expertise of private sector participants, results in better compliance with established standards, minimizes government interference with market processes and minimizes government expense while permitting the government to assure that certain investor protection and market operation standards are maintained.

2. Governance of Exchanges

Securities exchanges began as private organizations made up of a group of securities brokers who got together in order to trade securities more efficiently. These organizations were governed by those who were members.

In some countries, governments organized and operated securities exchanges because of their importance to the growth and development of economic activity. These exchanges were governed by government employees.

Exchanges serve many constituents such as companies who desire to obtain capital from investors, investors, various securities professionals such as broker/dealers, investment managers and advisors, and also the general public. The interests of other constituents do not always correspond to those of securities exchanges members. In order to make exchanges responsive to the interests of all parties, those established and controlled by governments are including private sector persons on their governing boards or making the exchanges into private organizations with representation of various interests on their boards of directors.

On the other hand, governments in countries where private exchanges have operated as clubs representing only their members on their boards are requiring that some board members be persons other than exchange members such as investors, issuers, economists, financial advisors, etc. With respect to exchange committees responsible to assure member compliance, members of such committees are made up entirely of non-broker/dealer board members. These changes apply to securities exchanges in virtually all countries.

3. Evaluation Powers of the SEC

There are a number of provisions in the Revised Securities Act and SEC rules that deal with evaluations by the SEC such as maximum commissions for public offerings, whether a security is a safe

investment, whether the issuer's business is sound, clearance or approval of listed companies' news reports and certification of financial statements. The advisor should review the appropriateness of the SEC in engaging in these types of evaluations and, on the basis of that review, possibly recommend that the SEC not use such authority.

Generally, commissions are best established by negotiation between the parties, by competitors seeking to increase their business, and by investors or consumers of the services seeking the best service at the lowest price.

Except in instances of privatization of government-owned companies in which the government is the issuer, prices for new issues of securities should not be determined by government officials but by private issuers and professionals after evaluating the supply and expected demand for the security. The issuer desires the maximum price per share. The underwriter desires that the shares will be sold to investors. These parties should negotiate the price of the offering which should not be required to have any specified relationship to "par value" or the offering price of any previous issue of the same class and type of securities. With access to adequate information about the operations and financial conditions of the issuer, investors can and should be responsible for deciding whether, considering their own investment goals and ability to take risks, a particular security should be bought or sold.

The SEC takes a big risk when it determines whether an investment in a security or even an industry is a safe investment. Certain criteria can be established as standards to be used but risk and safety are evaluations that can best be made by private professionals, whose views often differ, and ultimately by investors and prospective investors.

The SEC should not take the responsibility to clear, approve or disapprove news reports of listed companies. The SEC may establish standards and formats if it determines that needs for investor protection are not being met by a company in accordance with requirements established by law, SEC rules or by the exchange where a company is listed, but advance approval should be imposed as a penalty requirement only after a company has not complied with the standards in prior news reports. Even then, the exchange should generally be responsible to grant or deny the approval.

Refraining from the above types of evaluations are an important part of self regulation and permitting maximum private sector decision making, which generally results in better economic decisions than can be made by government officials.

C. SEC Organization and Methods

The present SEC is headed by Chairman Rosario N. Lopez and assisted by 4 Associate Commissioners, namely Rodolfo L. Samarista, Armando Z. Gonzalez, Merle V. Manuel, and Fe Eloisa C. Gloria. Except for Mr. Gonzalez, all, including the Chairman, are career officials.

The Chairman exercises general executive control, direction and supervision over the work and operation of the Commission and its members, board, units, personnel and all of its administrative business. Each of the four Associate Commissioners oversees and supervises the operations and activities of two departments on a rotation basis and makes necessary reports and/or recommendations to the Chairman and/or the Commission.

1. The Departmental Organization

The SEC is composed of 9 departments, namely:

- (1) Administrative and Finance Department (AFD)
- (2) Brokers and Exchanges Department (BED)
- (3) Corporate and Legal Department (CLD)
- (4) Examiners and Appraisers Department (EAD)
- (5) Investments and Research Department (IRD)
- (6) Money Market Operations Department (MMOD)
- (7) Prosecution and Enforcement Department (PED)
- (8) Securities Investigations and Clearing Department (SICD)
- (9) Supervision and Monitoring Department (SMD).

Each department is headed by a Director and divided into various divisions with specific and specialized areas of responsibility. Like the Associate Commissioners, Directors are also rotated from one department to another. The decisions, actions, orders or rulings of each department are appealable to the Commission sitting en banc. The records of the case are elevated to the Office of the Chairman, Commission En Banc (OC/EB) for review and thereafter presented to the Commission en banc for deliberation and resolution of the appeal.

2. Brokers and Exchanges Department

The Brokers and Exchange Department (BED) has been given the primary responsibility to oversee and regulate brokers', dealers' and stock exchanges' functions. However, other departments, except for the Administrative and Finance Department and the Securities Investigations and Clearing Department, also have some involvement with the latter department.

3. Areas of Overlapping Functions

The following appear to be examples of overlapping functions among departments or divisions that might be shifted to another department to make each department's activities more homogenous:

- (1) Corporate Regulation Division under the Corporate and Legal Department (CLD) oversees and regulates the operation of investment houses which are defined in Decree #129 as "any enterprise which engages in underwriting securities of another person or enterprise." These functions could be more appropriate in the BED.
- (2) Investment Information Division under the IRD scrutinizes reports from listed companies. This might be more efficiently done by the Department that processes the original registration of the company's securities.
- (3) Division "D" of SMD supervises the operations of stock market and commodity futures market. This appears to overlap with responsibilities of BED and other SMD activities appear to overlap with those of other departments.
- (4) Registration and Licensing Division of the BED "processes applications for registration of securities and requests for exemptions from registration." The Securities Trading Regulation Division of BED "ensures that no unregistered securities are being floated to the public." These functions relate more to disclosures required of issuers than to securities industry participants and therefore are more similar to the other activities of EAD than those of BED.

Accordingly, the above functions of the other SEC departments in some way overlap or duplicate some of the functions of BED relative to the registration/licensing, regulation and supervision of stock exchanges, brokers, dealers, securities salesmen, futures commission merchants, floor brokers, commodity futures associations, commodity pool operators and commodity futures advisors/solicitors, as well as the registration of securities for public offering/sales and the listing thereof on the stock exchanges for trading. Thus, a rationalization of the functions of each department may be considered to avoid such overlap/duplication.

III. ROLE FOR USAID ASSISTANCE

A. USAID Role and Overall Objectives

The primary way in which USAID can assist the SEC at this time is by providing advisors who can work with SEC personnel to make recommendations of specific actions to resolve problems that have been discussed in prior reports and of which the SEC is already aware. The overall objective of providing the SEC with technical assistance is to:

- o Enhance the institutional capability of the SEC to regulate the securities industry in a manner that provides appropriate investor protection and promotes fairness and efficiency without over-regulating the securities industry
- o Strengthen the technical capital market skills of SEC staff, as required for their regulatory role
- o Create a compatibility of automation with the stock exchange(s) in terms of market surveillance
- o Promote a productive relationship between the SEC as regulator and the private securities industry as executor/promotor
- o Instill confidence in the Philippine and foreign investor community through improved regulatory and enforcement effectiveness.

The two most critical areas to improve the effectiveness of the SEC in the development of the Philippine Capital Markets are in Implementing Rules and Regulations and in Organization and Methods/Automation. Following are the Terms of Reference we suggest to formulate the technical assistance of the two SEC advisors.

B. Implementing Rules and Regulations Component

1. Objectives

The objective of USAID technical assistance is to promote the efficiency and effectiveness of the SEC's influence on capital markets through rule-making. The objective of this advisor is to serve as an "invisible aide" or resource to assist the SEC in the rationalization of its implementing rules and regulations, as they relate to the securities industry. The goal of this task should

result in a set of rationalized and updated rules (preferably in codified form), drafted with the SEC and issued by the SEC itself.

2. Scope of Work/Methodology

The technical advisor will ideally work directly under the Chairman of the SEC and draft rules in conjunction with the Director of the Brokers and Exchanges Department, as well as any other Directors whose Departments have activities relating to public offerings of securities and transactions in such securities. Since the advisor will be USAID-sponsored, he/she will have the autonomy to draft rules and regulations directly to the SEC Chairman in cases of disagreement by the affected departments.

The scope of these rules and regulations is limited to those which regulate the securities industry. To attempt to draft rules which, for example, also affect the registration of companies or the administration of the SEC would exceed the scope of this project.

The long-term advisor could be expected to focus on the following categories of rules:

- a. Evaluations: Assist in reviewing the appropriateness of and possibly removing SEC rules that deal with evaluations by the SEC, such as maximum commissions for public offerings, whether a security is a safe investment, whether the issuer's business is sound, clearance or approval of listed companies' news reports and certification of financial statements.
- b. Streamlining: All rules related to or that deal with offering or trading of securities, by brokers, dealers and investment houses, should come under the jurisdiction of the Brokers and Exchanges Department (BED). Review of all rules should be executed with careful detail to overlap and duplication. The advisor should closely coordinate with the Organization Advisor in completing this task.
- c. Automated Trading, Clearing and Settlement: Assist in drafting rules pertaining to trading, clearing and settlement, particularly if the private securities industry institutions move toward the automation and integration of these functions.
- d. Underwriting/Issuing: Assist in reviewing and recommending changes in rules and regulations to carry out the SEC's responsibilities and functions pertaining to underwriters and issuers (e.g., underwriter contracts, allotment, oversubscription, underwriting records and procedures, price stabilization, registration of offerings, registration of public companies, prospectus

definition, public company disclosure, insider disclosure, reporting requirements, underwriting results, suspension of offerings).

- e. Market Surveillance: Assist in drafting rules and procedures for the SEC in surveillance matters; assist in determining the computer systems requirements to carry out the surveillance function.
- f. Short-Term Technical Assistance: Areas where the long-term advisor may require access to specialists on a short-term basis include:
 - (1) Inspections: Assist in reviewing and recommending changes in rules and regulations pertaining to the SEC's inspection of securities market institutions (e.g., broker/dealers, securities exchanges, investment managers, etc.) to determine compliance with their responsibilities and any new rules and regulations that may be established in a new automated exchange system. Develop criteria for the stock exchange(s) to fulfill their role as self regulators of members and listed companies.
 - (2) Legal/Administrative Appeal: Assist in reviewing standards and possibly drafting rules and regulations pertaining to administrative appeals (e.g., appeal procedures for the SEC to follow when a person believes that a sanction imposed either by the SEC or a self-regulatory organization is inappropriate appeal request, required records, appeal decision).
 - (3) Enforcement: Assist in reviewing rules and regulations pertaining to structuring an administrative action by the SEC to establish the basis for limiting a person's license, canceling a person's license, barring a person, assisting in a legal action for the purpose of a fine, imprisonment and/or restitution of ill-gotten gains.
 - (4) Stock Exchange Operations: Assist in reviewing rules and regulations pertaining to stock exchange operations (e.g., listing/delisting, rights offerings, trading and floor procedures, block trades, odd lot trades, floor trading procedures, floor trading personnel, commissions, member ethics and affairs, membership, member discipline, examinations, clearing and settlement).
 - (5) Clearing and Settlement: Assist in reviewing rules pertaining to clearing and settlement (e.g., inspection application, records, reports, licence application, stop/resume clearing, disciplinary action, inspection procedures).

In addition to his/her rulemaking function, this Advisor should be available to the Chairman of the SEC and other appropriate officials to respond to any other related issues that may arise, such as assistance in speech writing and in addressing specific issues coming before the Commission.

The methodology suggested for drafting these rules is to work closely with SEC staff on an interactive basis, assisted by local Philippine consultants to the maximum extent possible. This would ensure that the rules and regulations implemented would be relevant in the Philippine context, and that they would be products of the SEC, and not of outside advisors. The advisor would begin his task with an overview of the rules applicable to the BED, and work with SEC staff to issue an initial regulatory strategy paper, detailing the areas of rules and functions which he/she will undertake to examine and draft. Thereafter, the drafting of rules will be issued on an interactive, consensus basis, with possible interim reports to USAID on the status of the implementing rule project at crucial points. The final result will be the successful implementation of the rules from the SEC.

3. Staffing Requirements

The following specialists can be provided most expeditiously by an institutional contractor who would provide:

- a. Regulatory Specialist (expatriate), with significant experience working at a senior management level in an SEC-type organization. The ideal candidate would have consulting experience with government agencies in a developing country context as well as a working knowledge of securities markets and management experience with an SEC-type organization. Familiarity with the Philippine capital markets and the current organizational status of the SEC would contribute greatly to focusing the skills of the short-term consultant teams on the needs of the SEC.
- b. Technical support staff (local), to assist in drafting rules and regulations under the direction of the Regulatory Specialist. Must have some knowledge of the capital markets and prior work experience. A knowledge of the Philippine governmental institutions is strongly recommended.
- c. Short-term expatriate technical assistance (local and expatriate), as needed.

- d. Home Office Support provided by the Contractor's senior management to provide project oversight and quality control, and assist in sourcing short-term technical specialists.

4. Deliverables

The principal deliverables would be in the form of actual rule changes and resulting improvements in the operation of the SEC and development of private sector self-regulation and decision-making. Other reports may take the form of:

- o Initial regulatory strategy
- o Draft rules, forms and implementing regulations
- o Occasional memos addressing regulatory issues as the pertain to the rule-making process
- o Periodic memos containing a detailed list of all major regulations which may be in process over the next year, indicating research needed
- o Scopes of work for short-term technical assistance.

C. Organization, Methods, & Automation Component

1. Objectives

As the overall objective of this component is to assist capital market development through the more efficient operation of the SEC, the foremost objective of this advisor is to enhance the institutional capability to effectively regulate the securities industry via strengthening the Commission's organizational and procedural functions, with a view to automating those functions, as appropriate. This advisor's goal should be to work within the SEC to review and make recommendations to remove overlap and duplication of functions while ensuring coordination of the complementing activities between departments.

2. Scope of Work/Methodology

The technical advisor will ideally work directly under the Chairman of the SEC, and have her support in developing and recommending organizational and functional changes. The advisor will work directly with the Executive Director to review and draft changes, as well as with the Directors of Departments that will be affected

by the organizational/functional changes. Since the advisor will be USAID-sponsored, he/she will have the autonomy to present organization/procedural/automation improvements directly to the SEC Chairman, in the case of disagreement.

The scope of this organization, methods and automation component should focus on the following areas:

- a. Operational Strategy: Assist the SEC in reaching a consensus on a master strategy by (1) analyzing the operational goals of the SEC and providing comparative information on the structure of securities market supervisory agencies in other countries; and (2) assisting with the planning for the reorganization or restructuring of internal procedures.
- b. Procedures: Develop a procedures manual would specify operating procedures for all SEC tasks listed in the master plan. This procedural manual would be part of the SEC rulebook and would contain organization charts, job descriptions and operation flow diagrams.
- c. Records and Automation: Develop a records and automation plan which specifies SEC record keeping requirements and determines how they are to be stored and accessed. It would cover external, as well as internal, SEC documents. This plan would describe the SEC's needs for automation--current and future. These specifications and review would serve as the basis for further implementation.
- d. Human Resource Development Plan: After making an assessment which compares job requirements and existing staff skills, develop a human resource plan which determines how any gaps between requirements and existing skills are to be bridged in the short run, as well as recommend a long-term strategy for developing and maintaining the human resources which the SEC needs to operate effectively. This plan would be the basis for specific training programs which could then be implemented under the overall training component.

3. Staffing Requirements

The following specialists can be provided most expeditiously by an institutional contractor who would provide:

- a. Organization and Methods Specialist (expatriate or local), with at least eight years' experience in consulting on administrative organization and methods, and at least two years' at the project manager level. Critical skills include: analytical ability, writing and

developing manuals, ability to access quantitative work needs and manpower requirements, and the ability to conceptualize work flows and organizational interaction. The ideal candidate would have consulting experience with government agencies and the private sector, with a working knowledge of securities markets and the regulatory procedures of the SEC.

- b. Technical support staff (local), with some experience in information systems and/or human resources consulting. A knowledge of the Philippine government institutions and the capital markets would be ideal.
- c. Home Office Support provided by the Contractor's senior management to provide project oversight and quality control, and assist in sourcing short-term technical specialists.
- d. Short-term expatriate technical assistance (local and expatriate), as needed.

4. Deliverables

The principal reports or deliverables that could result from this technical assistance would primarily be internal SEC documents, such as:

- o Procedures manual
- o Human resource plan
- o Data resource plan
- o Document management plan
- o Automation plan.

M E M O R A N D U M

To: Mark Camstra, Team Leader

From: John Schroy, Capital Market Institutions Specialist
John Ruckrich, Stock Market Automation Specialist

Date: September 27, 1991

Re: Specialist Report

Attached is our report on capital market private participants, and stock market management, operations and automation, as contained in the scope of work. Please advise if you need additional information.

attachment (as stated)

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APPENDIX: KEY ELEMENTS OF A MODERN SECURITIES EXCHANGE

Five Basis Services Provided on a Fully Automated Basis

1. Management of Customer Orders on an Automated Basis
2. Automated Trade Execution
3. Automatic Settlement
4. Automatic Production of Customer Statements and Confirmations
5. Automated Price Information

I. INTRODUCTION

The growth of securities markets depend upon the ability of many competing broker-dealers to join together and establish an efficient stock market institution. Broker-dealers of all sizes and types have a common interest in the overall efficiency of the market, since the bigger and better the market, the easier it is for each broker to attract clients. In developing countries like the Philippines, the potential number of investors is so great, that excessive competition among brokers for customers should not be a problem for many years.

Throughout the world, broker-dealers organized themselves and promoted their common interests by means of a stock exchange. International specialists in stock market development have been studying the Philippine market for some years. Although proposals vary, the recommendations of most specialists have been remarkably similar on one point: The Philippine stock exchanges should be automated as one efficient processing body. In addition this automation effort should cover at a minimum trading, clearance, settlement, and price information, and ideally it would include the back-office functions of managing the customer order, production of customer statements and confirmations.

To those people who would suggest that partial automation would be prudent, it will be recorded here that it is the considered opinions of the authors, backed by their many years of experience in automation in the securities industry, that a completely integrated system is actually simpler and easier to install than a partially automated system. Furthermore, partial solutions take as long to implement as complete solutions, and probably do not represent any savings but rather load additional costs on to the eventual full automation.

Emerging markets are rapidly gaining in sophistication. Numerous markets are in the process of implementing more effective regulatory environments, better information systems, advanced trading systems, and centralized, streamlined clearing and settlement procedures. Efficient markets cannot function without credible information that is disseminated quickly.

These markets are like stock markets everywhere: they go up and down, sometimes with dramatic speed. Over the long run, however, they can provide substantial benefit to local economies and to foreign investors. But only recently have many of them begun to demonstrate their potential. A new, revitalized stock exchange structure supported by a fully automated single system trading, settlement and back-office system is a critical component in the Philippines achieving strong economic development through its capital markets.

The goal of the program recommended here is to assist private sector participants to design, finance, and implement a modern, automated trading, settlement, and back-office system to be accessed by all capital market institutions and participants. A parallel goal is to broaden the product line of broker-dealers, improve distribution of quotation and basic market data, and create a modern consensus regarding the function of broker-dealers and the marketing of their services.

We would also like to record our opinions on the "free system." Although some stock exchanges will donate exchange software to other exchanges, all of these systems require considerable investment in programming in order to be usable. Many operate on equipment which is obsolete for this purpose. The complexities of an automated system require that only the best be purchased from vendors that guarantee installation and a technology transfer which permits the purchaser to be self-sufficient after implementation.

II. PERCEIVED AREAS FOR IMPROVEMENT

A. Need to Focus Efforts

A review of prior studies dealing with the development of the Philippine capital market indicates that development agencies and donors have both received and offered advice that is poorly focused and consists mainly of comparisons with conditions in developed markets, without indicating the issues which are critical for market development in the Philippines. Furthermore, there is emphasis on issues which tend to misdirect attention from more immediately critical subjects. Among these issues, which are important but not of immediate, near-term importance, are: insider trading, stock manipulation, accounting standards, preemptory rights, attitudes of owners of closed companies, and a "credit rating agency."

B. The Primary Problem: A Lack of Liquidity

The two Philippine stock exchanges have a reasonable number of securities listed, well-defined exchange structures, a basic level of available information, and an adequate number of broker-dealers. However, the average trading volume per listed security is too low. It is important to recognize that there are good companies worth investing in but the volumes still remain low. The primary problem, then, is one of poor liquidity in the marketplace. It is important, then, that many of the recommendations made by the Design Team be directed at analyzing and addressing the liquidity problem if USAID is going to make a difference in the growth of the capital markets in the Philippines.

C. Improving Liquidity

Based on information uncovered in the review process of all current studies on the status of the capital markets in the Philippines, combined with knowledge gained in the interviewing process conducted during this current USAID engagement, the following seem prime areas to direct attention:

- o Inefficiency in order execution (i.e., a high ratio of unexecuted orders)
- o Excessive turn-around time (i.e., delay in registry of securities,; settlement in certificate form; inefficient registrars)

- o High transaction costs (commission of 1.5%; 0.25% tax on transactions; registry taxes)
- o Lack of convincingly safe, efficiently managed securities accounts available at brokers
- o Public perception that brokers do not deal fairly with clients in executing orders.

All of these problems, with the exception of the tax on transactions, can be resolved by installing a fully automated, integrated single trading, settlement, and back-office service focused on a central custodian.

III. STOCK MARKET ORGANIZATION AND MANAGEMENT

A. Current Status of a Possible Merger of Exchanges

Discussions with both the Manila Stock Exchange (MSE) and Makati Stock Exchange (MKSE) revealed a strong disinclination to merge, particularly if such a merger were to be decreed by the SEC. However, the SEC, the MSE, and the MKSE all agree on the need to automate and modernize, and that some integration between the markets is necessary. The SEC appears to favor a merger and the acquisition of a new building. Both of the exchanges appear willing to incorporate the other, but not to be incorporated, and both are wary of the costs involved with automation and a new building. All parties seem to be misinformed regarding the costs of automation and the need for a new building. The exchanges have informed the SEC that they would be amenable to some form of association, provided that the SEC commissioned a study showing the commercial and technical advantages of doing so.

A plan can probably be worked out, acceptable to both exchanges and the SEC, along the following lines:

- o A study would be carried out, financed by a USAID grant, to describe, define, and design a modern integrated system for trading, settlement, and back-office services that would serve the members of both exchanges and the public. This study would also specify costs and how the plan might be implemented. Since a modern system would involve substantial change, both for the brokers and for their customers, an in-depth market research effort would be carried out by a professional market-research firm in the Philippines.
- o While the above study is in process, a program at consensus building regarding the advantages of automation and modern exchange practices would be undertaken. As a result of this program, brokers will obtain an accurate, factual picture of modern exchange practices in other countries, as well as standards proposed by international associations, such as the Group of Thirty. The final part of this consensus-building process would be to explain the advantages of the proposed plan for the Philippine market, and to present the results of the market survey. The consensus-building process would also provide broker-dealers with a picture of modern financial marketing techniques and business practices, showing how the proposed system will help them increase their business and profits.

- o Based on the results of the consensus-building phase, experienced specialists, with an in-depth knowledge of the proposed systems, will assist the exchanges, brokers, and SEC to devise a plan for implementing the new system and establishing a new market. There are many ways in which this might be accomplished. For example: a commercial service organization might be founded to provide services of central custody, settlement, back-office operations, and automated trading to members of both exchanges, by means of terminals installed either on the existing trading floors or in the offices of the members, as each member prefers. This service organization would entirely finance the costs of automation and would acquire and manage all automated facilities and services.
- o No new building need be constructed for the purposes of merging the exchanges, although each exchange could build its own new building, if it so desires.
- o Instead of a new building, the commercial service organization would install and manage a Philippines Securities Exchange Visitor Center, at a third location. (Visitor's centers of this type are common in well-managed exchanges.) The Vancouver Stock Exchange (VSE), for example, has a well-designed visitor's center in lieu of a trading floor. In Manila, such a center could inform the public of the history of the two markets, describing trading practices prior to automation. Exhibits would familiarize the public with modern automated trading.
- o The acquisition of a fully automated system for both markets is estimated as costing approximately US\$ 10 million, according to prior studies we have made. Based on the current volume of the exchanges, this might be financed as follows:
 - (1) Fifteen percent of the broker's commission, in payment of all back-office services (current costs are about 40 percent)
 - (2) Vendor financing of \$6 million in three years
 - (3) Investment by each exchange of \$2 million in the service company (alternatively, other investors could capitalize the service company, such as the custodian banks, since the proposal represents a profitable business proposition that should stand on its own.)

There are many alternate forms of financing, but all can probably be worked out on a normal commercial basis because the income to finance the operation already exists in the form of commissions and fees on transactions.

B. Organization and Management Functions

Implementation of a modern exchange, as suggested above, would dramatically reduce the management needs for the operational side of the securities exchanges. The proposed system would have built-in surveillance capabilities, and by re-engineering the entire exchange, rather than by merely automating current manual, certificate-based operations, the need for inspection of broker-dealers would also be reduced.

Irrespective of the final form of "unification," and assuming that a common service for trading, settling, and back-office processing is shared, exchanges would still be required to manage the following functions:

- o Membership: Admission, discipline, and inspections. Handling of complaints from the public.
- o Administration: Management of the exchange floor, to the degree the members decide it should still exist. Promotion of the exchange as a group of brokers following certain standards of excellence. Handling of exchange finances, real estate, if any, and membership dues, fines, reporting.
- o The exchanges would oversee the following operations, by means of joint committees, if necessary. Actual performance could be done by the service company professionals, under contract, where applicable:
 - Listing and delisting
 - Trading rules and practices
 - Market surveillance
 - Promotion of the common system.

The articles of association of the service company and the contracts between the service company and private exchanges would need to be carefully worked out during the implementation of the plan.

IV. STOCK EXCHANGE OPERATIONS

A. Current Trading, Settlement, Clearing Procedures

Current trading procedures are entirely manual, based on a two-way auction and open-outcry system, using white boards to mark up offers and deals. The procedures are arcane and do not contribute to efficiency in order execution, fair trading, nor the development of a liquid market. Due to the complex nature of trading rules, it is understandable why the public is distrustful of the current system.

Settlement and clearing procedures are conducted independently for each exchange and are paper-based. There is no compliance with Group of Thirty recommendations regarding: book-entry settlement, central custody, and delivery against payment. Activities of transfer agents have a three-week standard, already far too long, but still frequently not met. The inefficiencies in the settlement process is a major factor holding back the development of the market. (See John Ruckrich and Leo Mascacina specialist report on automation for additional information in this area.)

B. Capacity of the Exchanges to Regulate Themselves

1. Trading

Execution and priority of clients orders under the current system is inefficient and subject to inaccuracies and misuse that are hard to detect when the market becomes busy. The current system is appropriate only for an inactive market.

2. Self-Regulation and Enforcement

The exchanges do regulate themselves. However, the question is: to what end? Supervision of rowdy conduct on the exchange floor and competing members advertisements and recruiting practices are hardly matters of prime interest to the public. Furthermore, the paucity of independent professional managers in the administration of the exchanges cast serious doubts on the willingness of the exchanges to rigorously inspect and severely discipline their membership.

V. AUTOMATION

A. Current State of Automation of Trading, Clearing and Settlement

Trading is not automated. One exchange has a partially automated quotation service. The clearing and settlement facilities are partially automated, with antiquated batch processing systems. Some broke-dealers have automation of some back-room services. Regarding the exchanges and clearing/settlements, the systems are approximately thirty years behind the times, both in technology and in terms of exchange practices. (See John Ruckrich and Leo Mascacina specialist report on automation for additional information on this subject.)

B. Range of Automation Options

There are many options for automation, and just as many pitfalls. The Taiwan stock exchange has offered its system free of charge, as it has done to other markets. However, this system is outdated and has major design flaws. The Midwest Stock Exchange, the Australian Stock Exchange, OM International of Sweden, the Toronto Stock Exchange, and the Vancouver Stock Exchange (VSE), all offer systems. The most modern of these systems is that of the Vancouver Exchange, but this needs to be integrated with central clearings and custody services to provide state-of-the-art services at least cost for the Philippines. The specification of the required system would be part of the study proposed above. The adapted VSE system would offer the best facilities for surveillance by the SEC.

VI. SUMMARY OF KEY NEEDS/PROBLEM AREAS

The exchanges should unite trading, settlement, and back-office services by means of integrated automation through a single service company. This is the fastest, simplest, and least expensive course of action. The current system does not meet modern standards with regards to trading, settlement and back-office services.

There are misconceptions both by the exchanges and the SEC with regards to the need for substantial investments in a building and the cost and difficulty of financing full automation. There are also misconceptions regarding the need for an exchange floor, the value of the open-outcry system, and the value of actually merging the current exchange organizations.

The key need at this time is to present a professionally-designed plan for integrated and automated trading, settlement, and back-office services, fully describing the system and the method of financing and organization. This plan then needs to be "sold" to all the principal participants: the SEC, the exchanges, the brokers, the transfer agents, and others. Finally, the participants need impartial, third-party advisory assistance in organizing the new structure.

VI. POTENTIAL ROLE FOR USAID

A. Technical Assistance

The key role which USAID could play in the development of the Philippine capital market would be to provide the proper technical assistance in implementing a multiple-phase plan, including the following steps:

- o Design of the appropriate specifications for a modern securities exchange system for MSE and MKSE that would be both economical and would remove current market deficiencies
- o Technical and training assistance designed to build a consensus in favor of the modernization plan
- o Provision of technical assistance in organizing the participants so as to finance and implement the plan entirely with private sector funding.

B. Training

With regards to training activities, the key role which USAID could play would be to train professional managers for the exchanges, and to assist in providing specialized business training from broker-dealers in their professions.

C. Commodities

With regards to commodities, there is a perception that automation is expensive and needs to be subsidized. We do not believe this to be true. There is also the perception that a new building is necessary, which we also believe to be a waste of resources. However, the Visitor's Center, mentioned above, is actually very important in bringing the market together in the public perception and in overcoming the psychological problems associated with automated trading and post-modern exchange structures. To the extent that USAID does get involved in providing commodities toward to automation of the exchange (e.g., a "challenge grant" in the area of clearing and settlement), it is essential that these resources not be utilized to subsidize an arrangement that would not have otherwise gone forward on a stand-alone, commercial basis.

VIII. A PROPOSED ACTION PLAN

A. A Five-Step Technical Assistance Program

A five-step technical assistance program aimed at significantly increasing liquidity on the Philippine exchanges is suggested. These steps are as follows:

1. System Design

The objective is to design an integrated computerized trading, settlement and back-office system. Issues which might be resolved in a different fashion within the Philippine context requiring special analysis include:

- o Handling of transaction credit
- o Relationship of the central custodian and service company to exchanges
- o Relationship between brokers and securities accounts in the central custodian
- o Use of trading floor and communication limitations
- o Relationships with international and other domestic markets.

Parallel to this automation effort, an analysis should be made and incorporated in the automation plan with regards to broadening the product line of the broker-dealers to include underwriting services, fund management, and trading in fixed interest securities. The legal basis for fungibility and book-entry settlement would need to be determined. In the process of this design, assistance of local lawyers and active broker-dealers is required. The output would be a written report and recommendation for general distribution.

2. Consensus Building

The objective is to develop a consensus in favor of the proposed system among broker-dealers, officials of the SEC, custodians, registrars, and other market participants. It is unlikely that full consensus will be achieved; however, the basic idea must be sold to those who will lead the changes in the market. This consensus-building effort will occur by means of seminars, speeches, and papers that reach the target audience.

Recommendations of the Group of Thirty, ISSA, and FIBV should be well understood. Seminars in marketing of securities exchange services and financial services of broker-dealer should be emphasized. The objective of this phase should be to convince current members of the exchanges, or others, if exchange management cannot be convinced, of the business benefits of modern exchange organization and the appropriate business strategy for broker-dealers. A professional marketing study should be commissioned regarding the attitudes of Philippine investors with regards to the exchanges and broker-dealers.

3. Organization

The objective is to organize a central custodian-automation service company to serve all broker-dealers, independently of the exchange on which they operate. The ownership and management of this enterprise will be determined by the results of the design and consensus-building phases. The central custodian may be under contract with both exchanges, or with only one, or even with a new exchange. During this phase, the activity will mainly be that of the investment banker: do the financial planning, arrange the funding, organize the enterprise and important contracts. This service will be offered to whatever private sector promotional group arises out of phase 2 above. Preliminary indications are that the total investment required will run between \$10 and \$20 million (probably the lower figure), and that this amount should be financed by (1) vendors, (2) business interests, (3) and participants, strictly on a commercial basis. (N.B. the \$100 million figure suggested in the work papers is way out of proportion to the real needs.)

4. Implementation: Contracting the System

The objective is to provide assistance to the custodian-service company unit in contracting the acquisition of the automated system from international vendors. The specification and negotiation of the contract for the automation of the trading, settlement and back-office functions is in itself a highly technical task and requires that exchange management be assisted by competent independent specialists in the field, as well as legal counsel. These specialists should be acquired to facilitate the following processes:

- a. Establish an operational strategy: An operational plan should be determined by the organizers of the automation effort. Preliminary agreement should be obtained from a bank to act as central custodian.
- b. Select an operational Vice President: The stock exchange will select a Vice President of Operations who

should be given the responsibility to implement the plan, subject to the approval of the Board of Directors. The Operational Vice President should chair a special management committee that is assigned to monitor the modernization process.

- c. Manage Bidding and Contracting: The Operational VP should obtain technical assistance regarding the process of requesting bids and contracting for the implementation of the plan. The responsibilities of the central custodian should be determined in detail and a contract negotiated. With technical assistance, the following tasks should be accomplished:
- c.1 Design the bidding process
 - c.2 Request proposals for implementation of the operational plan
 - c.3 Award the bid by selecting the winning bidder and negotiating final contractual details
 - c.4 Sign the contract.

5. Implementation: Contract Management

The objective is to provide contract management assistance during implementation of the automated system. The systems being recommended in this report should be acquired by means of a purchase-and-service contract with a qualified vendor. In order to simplify contract management, such vendor should be a consortium of software and hardware firms, along with specialists in custodial services. Invitations for bids should call for a team that has the combined know-how and ability to deliver the system within a specific time period, with adequate performance guarantees. The contract should also require the vendor to train the brokers, the central custodian, and the exchange officials in its use.

An important element in the acquisition of these systems is technology transfer. Such transfer requires the vendor to train Philippine personnel in all aspects of running, maintaining, and programming the system. This transfer will provide the exchange with the ability to run and maintain the system without outside assistance. Technology transfer is needed so that the new system can be readily adapted for new products and services as well as upgrades to capacity to handle more listings, investors and trading volume. The contract should provide that, for a percentage of the transaction fee, the service company will operate the system after installation, making necessary adjustments and further adaptation, assuring a full transfer of technology. Therefore, the service company should purchase and install the equipment, manage the computer facilities, provide

financing, deliver managerial and technical assistance to the central custodian, and operate the system. After the contracted period has elapsed, the need for a service company to manage the installation should be reduced, although there may be business reasons for continuing with such an arrangement.

B. Preliminary Technical Resource Requirements

The resources needed to implement this plan are estimated on a preliminary basis as follows:

1. Design: Needs operational specialists in securities exchange design assisted by technical support, office personnel, and local legal experts.
2. Consensus Building: Needs specialists in training, seminar organization, and consensus formation working with the specialists in design phase and seminar participants, technical support, office assistance.
3. Organization: Needs specialists in "investment banking" and financial and operational planning knowledgeable of the plan. Should work in conjunction with specialists responsible for consensus-building.
4. Contracting: Needs specialists in contracting of major systems contracts to work in conjunction with specialists from step 3.
5. Contract Management: Needs specialists in contract management of major systems contracts during the implementation stages.

C. Continuing Requirements for Professional Exchange Management and Operations

Implementation of a modern exchange, as suggested above, would dramatically reduce the management needs for the operational side of the securities exchanges and brokerage houses. However, even with automated trading, there are many vital tasks left for the professional management of the exchange, including:

- o The development of trading and settlement rules
- o The supervision of the operations of members

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- o The management of listings and de-listings
- o The distribution of price information
- o General administrative tasks such as management of the exchange floor, to the degree that the members decide it should still exist
- o The general marketing of the stock exchange institution
- o Administration of membership rules and admission requirements
- o Inspection of broker/dealer records
- o Handling of complaints from the public
- o Developing and executing built-in surveillance capabilities.

Regarding surveillance, the proposed system would have built-in capabilities, and by re-engineering the entire exchange, rather than by merely automating, the need for inspection of broker-dealers would also be greatly reduced, yet still required. Automated trading allows exchange supervisors to electronically monitor brokers activities and to halt any transaction which does not meet certain criteria. Furthermore, the system allows supervisors to examine and approve or avoid unusual trades before they happen. This includes unusual price movements or extremely large trades.

APPENDIXOVERVIEW OF THE KEY ELEMENTS OF A MODERN SECURITIES EXCHANGEA Brief Description of the Five Basic Services
Conducted on a Fully Automated Basis1. Management of Customer Orders on an Automated Basis

Each investor deserves individual attention. Even with a low volume of business, order management requires considerable effort. For example, when a client says "Buy stock XYZ if the price falls to \$10.00 by next Tuesday," a good broker must spend time tracking the order from day to day. A broker must also assure that the client has enough funds or shares to settle the transaction once executed. Automated order management does this for the broker. When a broker enters an order in the computer terminal, the system verifies the customer's credit and tracks the order until it is executed or canceled. This means that no client's order is forgotten, and brokers are protected against credit risks. At any time, the broker may enter a command at his terminal and receive a print-out of orders by client, by date, or other special breakdowns.

Under this system, every investor must open a securities account with the central custodian. Each such account must be tied to a specific broker, indicated by the investor. If an investor uses more than one broker, he must have a securities account for each broker with whom he deals. This means that most investors will form permanent relationships with a single broker.

When a broker enters an order into the trading terminal, he indicates the commission rate table which will apply to that client. When the trade is executed, the system automatically calculates the broker's commission, debits the investor's account, and credits the broker's account with the custodian for the amount of the commission. The broker receives his commission automatically on the day following the trade, according to whatever schedule he had agreed with the client.

2. Automated Trade Execution

Investors demand to be treated fairly. Confidence in the fairness of the trading system is essential for market expansion. Orders must be executed on the basis of price-time priority. Automated trading assures a fair market, since no order is forgotten and price-time priority is rigorously observed. By automatic trading, brokers are able to guarantee to clients that the system is rigorously fair.

3. Automatic Settlement

A critical aspect of securities market operations is settlement. Settlement is the exchange of securities for money, in performance of the trading contract. Settlement is by book-entry. Securities accounts with the central custodian are maintained by computer. The computer is linked to the automated trading system. Once a trade is matched electronically, information such as the custody account of the buyer and seller, the price, and other details are electronically reflected in the accounts of the buyer and seller, which are debited and credited for cash and securities. The next day, investors receive written confirmation of the transaction from the custodian. In all developed markets, brokers are obliged to settle promptly, whether or not they receive the money or securities from their clients. If settlement is not handled carefully, a broker may receive false or stolen securities or bad checks. Settlement can entail substantial dangers, unless properly organized. Modern markets use central book-entry settlement, which means that shares and money are exchanged by accounting entries in a special depository institution. This eliminates the risk of counterfeit certificates or bad checks. Fully automated settlement means that transactions are settled electronically soon after execution, without effort on the part of the broker. Automated settlement increases broker's profits, and expands the market by improving the quality of service to investors.

A complete understanding of this section requires a discussion of the issue of fungibility. Securities are said to be "fungible" when all securities of the same type and class are interchangeable for the purpose of settling securities transactions. This means that the serial number of a share is irrelevant for the purpose of settlement. Fungibility is necessary when modern stock exchange practice and techniques are to be employed. Securities accounting requires fungibility to be efficient. Without fungibility, the capital market will not develop rapidly. Fungibility is simply a market custom or practice. In other words, when investors and brokers agree that they are trading rights to a certain number of shares of a given type or class, but not actual shares with specific serial numbers, fungibility is created. "Collective safe custody" is a capital market technique used in certain emerging markets to achieve "fungibility" and to make book-entry settlement practical. Shares are said to be in "collective safe custody" when shares of many investors are deposited with a single custodian, with instructions that such share be held collectively. Shareholders give up their right to receive an equivalent number of shares in the collective pool. When the shareholder withdraws the shares from "collective safe custody," he will probably receive a certificate with a different serial number from that which he deposited, but he will have the same number of shares of identical type and class. The books of the issuer show the name of the custodian as "representative" of the

interests of unspecified shareholders who own such shares collectively.

4. Automatic Production of Customer Statements and Confirmations

Rules issued by the regulatory body and exchange management typically require that broker-dealers keep proper records of customer transactions and issue confirmations and receipts to document movement in a client's account. This accounting responsibility is shared by brokers throughout the world and when done by manual methods, creates cost that often absorb forty percent of commission income. To handle such "back-room" work by manual methods requires a permanent staff of accountants, bookkeepers, and clerks. This staff represents a fixed overhead expense that cuts into the broker's profits every time trading volume declines. By automating bookkeeping functions, costs can be reduced substantially. Central automation of customer bookkeeping can be paid on a transaction basis, therefore reducing a broker's fixed overhead. By automating the production of statements and confirmations, brokers are able to efficiently handle increased volume at less cost (perhaps as low as twenty percent of commission income) without creating the fixed overhead that eats into profits in lean markets.

5. Automated Price Information

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

M E M O R A N D U M

To: Mark Camstra, Team Leader

From: Leo Mascarinas, Automation Specialist (SEC)
John Ruckrich, Automation Specialist (Stock Market)

Date: September 27, 1991

Re: Specialist Report

Attached is our report on the automation of the Securities and Exchange Commission (SEC) and the stock market, as contained in the scope of work. Please advise if you need additional information.

attachment (as stated)

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I. AUTOMATION: SECURITIES AND EXCHANGE COMMISSION**A. Background**

Computerization at the Securities and Exchange Commission (SEC) was initiated in the mid-70's with the development of two application systems: the Corporation Registry System and the Financial Statements System. Not having its own computer resources, the SEC had the two systems developed by and processed at the National Computer Center. The state and cost of information technology prevalent at that time limited the SEC's capability and responsibility to data preparation functions in a batch processing-oriented automation environment.

Over a decade hence, no significant progress in automation was achieved despite advancements in the technology and the lower cost of computers. The SEC's applications portfolio consisted of only the two systems previously mentioned and a PC-based Corporation Name Verification System. The EDP Unit's staffing had increased but nonetheless it still had no capability to provide other information technology (I.T.) services, particularly systems development.

In 1987, the Commissioner recognized the impact of enhancing information technology applications in SEC's operations. Through the assistance of a consultant working for the Economic Development Foundation (EDF), an SEC MIS Plan was formulated. While it was hoped that the implementation of the Plan would be funded by Japan International Cooperation Agency (JICA), the National Economic Development Authority, in-charge of allocating the JICA funds, had placed the SEC on the long list, thus of lower priority.

A later request made to the Department of Budget and Management (DBM) eventually provided the SEC with P20M for its automation project. The Commission was able to acquire two minicomputer systems. The development of all new application systems is currently being done by the DBP Data Center, Inc. (DCI).

The year 1992 will be crucial for the SEC's automation efforts. Most of the systems being developed by DCI will be delivered to the SEC by the end of this year. The EDP Unit will be elevated to a departmental level with the approval of ten new key information technology positions by DBM, although this is subject to allocations in the National Budget which has yet to be passed by Congress. Thus, automation at the SEC will be reviewed in the following sections by taking into consideration both current status and immediate plans.

B. Information Technology (I.T.) Management

1. Information Technology Organization

Current: The SEC has an Electronic Data Processing (EDP) Unit as its main automation entity in the organization. Since its creation, the EDP Unit has been under the Investments and Research Department (IRD). With respect to internal structure, it is divided into two groups which take care of data transcription and data encoding activities. The highest I.T. position in the organization is that of a Senior SE Specialist.

Plans: The SEC has considered elevating the EDP Unit to a departmental level to better serve the growing automation needs of the Commission. To be headed by a Management Information System (MIS) Manager, the proposed MIS Department shall have three Divisions, namely Systems Application, Computer Operations, and Database Administration.

Comments: The move to elevate the EDP Unit will make it more responsive to the computerization requirements of all other departments, and not just IRD. With a single unit serving the entire Commission, priorities could be properly set. Also, departmentalized application systems could eventually become tightly coupled and systematically integrated. The proposed I.T. internal structure will provide vital services needed in supporting the implementation of the new systems developed by DCI.

2. Human Resources

Current: Based on the plantilla, there are thirty two (32) positions attached to the EDP Unit. In reality however, most of these positions have been "allocated" to other departments, virtually reducing the size of the EDP Unit to about half. The remaining EDP staff mainly function as data transcribers and data-entry operators. In terms of computer skills profile, system development expertise is practically non-existent. Although fifty SEC staff members have recently undergone an Informix user training program, it would be misleading to categorize them as effective software developers.

Plans: The proposed MIS Department will have an additional ten people who will occupy the highest management and technical positions in the department. Their role will be absolutely critical in bridging the transition from a mere data preparation-oriented unit to a comprehensive computer center.

Comments: There is uncertainty as to how the new positions will be manned. Given the government pay scale, which is considerably lower than in the private sector, the SEC will have difficulties in recruiting from the outside. Possibly, the alternative

external source would be other government offices. However, since salaries are standardized in the government, transfers may not be easily effected unless it would mean a promotion for a candidate.

With respect to internal sourcing, no one at the SEC at present would justifiably qualify for the key management and technical positions specified in the proposed MIS structure. Although developing the current staff can be considered, it is not an overnight process. Providing the staff with training may not be sufficient as the capability development process must also include progressive experience.

As in the case of some government offices, plantilla positions are occasionally given out to other units or non-qualified persons as a matter of reward or favor. It would be most unfortunate if SEC would use the new positions for this purpose.

3. Information Technology (I.T.) Management

Current: Directions for automation are generally guided by the 1987 SEC MIS Plan. Present concerns are focused on the system development projects contracted out to DCI. In the absence of an I.T. officer with the appropriate authority to make decisions and recommendations, the SEC set up an MIS Committee to oversee the projects. The Committee is comprised of representatives from the various departments and is headed by the Executive Director. Individual project managers are assigned to each system project.

Plans: The SEC will have an MIS Director as its highest I.T. officer.

Comments: Currently, I.T. plans are made and carried out by a group of officers and managers with no one among them having the appropriate technological expertise. It is therefore probable that certain key issues are not being properly addressed, and that potential problems are not being recognized early enough.

The role of the MIS Director will be extremely critical. Of his immediate concern will be the implementation of the new systems which are bound to present various problems especially in the initial year of implementation. The new Director must also contend with organizational inertia in vitalizing the SEC towards an automated environment. Another major responsibility is the shaping of appropriate technology policies and standards for the organization. Most significantly, as I.T. transcends the traditional backroom operations function, the MIS Director will be concerned with providing strategic directions for the SEC, especially in the eventual automation of the stock exchanges.

It is not unlikely that the SEC would promote a manager from one of the departments to the MIS Director position, despite the person not having the appropriate I.T. background. In such event, without the support of a highly competent I.T. staff and external assistance, the SEC's computerization efforts are bound to be ineffective.

C. Application Systems

1. Applications Portfolio

Current Status: Only the Corporate Name Verification System can be considered as fully operational. Seven application systems are in either the design or development stage. These are:

- o Corporate and Partnership Registration System
- o Corporate Monitoring System
- o Equity Securities Management System
- o Debt Securities Management System
- o Legal Information System
- o Investments Research Management System
- o Records Indexing and Retrieval System

Comments: The seven listed application systems were identified for development in the SEC MIS Computerization Plan. A cursory review of the Equity Securities Management System, the system most directly related to the capital markets, reveals that it mainly covers the registration, licensing and compliance monitoring of issuers of equity, investment contracts, proprietary membership certificates, stock options, tender offers, trust funds, etc. Its Securities Registry module is aimed at providing information on the number of shares available to the public and listed at the stock exchange.

The SEC applications portfolio tends to target internal operational requirements only. An "inside-out" approach that identifies significant linkages with external entities, such as the stock exchanges, the Department of Trade and Industry or the Board of Investments, has not been considered.

2. Systems Architecture and Development Approach

Current Status: Evidently, a vertical approach was adopted in defining the application systems. Thus, each system follows very closely departmental boundaries. The systems development approach calls for a module development phase followed by an integration phase. The integration plan for tying up all the systems is not expounded. The systems specifications as defined in the terms of reference were based on existing operational procedures which had been "literally translated" into a computerized mode.

Comments: Although this would have been an opportune time for adopting a top-down approach, system ownership issues had to take precedence over functional integration benefits, thus resulting in department-oriented systems. The application systems, while being developed almost simultaneously by a single contractor, are treated as distinct projects with deliverables addressed to a specific department of the SEC. As information systems in general cut across departmental boundaries, certain inefficiencies could be expected from the departmental systems.

Guided by the contractual terms of reference, the contractor's system development efforts have proceeded to strictly meet the specified requirements. Unfortunately, the requirements, defined by SEC representatives who have very limited exposure to automated systems, were derived from manual procedures. As a consequence, the automated systems tend to be "literal translations" of the manual systems with no significant innovation in the conversion to an automated environment.

3. Systems Management

Current Status: The SEC has yet to obtain and develop the capability to manage computerized systems on its own.

Comments: There is reasonable doubt that the SEC would be able to organize its MIS Department before the delivery of the last application system by the contractor. Simultaneously implementing seven major systems developed by a third party would pose major difficulties to any I.T. unit, particularly one that has no practical experience in managing I.T. projects.

D. Technology Environment

Current Status: The SEC has a moderately powerful computing resource with hardware components comprising two AT&T 3B2/1000-60 minicomputers, along with approximately 50 PC's distributed in the departments. With respect to the software environment for the minicomputers, the operating system is Unix System V with

Informix as the major application system platform. C-Language and Cobol compilers are also available. Office automation is supported through spreadsheet, word processing and electronic mail services.

Comments: The SEC's technology environment is fairly advanced and in line with current trends. The SEC's decision to adopt Open Systems over proprietary platforms is appropriate for its stage of computerization.

E. Potential Role for USAID

At the SEC, there is a general misconception that powerful hardware and software systems are the only ingredients needed for a successful automation. What the SEC fails to recognize is its own lack of readiness and capability to manage these resources. There are myriad problems concomitant with automation.

Implementing a set of entirely new application systems is a formidable task, especially considering that the SEC has yet to acquire and/or develop the requisite I.T. human resources at this stage. Any system for a new application area, as in the case of most of the SEC's systems, can be expected to evolve and undergo modifications. Indeed, the SEC faces several problems and issues related to automation, a number of which it must resolve on its own.

The following are potential areas of assistance by USAID:

1. Technical Assistance

A consultant team (consisting of expatriate and local staff) to lead the development and management of SEC's Strategic Information Systems Plan (SISP) which covers the following:

- o Applications Plan which emphasizes mission-critical functions of SEC, including those that relate to other entities such as the stock exchanges, DTI, investors, etc.
- o Documents Management for improving public-oriented systems services
- o Data Resource Plan to facilitate the integration and maintenance of systems
- o I.T. Management both from an internal and an external perspective

- o Technology Strategy to guide the development and enhancement of systems, including the requirements for linkages with stock exchanges

2. Training

Training requirements will be defined by the SISP component. System management methodologies is a candidate area.

3. Commodities

No critical commodity requirements are foreseen for the short-medium term. As it is, current hardware resources are substantial and DCI has not made any recommendations for major upgrading to accommodate the seven systems.

With P5M still available in its I.T. project budget, the SEC can enter into agreement with a contractor to perform Facilities Management and Data Entry.

Depending on developments in the are of stock exchange automation, peripheral devices and data communication may be required for the SEC head office and selected regional offices.

F. Technical Assistance Positions

1. Long-Term: Resident I.T. Advisor

The overall objective of the resident I.T. Advisor would be to provide directions for the SEC's automation efforts, and to guide the development of the SEC's overall I.T. capability. This would include providing directions for automation of both the SEC's internal systems and those that link with other external entities such as the stock exchange(s), Department of Trade, etc. The I.T. Advisor could also provide advice in I.T. management at the SEC. Specific tasks could include:

- o Formulate an SEC strategic information systems plan
- o Identify information linkages with other entities and determine the SEC's role and extent of participation in potential muti-entity systems projects
- o Develop innovate applications of I.T. in the most relevant areas
- o Define an enabling technology environment

- o Develop initial I.T. policies as well as guidelines for reviewing and adjusting them as the SEC progresses through maturity in I.T.
- o Provide technology transfer by advising the MIS Director, particularly if this individual has limited I.T. experience.

Specific deliverables could include:

- a. Strategic Information Systems Plan (SISP) which defines:
 - (1) Areas of potential strategic advantage
 - (2) SEC applications portfolio
 - (3) Application development strategy for each application
 - (4) General technology options
 - (5) Implementation plan.
- b. Computer Configuration Study, including a needs assessment of:
 - (1) SEC Head Office
 - (2) SEC Regional Offices
 - (3) Data communications requirements.
- c. I.T. Management Study, including:
 - (1) Identification of management services and skills required to support target I.T. environment
 - (2) Recommendations regarding appropriate I.T. organizational structure and staffing level
 - (3) Specification of an I.T. training plan
 - (4) Recommended policies and standards for planning and management control, project management, system development and maintenance, end-user support, data administration and technical support.

2. Short-Term: Data Modelling Specialist

The overall objective of this specialist would be to perform a data planning function and facilitate a coordinated and controlled approach to defining and developing applications. A Data Modelling Specialist would provide the information engineering expertise needed for restructuring the SEC's current applications to achieve a cohesive integration of systems, and to facilitate the development of future systems. Specific tasks could include:

- o Review current data
- o Develop an entity relationship model
- o Define subject areas
- o Develop data architecture down to the logical and physical design level.

Specific deliverables could include:

- o Entity-relationship model
- o Logical and physical data models
- o Data dictionary
- o Evaluation and selection of computer-assisted software engineering tool (CASE) tools
- o Training of selected SEC I.T. staff on CASE tool.

II. AUTOMATION: STOCK MARKET

A. Current Method/Degree of Automation/Problem Areas

1. Manila Stock Exchange

a. Trading

Trading on the floor of the Manila Stock Exchange (MSE) is a manual procedure based upon an open outcry system. A tote board is used which lists the buyers/sellers and bid/ask prices. When the buyer and seller reach agreement on price, the execution is recorded on the tote board and the Selling broker prepares a sales contract which indicates the selling and buying broker, in addition to the quantity and price per share. The contract is signed by both brokers and given to the trade recording clerks of the exchange. The contracts are transcribed directly into the exchange's computer system and the Purchase & Sales report is prepared and available within several hours after the close of the trading floor. The brokers have 24 hours to review their P & S reports and submit any necessary corrections to the exchange. On T+2 the Clearing Reports are prepared for the brokers and on T+3 the MSE sends the Clearing Reports to the Clearing house, the Equitable Bank, along with a diskette of the transactions for semi-automated processing by the Clearing House.

Problem areas: The discussion here will center on the problems of conducting today's trading activities with the underlying assumption that by correcting today's problems, problems associated with both throughput, credibility and investor confidence would be significantly reduced. The primary problem is that trading is a manual activity dependent on both the buying and selling brokers negotiating the trades and manually recording them. A great deal of time is then lost in the execution of a single trade. Furthermore, there is good reason for a prospective investor to question if their trade was executed at the best price in light of the manual procedures supporting the open outcry approach to trading. The system is lacking in the preciseness that the investment public has come to expect of securities trading if they are to have faith in the system. Both stock exchanges suffer the adverse publicity of being called a casino.

b. Clearing

The reports given to the Clearing House, Equitable Banking Corporation, are of a detail and summary nature. The Clearing House uses the MSE-provided diskette to in essence produce the same reports on their own PC, and then compare their internally

produced report to the ones produced by the Exchange. If the comparison is favorable, then the Clearing House generates check payments and prepares advices and summary tickets. These advices and summary tickets are given to the brokers for use on T+4 for all required deliveries.

Problems Areas: This system is volume sensitive and clerical intensive. Volume upswings rarely come with advance notice and delays in this process could be very costly because of the impact on a timely settlement. The further away from Trade date that settlement occurs increases the risk associated with trading.

c. Settlement

On T+4 the Clearing House accepts payment from brokers with Net Due Clearing balances. This payment is in the form of a same day funds instrument; e.g., a cashier's check and a debit advice is issued to these brokers. In addition, an Official Receipt is given to each broker for all payments received. After all monies due have been taken in, the Clearing House releases payments to brokers with Net Due Broker accounts. These payments are in the form of cashier's checks and advices reflecting the transaction are also given. These latter brokers are the ones who also must deliver securities as part of their transaction before the checks are released to them.

The securities must be accompanied by a Delivery Letter and a Summary of Transactions. The receiving brokers must furnish the appropriate Transfer Instruction and a Summary of Transactions. The Clearing House then transcribes all this data which has been handed to them for entry into their PC-based system.

The Clearing House has four days (T+5 thru T+8) to process the data received on T+5. The activity conducted during this period consists of balancing issuances against cancellation on a per issue basis and the preparation of transfer transmittal letters to respective transfer agents of which there are approximately 40. There is a great deal of recordkeeping associated with this activity of sending securities to transfer and receiving same.

It would be inappropriate to cover all the detail associated with this activity at this time. Suffice it to say that the following process is an extremely important one, carrying potentially great risk if permitted to get out of control. The Transfer Agent has fifteen days to process these transactions. Part of this fifteen-day period is spent in the hands of the registrars who upon receipt of the newly-issued securities prepared by the Transfer Agent record them on the books of the corporation. When the Transfer Agent receives the returned securities from the Registrar, the Transfer Agent prepares a Billing Statement which is sent to the Clearing House advising them of the necessary amounts owed for the documentary stamp tax and transfer fees. The Clearing House has two days to perform the clerical tasks

necessary to communicate the charges to the brokers, collect the moneys and pay the Transfer Agents. When the Transfer Agent receives the payment he releases the certificates to the Clearing House.

On T+26 through T+27 the Clearing House processes the new certificates received from the Transfer Agents attaching the certificates to delivery letters, release and billing forms. A review is conducted by the Clearing House for identifying certificates that the Clearing House has received Pull Instructions and Power of Attorney for retransfer of the securities because of their sale during this lengthy processing cycle. The Clearing House collects the monies owed for the transfer fees and documentary stamp tax from the brokers. On T+28 through T+29 the brokers review the certificates received from the Clearing House, verify their records and release the securities to the customer.

Problem areas: The mere existence of physical certificates creates the environment for problems. Problems such as lost certificates are likely in the shipment of the certificates from the Clearing Agent to the Transfer Agent, and again from the Transfer Agent to the Registrar and back to the Transfer Agent, then to the Clearing Agent and then finally to the broker. Such activity is an inhibitor to creating an attractive environment for investors. For the true trader, the paperwork required to keep up with all the buys and sells would defy having a back-office system to support the paperwork requirement. Also, where the security is going to be delivered to a third party in a Delivery versus Payment transaction outside the system, the Delivering member must wait until the certificate is registered and returned to him before he will receive his money. Finally, it should be mentioned that the stated time for these activities to be completed by both the Transfer Agent and Registrar is not always met in today's low volume environment, and that the transfer cycle could easily be 40-50 days for some issues.

d. Miscellaneous Stock Certificate Activity

There are two other areas of processing that the Transfer Agents and Registrars perform which, while unrelated to trading on the Exchange floor, are activities tied to the immobilization of the stock certificate. These two areas include (a) transfers for satisfying Over the Counter transactions, and (b) Underwriting activities related to the issuance of the initial securities offering.

Problems areas: Once again, the problems inherent in the presence of the physical certificate are the primary problems here.

2. Makati Stock Exchange

a. Trading

The trading procedures of the Makati Stock Exchange (MKSE) are essentially the same as the Manila Exchange, and require no additional explanation.

b. Clearing

Clearing is performed by a different Clearing Agent, Rizal Commercial Banking Corporation, but is functionally and procedurally the same as that of the Manila Stock Exchange.

B. Automation Options in View of Problem Areas

The advantages and disadvantages of various forms of trading, settlement and clearing under alternative organizational scenarios are presented below. (Also see the attached Memorandum to Cornelio from Ruckrich.)

1. Trading

a. Unified Stock Exchange

a.1. Single System/Single Stock Exchange

Advantages:

- o Guaranteed best price regardless of place of execution
- o Economies of scale for hardware, software, physical site preparation and ongoing operational expenses
- o Uniformity in reporting and enforcement.

Disadvantages:

- o Historical divisive issues could undermine or derail implementation
- o The time required to disassemble two stock exchanges and assemble one stock exchange could cause the window

of opportunity for the Philippine financial community to establish itself in the world community in the capital markets to close

- o The "building issue" could become a major stumbling block due to problems of selecting a location or obtaining funding.

a.2. Interfaced Multiple Systems/Multiple Exchanges

Advantages:

- o Avoids dismantling of current stock exchanges and its attendant time loss and risks to a successful implementation
- o Achieves for the investor the guaranteed lowest price in a completely fair market
- o Permits a single focus for regulation enforcement
- o Permits the increased volumes to be processed with certainty and according to pre-agreed upon trading rules
- o Permits flexibility for policy changes such as rescinding the dual listing requirement by permitting trades to be executed only by brokers of certain exchanges
- o Permits the creation of exchanges in the future regardless of location
- o Permits listing requirements to vary by exchange, thereby accomodating exchange specialization by industry or location.

Disadvantages:

- o Introduces an extra step to the trading execution process
- o Software costs for development and maintenance are two to three times what would be required for a single system/multiple stock exchange or single system/single stock exchange approach
- o Physical site preparation and on-going operational expenses would be two to three times greater than that required for a single system/multiple stock exchanges or single system/single stock exchange approach

- o Unnecessary systems and procedural complexities are introduced
- o May not provide investors with as good a price as the Single System/Single Stock Exchange approach.

a.3. Single System/Multiple Exchanges

Advantages:

- o Avoids all the disadvantages contained in (a.1.) and (a.2.)
- o Has all the advantages contained in (a.1. and (a.2.).

Disadvantages:

- o Will not satisfy any faction that desires the dismantling/integration of the current stock exchanges.

b. Not Unified Stock Exchanges

b.1. Non-Interfaced Multiple Trading Systems/Multiple Exchanges (Status Quo)

Advantages:

- o Persons with a vested interest in preserving the status quo will be satisfied.

Disadvantages:

- o The Philippine capital market will miss a window of opportunity to address the lack of liquidity, low P/E ratio problem.

2. Settlement/Clearing

a. Unified Stock Exchanges

a.1. Single Trading System completely integrated with a single clearing system/single custodian system

Advantages:

- o The most efficient of all options because of the absence of data base, communications and transaction record interfaces. Efficient trading could include the ability to enforce the no-short sale rule and guarantee that the trader would be able to settle.

If neither securities or money were available, the trade could be precluded from consummation at the time of attempted execution rather than at end of day. The risk factor inherent in trade execution without settlement certainty is eliminated. This is in keeping with the Group of 30 recommendations which it is reasonable to assume will eventually come into effect on a worldwide basis as sophisticated investors demand certainty in knowing that once the trade is consummated that settlement will take place without hinderance.

Because the sophisticated investor is becoming more and more of a world investor, the individual countries actively promoting investment in their countries must recognize that the back office and subsequent interfacing problems between depositories and clearing corporations will exist until there is a single world market. Until such time, if ever, the countries should do everything in their power to have the trading/clearing/settlement systems within their country be as simple and efficient as possible.

Disadvantages:

- o If Custodian and Clearing activities should expand to include trading and settlement requirements beyond those required by the stock exchanges, the systems processing requirements could wind up at cross purposes with trading requirements and potentially create priority processing conflicts.

**a.2. Single or Multiple Trading Systems/
Multiple Clearing Systems/Single
Custodian System**

Advantages:

- o This permits the stock exchanges to continue their relationship with their current Clearing Agent for whatever reason they feel such unique control might be necessary. An example of this would be if the dual listing requirement were rescinded and the single Clearing Agent did not want to make eligible the securities requested by one or another stock exchange.

Disadvantages:

- o An unnecessary level of complexity has been introduced which has higher development and ongoing operational costs. This is a situation to be studiously avoided because now the investor has been forced to recognize two different back-office operations with which he must interface. History will repeat itself as the investor will force the transparency of the multiple Clearing Agents and the marketplace will be left with unnecessary institutions fighting to retain and justify their existence.
- o There are built-in problems in data base synchronization.
- o The investors are potentially forced into multiple communication interfaces whether terminal or CPU to CPU as each separate entity defines efficiency.

a.3. Single or Multiple Trading Systems/Single or Multiple Clearing Systems/Multiple Custodians Systems

Advantages:

- o Permits a greater flexibility for inclusion of financial instruments into a depository environment than if a monopoly existed for the single designated custodian.

Disadvantages

- o This is the second most expensive option, coupled with potential computer system incompatibilities which would result in extreme operational difficulties and inefficiencies.

b. Not Unified Stock Exchanges

b.1. Multiple Trading Systems/Multiple Clearing Systems/Single Custodian System

Advantages:

- o The physical security is immobilized and a major risk has been removed from the marketplace

- o The long lead time from settlement to receipt of securities has been eliminated
- o Active traders can pursue their buys and sells without all the attendant recordkeeping associated with today's environment
- o A major improvement in instilling investor confidence in the system has been achieved.

Disadvantages:

- o The investor is still left to deal with multiple trading/clearing systems
- o Problems of synchronization of eligible securities and other interface issues
- o The investor still does not know if he has received the best price
- o The Philippine capital market will have missed a window of opportunity to address the lack of liquidity problem.

b.2. Multiple Trading Systems/Multiple Clearing Systems/Multiple Custodian Systems

Advantages:

- o The physical security is immobilized and a major risk has been removed from the marketplace
- o The long lead time from settlement to receipt of securities has been eliminated
- o Active traders can pursue their buys and sells without all the attendant recordkeeping associated with today's environment
- o A major improvement in instilling investor confidence in the system has been achieved.

Disadvantages:

- o Investor still left to deal with multiple trading/clearing/custodial systems
- o Problem of synchronization of eligible securities and other interface issues

- o Investor still does not know if he has received the best price
- o The Philippine capital market will have missed a window of opportunity to address the lack of liquidity problem.
- o This is the most expensive and most undesirable combination of financial institutions to support the development of the market.

b.3. Multiple Trading Systems/Single Clearing System/Multiple Custodian Systems

Advantages:

- o The physical security is immobilized and a major risk has been removed from the marketplace
- o The long lead time from settlement to receipt of securities has been eliminated
- o Active traders can pursue their buys and sells without all the attendant recordkeeping associated with today's environment
- o A major improvement in instilling investor confidence in the system has been achieved.

Disadvantages:

- o Investor still left to deal with multiple trading/custodial systems
- o Problem of synchronization of eligible securities and other interface issues
- o Investor still does not know if he has received the best price
- o The Philippine capital market will have missed a window of opportunity to address the lack of liquidity problem.

b.4. Multiple Trading Systems/Single Clearing System/Single Custodian System

Advantages:

- o The physical security is immobilized and a major risk has been removed from the marketplace
- o The long lead time from settlement to receipt of securities has been eliminated
- o Active traders can pursue their buys and sells without all the attendant recordkeeping associated with today's environment
- o A major improvement in instilling investor confidence in the system has been achieved.

Disadvantages:

- o Investor still left to deal with multiple trading systems
- o Problem of synchronization of eligible securities and other interface issues
- o Investor still does not know if he has received the best price
- o The Philippine capital market will have missed a window of opportunity to address the lack of liquidity problem.

C. Potential Role for USAID

After considerable research and carefully reviewing the last twenty years of the evolution of the capital markets, we recommend without reservation that all persons concerned with and involved in the development of the Philippine capital market pursue a Single Trading/Clearing/Custodial System and not burden the future with the unnecessary bill for repeating history. We further believe that USAID is in a strong position to play a major role in facilitating the development of such a system (see Schroy/Ruckrich Specialist Report for a recommended USAID program of action in this area).

M E M O R A N D U M

To: Mark Camstra, Team Leader
From: David Brunell, Financial Market Training Specialist
Date: September 27, 1991
Re: Specialist Report

Attached is the training needs assessment report, as contained in the scope of work. Please advise if you need additional information.

attachment (as stated)

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I. INTRODUCTION

The training related portion of the scope of work provides the "North Star" for this needs assessment, an abstract of which follows:

- o Technical Assistance and Training Needs
 - Private Sector Participants
 - Stock Exchanges
 - Securities and Exchange Commission (SEC)
- o Unique Strategic and Program Thrusts
- o Private Sector Participation in Capital Market Technical Assistance and Training
- o Stock Exchange Management and Operations
- o Non-Government Organization (NGO) Counterparts to Institutionalize Capital Market Training Capacity
- o Terms of Reference for Training (People) and Related NGO(s).

In addition to considering the obvious target areas and organizations, this report will focus on other significant factors and concepts, such as "unique strategic and program thrusts," "private sector participation," "NGO counterparts (hereafter referred to as private sector counterparts)," "institutionalization," and "capacity building."

The purpose of this effort is to provide USAID with the basis for program design judgments that can make a real and lasting difference in Philippine capital market development.

The methodology and approach involve several facets:

- o Full review of over a dozen previous studies, reports and proceedings about the capital markets and pertinent groups
- o Comprehensive discussions with the top management of a cross-section of private sector players, as well as with leadership and staff of the SEC and the exchanges
- o Review of training related activities and initiatives within the target organizations and throughout the private sector arena

- o Examination of intra-organizational factors (patters of communication and relationships) as well as inter-organizational perceptions and realities.

II. CONTEXT AND PERSPECTIVES

To assess the real need, opportunity, and potential value of a USAID-supported training strategy for the capital markets, we must look at the details of today's situation in a larger context. Several perspectives should be considered:

- o The gap between where the situation stands today, and the future vision toward which participants want and need to move
- o An understanding of what training is about, the various ways it can apply, and the possibilities for change that it offers
- o An appreciation of the unique facets of the Philippine capital market that shed light on the challenges, the needs, and possible courses of action.

Additional key points include:

1. A needs assessment focuses on the difference between present capabilities and those required for a successful future

This involves looking at (1) present levels of operation and performance, (2) the demands, standards, and requirements of the future, and (3) the problems, barriers, limitations and challenges that stand between where people and organizations are today versus where they need and want to be in the future. Capabilities range across a spectrum which includes understanding/information, attitudes, skills and behavior/practices.

2. "Training" refers to a broad range of techniques and processes

Their aim is to bring about changes in understanding, attitudes, skills and behaviors. Briefly, training covers a wide spectrum of activities including assessing needs, designing appropriate and effective programs, delivering training, training trainers, strategies for organization and system change, team building, process facilitation for groups within an organization (inter) as well as among and between organizations (intra) in a sector such as the capital marketplace. The training needs in the Philippines will require a wide range of training capabilities and skills.

3. Training is a means to an end, not an end in itself

The essential point is that training technology offers a wide variety of tools which can only be selected and used after needs are identified and purposes (goals, objectives and desired outcomes) are thoughtfully defined. Then, wise choices can be made about design, modes of delivery, technique, process, types of training skills, etc. In the Philippine capital market, the particular purposes of the training needed will determine the choices of technology, technique, or process.

4. A training needs assessment should consider the "total system" of the capital market rather than only what is inside each constituent organization

This means the whole feedback loop or "value chain," which includes looking at the relationships and activities between organizations, in order to assess the performance and needs of the whole system rather than just within component entities. Every group in the loop/chain receives "services" from one or more suppliers, and every group "adds value," and then provides services to certain clients or customers. Inside each organization and throughout the entire system there are incentives and disincentives for growth and change.

5. Advances in training technology and practices today create more powerful possibilities for change

The frontiers of training and its applications have expanded rapidly over the last 20 years. More and more emphasis and strategic value is being placed on the role of the individual, the power of teams, the importance of organizational environments/cultures/systems, the relation and interplay of an organization with all relevant entities and groups in its external marketplace and environment.

Newly emerging fields and disciplines offer more promise for individual growth and organizational effectiveness than ever before. Examples include Organization Development (OD), Organizational Transformation (OT), various strategies for Total Quality and Excellence, Self Organizing Groups, High Performance Work Systems, Continuous Learning Organizations and a "customers/service/value-added" orientation for all jobs and organizations.

The main point is that today's trends in training technology open up greater possibilities for change in the Philippine capital market than may have been imagined before. This is encouraging because the challenge here involves major changes and leaps forward

on the part of systems, people and organizations, rather than a few incremental changes.

6. There are unique aspects of the Philippine capital market situation which provide insight into the importance of training

Without belaboring the obvious or getting too far afield of the needs assessment, several examples may help sharpen the larger strategic perspective within which training can play a role:

- o Twenty years ago the Philippines was an economic leader in the region and now it is lagging behind as others are forging ahead. People here are keenly aware of this, even somewhat depressed and fearful.
- o The business system and capital markets have been dominated by a relatively small number of families and groups which are in the process of opening up for a host of reasons: generational change, conflicting interests, competition, need for capital, political democratization of opportunity, etc.
- o The capital markets have been an insiders' club with various understandings and arrangements which have greatly limited the fundamentals of the market and its performance as a marshaller and mobilizer of capital.
- o There are government policies, structures, arrangements, economic system problems and disincentives which have greatly limited capital market development (e.g., tax and fiscal measures that make debt financing more attractive than public equity, etc.) At the same time, there are very significant opportunities for change within the present policy framework.
- o Regional capital market resurgence, competition, and the globalization of investment and capital flows are upping the stakes as well as the opportunities. For example, regional computer-linked trading systems are actively being discussed.

The capital markets in the Philippines are quite literally on the cusp of change, with gathering domestic, regional, and international forces driving the needs for change. Significant changes can be anticipated, rather than small linear and incremental steps. A private sector participant in the capital markets said "I am embarrassed when I compare the Philippines to the other ASEAN countries. My nightmare scenario would be staying the same as we are."

This frame of mind is compounded by six years of studies and discussions by external agencies and domestic players--with each enumerating long lists of problems and issues. There is a pent-up need and desire for real action rather than additional stand-alone studies which do not lay out a realistic, integrated program of action defining "how to get there from here."

Training and TA, broadly defined, can play a role in assisting Philippine capital market participants in transforming today's capital market to a future that, of necessity, must be quite different within the next three to five years.

III. TRAINING RELATED FINDINGS AND NEEDS

A. The Stock Exchanges

1. General Findings

- o The exchanges have previously been operated more like "clubs" than as independent professionally-managed businesses. The predominant mode of operations and learning was the passing on of "understandings" and patterns of work from person to person and generation to generation. This has contributed to the perception of home-grown management and a system that is "frozen in time." Also, the prevalence of ethnic networks and family firms has slowed the emergence of systematic professionalization and training initiatives.
- o Resources are not a serious limitation. The larger limitation has been an "investment in the way things are." Until now things have worked well enough for the "club" members to have favored the existing arrangements over new approaches or major system changes (the devil we know versus the devil we don't).
- o Further compounding the status quo is the way power is distributed among the players (mostly broker-dealers). Positive leadership is concentrated among a small number of dominant groups, while negative power (the ability to say no or refuse change) is distributed among many smaller groups. One of the unspoken "agreements" may be that the "leaders" can have things their way as long as they do not push the smaller groups beyond their "comfort zone."
- o However, for a variety of reasons including economics and competition, the exchanges are (in varying degrees) considering serious changes that will drive the need for training. These include:
 - Automation
 - "Unification"
 - Integrated systems and their financial requirements
 - Independent professional management
 - Linkages with SEC information systems
 - Revision of listing rules
 - Responses to SEC regulatory rules and systems
 - More productive contact with government and private sector players
 - More far-sighted policy dialogue
 - The inclusion of "outside" governors

- Ways to handle the blessing and curse of higher volumes of trading
 - Major problems with investor confidence, both foreign and domestic.
- o Progressive people in the exchanges are beginning to anticipate the significance of these many challenges and of the transition that lies ahead. Others appear to be opening up to the necessities and opportunities of change. All groups have an interest in managing cost, risk, and strategies for action, so that every party comes out a winner in giving up the status quo (everybody gets to share in a bigger pie rather than redivide the same pie).
 - o The exchanges are already in the early stages of studying and acting on the various components of change--and they are asking for professional guidance and assistance in the process. They not only want good information, they are asking the SEC and USAID for professional assistance in considering what changes to make and how to implement them.
 - o High quality TA can address the definition and choices of what to do, but ongoing training and professional development is needed for the how to implement part, as well as for the institutional and business development challenges facing the exchanges and participants (broker, dealers, investment houses, etc.). This includes "process facilitation" as a catalyst for consensus building, creating new visions of what is possible with new strategies and higher goals for success (making more money with the new system).

2. Specific Areas of Training Need

a. Professionalization of Exchange Management and Staffs

Specific areas include:

- o New technical and task skills
- o Professional and management skills required for modern exchanges, and the building of "the business"
- o Case-specific learning: problems, issues, projects, new models

- o Organization, system and institution development (intra-organization)
- o Industry development: market and investor orientation, consensus building, consultative dialogue with the SEC and the private sector (inter group relations).

b. Broker-dealers

Specific areas include:

- o Technical skills involving new systems, rules, automation, etc.
- o Professional research and analytic skills for serving their market
- o Business development, marketing and selling skills to expand their business
- o Case-specific: issue, problems, projects
- o Industry development: higher vision, expectations, relationships with other players.

B. Private Sector Intermediaries

1. General Findings

- o This group feels at the mercy of the problems and limitations of the SEC and the exchanges. Their first desire is to have one clear set of rules and regulations that are fair, out in the open, predictable, and consistently administered. This means clearer communication and dialogue with the SEC and the exchanges, as well as more participation in policy development, and new systems relying on compliance and self regulation.
- o These players are already well-schooled professionals with profitable businesses, but are nevertheless participants in the system as it is today. While they do not need technical, professional or management training, they will need to develop new strategies for their own market and business development as well as for capital market and industry development.

- o In today's capital market, there are a relatively limited number of players, most of whom are established and sophisticated. However, if the securities market and the SEC move into a new era that invites much higher confidence and trading volume, then there will be an opening for new players and new products to enter the game. This will create a longer-term private sector training opportunity.

2. Specific Training Needs

- o Rules, regulation, new systems
- o Case-specific: issue, problem, project, new models
- o Industry development: market development, policy development and advocacy, consensus building
- o New frontiers of business, product and market development.

3. Sector-Wide Findings

There are a number of observations, attitudes, and conditions that are common to the whole sector rather than a particular organization or interest group. They each carry implications regarding the development of a training strategy.

- o Attitudes which limit the vision of what is possible, such as:
 - Crisis of confidence in the system and its ability to change
 - Perception that self interest precludes a higher common interest
 - Unclear vision of higher business possibilities that could benefit every player.
- o Lack of hard, state-of-the-art information about automation options, system capabilities, and associated costs upon which to make sound and economically viable decisions with significant long-term implications.
- o Insufficient "market information" about problems and opportunities (how everyone can make more money), investor perceptions of the players, the system, needs and wants, barriers to participation, etc.

- o Lack of any cumulative focal point for policy development and advocacy.
 - o Very fragmented leadership, distribution of power, and spheres of self interest which leaves the system without a strong consensus-building capability and an organized pattern of relationships which contribute to the growth of the whole sector.
 - o Numerous examples of ad hoc and piecemeal training initiatives and pockets of capability without any common infrastructure or support center that contributes to sharing, continuity, synergy, and cumulative impact and learning.
 - o A real appetite for hands-on exposure to practical and real-world case examples of new technologies, new approaches to problems or opportunities, new developments in capital markets and regulation, state-of-the-art techniques, people and organizations who have "done it" before.
- C. The Securities and Exchange Commission

1. General Findings

The SEC has the full array of human resource problems and limitations of a government agency:

- o Very low pay scales and a civil service environment are serious disincentives to attracting and keeping top talent. Most go into the private sector for challenge, freedom, opportunity and reward. (The secretary of a top officer at SGV makes more money than Mrs. Aquino or high civil service officials). A bureaucratic civil service environment with very limited career advancement is discouraging to many.
- o Turnover and problems of discontinuity and re-training are prevalent. A few promising people come for a couple of years of exposure to the securities and regulatory arena and then leave for greener pastures.
- o While many structural limitations are unlikely to change without major policy and political reform, the availability of good training is one way to provide some offsetting benefits. This can include exposure to new ideas and state of the art techniques, professional and skill development, more open and dynamic work systems, personal growth, contact with

- pioneering people and projects in similar fields of activity, a new sense of vision with a "services" and client orientation.
- Resources for training, staff planning, and team building have been cut to almost nothing. Budgets for training had been a paltry \$10,000 per year for an agency with over 900 people (just over \$10 per person per year!). Even the meager training activities and annual staff planning and strategy retreats have been suspended.
 - Ad hoc, unconnected and intermittent training activities are the norm rather than the exception. Various examples were mentioned of seminars, workshops, on-site visits which were originated by well intentioned external or internal proponents (e.g. investment house, broker-dealer, stock exchange, internal SEC activist), but for which very little follow-through was evident. Typically there was a positive initial reception with no ongoing "traction" or continuity. These initiatives lacked any coordinated infrastructure, resource base, or synergistic documentation and institutional memory/learning component.
 - Staff members concerned with training are overloaded with administrative duties and have neither the time nor exposure to up-to-date training experience. However they recognize and articulate a sincere need for technical training and professional development in many areas, and at the bottom, mid-levels, and upper levels of the agency. They seem to have at least some motivation, interest and professional desire to address the needs, but lack the time, resources, and administrative priorities for any kind of breakthrough.
 - Not surprisingly, the most common theme of all people and organizations who interface with the SEC is a pervasive lack of confidence in its ability to execute and follow through on most fronts. This "crisis of confidence" involves a major gap between good intentions and operations, between policies and their execution, and between a mandate and timely action.
 - There is a consensus that some policy, rules, regulations, and structural changes are needed for the SEC to adequately promote and regulate the capital markets. However, there is an equally clear consensus that more effective execution of existing responsibilities could achieve quantum leaps of improvement.

- o The Chairman seems to have the instincts, vision and goals in mind for effective growth and regulation of the capital markets. She herself has benefitted from exposure to other markets and methods of operation. Consequently, she recognizes that many of the present limitations could be addressed through training and technical assistance.
- o Finally, it is likely that the staff of the SEC--from top to bottom, from leadership to technical and support--may not have a clear or useful understanding of how they are perceived by their "marketplace." This is not an uncommon circumstance. Certain kinds of training processes involving "market surveys" of SEC services and relationships with its "clients" could be very helpful.

2. Specific Training Needs

a. Technical Levels

- o Front line service: contact with "clients or customers"
- o Specific task/function/system oriented: emphasis on competencies, procedures and techniques (what to do and how to do it)
- o Professional and analytical (as well as analyst) skills, prospectus review/analysis, monitoring and enforcement
- o Team building.

b. Administrative and Support People

- o Same as above only with an administrative and "services" orientation versus a technical/professional orientation.

c. Management, from Mid-Level to Top

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

- Case-specific learning: project, problem, issue (exposure to counterparts and "pioneers" in other places and markets)
- Organization and institutional development: leadership, systems development, people development, strategic planning
- Industry and sector development: vision, "marketplace" orientation, policy development and implementation, intergroup relations and consensus building (dialogue and consultative relationships with other capital market players).

d. Institutional

The SEC needs:

- The resources and training delivery capabilities necessary to address individual, functional and organizational needs.
- Training for transition in systems, procedures, automation, records management, and unification of exchanges
- Training in values and services orientation.

D. Training Needs Summary

Key characteristics of near-term training that is wanted, needed and works include:

- Highly practical: e.g., knowledge, methods and benefits of working with new systems, rules, regulations, procedures
- Real cases, situations, projects; specific "real-life" examples
- Experiential versus academic training
- Exposure to successful examples in other countries
- A person who has "done it"
- Relevance and applicability to a developing market
- Some degree of attitude change and inspiration/vision

- o Appeals to self interest: how to make more money or gain professional status, growth and advancement
- o A "good" coach, teacher, trainer: personality, style, humor, dynamism
- o Credibility.

See the two Exhibits starting on the next page for an elaboration of the long-term training needs and time frames required for achievement.

IV. EXISTING PRIVATE SECTOR RESOURCES (The Supply Side of the Training Equation)

There is an impressive array of training-related resources in the private sector composed of public interest, educational, corporate and professional groups. They include:

- o Dedicated volunteers who lead committees (championing change, learning, or developmental activities)
- o Educational programs and conferences that focus on key issues
- o Training seminars and workshops organized by professional groups
- o On-site tutorials by company executives or technical people to show how certain tasks or jobs are done.

Prime examples are:

A. The Financial Executive Institute (FINEX)

FINEX is a well-established institution with a long track record, and a membership of 600 medium and high-level executives in the financial industry (many directly or indirectly relating to capital markets). It possesses an ongoing comprehensive program of educational, policy development, and advocacy activities, including the USAID sponsored Dialogue between private and public sector players in the capital markets. Preliminary indications are encouraging: a wide cross-section of serious ideas and conversations could take place within the framework of FINEX.

B. The Asian Securities Industry Institute (ASII)

ASII is a start-up regional professional group with ambitious aims to advance the standards, capabilities, and training of professionals in the securities industry. It organized a conference held July 91 with Philippine, Asian and International participants. ASII is presently in the formative and fund raising stage. Some of its key players are in the US, and the Philippine "center" has yet to be solidified. This may be a critical period during which synergistic partnerships could be explored, with creative latitude for defining identities and division of roles.

Training Needs Matrix - Long Term

Organization/ Group	TYPE OF TRAINING						
	Project Problem Issue Specific	Technical Task Skill	Professional/ Management and Skills	Business and Market Development	Organization/ Institutional Dev't and Capacity Bldg.	Industry Dev't Policy, and Consensus Building, Advocacy	
Private Sector Intermediaries	X			X			X
Exchanges B/Ds Management	X X	X X	X X	X X	X		X X
SEC Management Technical Administrative and Support	X X X	X X	X X	X	X X X		X X X
Priority	<u>1</u>	<u>1</u>	<u>2</u>	<u>2</u>	<u>3</u>		<u>3</u>

- 1. Highest/soonest
- 2. Important
- 3. Worthwhile

C. The Capital Markets Development Foundation

A recently-revived group led by a former SEC Associate Commissioner, the Foundation is also in the early stages of growth with three initial projects underway. The CMD Foundation is now planning a first series of four training and education to be held over the next year. Details include:

- o Schedule: One seminar per calendar quarter.
- o Attendance Goal Per Seminar: 35 middle and senior managers from private and public sector
- o Subject Areas:
 1. Corporate Finance
 2. Underwriting
 3. Prospectus Writing
 4. Securities Analysis
- o Length of Seminars: Three days each
- o Cost to attend: P3500 per person
- o Financing Strategy: The objective is market-supported seminars with attendees paying full cost (i.e., revenue generating)
- o Market for Seminars: Insurance Companies, Broker-Dealers, SEC, Financial Intermediaries
- o Location: AIM, Asian Institute of Management.

The CMD Foundation is coordinating with AIM and also exploring with ASII about ways to work together. Most importantly, the Foundation is in the early stages of discussions with AIM about the idea of these seminars being a first step toward creating a "capital markets institute" of some sort, with AIM as a sponsoring partner along with CMD Foundation and/or ASII.

D. The Capital Markets Development Committee of FINEX

This is perhaps the most active and wide-ranging policy and program-related group with a very active and "entrepreneurial" leadership. Its members cut across the capital market and financial sector, and the Committee is a leader in the Public/Private Sector Dialogue Project.

E. Corporate In-House Programs

Various companies, professional associations, financial markets intermediaries (investment houses, banks, CPA firms, lawyers, etc.) have ongoing training activities for in-house purposes, and on occasion organize seminars/workshops for SEC employees or broker-dealer personnel.

F. Conference on Capital Market Development

Held in 1988, this is one of a few gatherings that has examined and conveyed a cross-section of ideas on capital market development. Its proceedings foreshadow many of today's issues and challenges, including the 1988 call for a "Financial Markets Institute".

G. The Asian Institute of Management (AIM)

The AIM is sometimes the site for conferences and programs involving capital markets participants. Several faculty are interested in and teaching courses in related subjects such as investment banking, financial markets, etc. The Institute is the most credible and widely attended educational institution for entry, mid and senior-level managers serving both the Philippines and the region. The current Dean has a board and advisory role in a stock exchange, ASII and FINEX.

H. Positives and Negatives

On the positive side, this network of private sector initiatives and individuals represents considerable talent, energy, vision, and capability. On the negative side, there are some critical limiting factors in this private sector "supply side" of training capability. More often than not these efforts are:

- o Ad hoc, intermittent, unconnected
- o Without adequate institutional memory, continuity or follow-through
- o Lacking in "critical mass," insufficient synergy, multiplier effect, and cumulative impact
- o Do not foster and nurture the ongoing patterns of dialogue and working relationships between all the key players necessary to create proactive momentum in the capital market (information for problem/opportunity

definition, strategies and options, policy and program development, advocacy and change)

- o Do not create a powerful enough vision of a larger community of common business interests within which everyone's self interest can be more advantageously pursued.
- o Conducted with fragments of time (off-the-job, or secondary-to-the-job) without any full-time professional person or driving force to push things ahead all day/every day on an equal priority with day-to-day professional and business challenges. (For example, "Nick" Jacobs, the "entrepreneur" of the Capital Market Development Foundation and an ex-SEC Associate Commissioner, has just been appointed to head up the Philippine National Oil Company. This will certainly cause an interruption/discontinuity in the leadership of the CMD Foundation at a critical time.)

I. Summary

In summary, the key missing ingredients in this patchwork of initiatives and ingredients are at two levels.

- o At the level of addressing specific training needs on the demand side, private sector resources:
 - Fall short or leave major gaps in certain technical, task or professional challenge areas
 - Do not meet the requirements imposed by the major changes lying ahead
 - Tend to happen at the initiative of the supply side more than at the pace and rhythm of the need/demand side
 - Are aimed more at technical and task needs than at the higher-order challenges of professional, business, and market development
 - Are not accessing the full range of state-of-the-art training resources and technology.
- o At the higher level of institutional change, the existing training resources do not adequately address needs for organizational and system change, policy and strategy development, interorganizational communication and dialogue, and the consensus building (public and private sector) required to define and move toward a larger common vision.

V. CONCLUSIONS: OPPORTUNITIES AND CHOICES FOR USAID

A. USAID's Choices

The convergence of forces, needs, challenges and interests relating to capital market development over the next few years presents USAID with an opportunity to make a significant difference in what happens, how things happen, and when (how fast) things happen.

This situation lends itself to a serious training strategy--one which deals not only with the need to do things better, faster, cheaper and with less risk (productivity and execution), but with the need to make major system, organizational and institutional changes (development and transformation, or changing the playing field and even the game). It is almost a classic case of being able to respond at two levels. In the short run, provide well selected and delivered units of training (giving a man fish). It is also both possible and prudent to help provide some of the systems/rules/procedures training that will be needed in the short run (first 12 to 24 months). Over the longer run, help key players to build a real and enduring training capability (teaching a man to fish).

While there are important short-run training needs, the higher leverage/value/payoff option is at the level of helping to build a capability. The choices for USAID include:

- o What kind of, and how much of an impact does it want to have?
- o What range, degree and depth of capability building is desirable?
- o What level and duration of commitment fit both the capital market need and USAID's agenda?
- o Where are the points and vehicles for involvement that will maximize credibility, private and public sector participation, and leverage existing resources?
- o How best to employ/deploy resources (TA and training expertise and dollars) to achieve the desired purposes.

B. Training Design Premises

There are a number of design premises that will influence USAID's program strategy and design:

- o Resources must be channelled through a suitable private sector entity for allocation to other private sector "subcontractors," and, in the SEC's case, directly to the SEC without a government intermediary
- o Wherever possible create capabilities and programs which involve private and public sector counterparts participating together; also foster new patterns of collaboration and communication within the private sector
- o. The major impact should happen through, and as a result of, private sector involvement
- o Financial sustainability, self sufficiency and "market" supported programs must be a goal; avoid any sense of "entitlement"
- o Training must be offered on fees-for-services, cost sharing, or ability-to-pay basis, as appropriate
- o Maximize use of local and/or regional private sector training resources
- o Emphasize a train-the-trainer approach
- o Maximize the use of existing (on-the-shelf) training courses and programs where they are appropriate and sufficiently meet a need
- o Create at least 100 percent leverage through the private sector by way of challenge grants, cost sharing, and other methods
- o Strategies, programs, and resources should reach priority opportunity areas outside Manila.

VI. PROJECT ORIENTATION: A TRAINING CAPABILITY FOR THE CAPITAL MARKET SECTOR

A. Focus and Rationale

The primary focus recommended is on helping to create a long-term, private-sector based training capability for the capital market. This focus would include some near-term training activity; however, even this would be a building block within the larger program of creating a lasting capability. In fact, many specific training needs identified in this assessment can be addressed during and through the process of developing the capability.

B. Purpose

The purpose of a capability development program is to assist selected private sector organizations in collaboratively building a self-sustaining training, policy development, and advocacy capability which serves private and public sector people and organizations in the progressive development of the Philippine capital market.

C. Specific Objectives

Specific objectives include:

1. Designation and capacity building of an appropriate private sector implementing organization to:
 - a. Receive, allocate and monitor program assistance (technical assistance, training and financial)
 - b. Conduct capability-building programs of its own in professional education, policy development, and advocacy.

This organization must be highly credible to private and public sector leaders in the capital market sector, well positioned across the capital markets and financial sector, and have an impeccable track record in handling funds and conducting programs of value. It must have the vision, sense of mission and leadership to play this role. Based on these criteria, FINEX is the leading candidate.

2. Creation of a Center or Institute for Capital Markets Management Research and Policy which will be an institutionalized focal point for sector-wide incentives and programs in management education, training development and delivery, policy dialogue and development and research. This center will:
 - a. Develop and conduct programs for the private and public sector
 - b. Foster collaborative dialogue and participation of people and groups across the capital marketplace
 - c. Provide professional expertise and other resources such as infrastructure/office/space/support services for other groups who want to undertake worthwhile training initiatives (including information, policy, or advocacy related activities).

AIM is very well suited for this role and very interested in making an entrepreneurial commitment. FINEX, ASII, and the CMD Foundation are possible partners and have compatible and/or complimentary visions about the need, opportunity and value of such a center.
3. Capacity building of other selected private sector organizations who through their own agenda and effort can:
 - a. Bring a "niche" capability in the training, policy and advocacy area
 - b. Multiply the talent, resources, and energy available through the private sector.
4. Assistance to the stock exchanges in their efforts to professionalize at the Board and staff levels, as well in the professional, business and market development activities of broker-dealers and members.
5. Direct assistance to the SEC in building their in-house training and professional development capabilities.
6. Indirect and third-party assistance to the SEC through the private sector training sector capabilities to further supplement the resources available for:
 - a. The SEC's internal capacity building
 - b. Attaining desirable levels of interaction, dialogue, consultation between the SEC and private sector/capital market players.

7. Provision of near-term training services in the areas of systems/rules/regulations and automation within the stock exchanges and the SEC in the form of:
 - a. Quality control management of training services that should/will be supplied by the vendors of new computer-based systems
 - b. Actual training capability/services which are needed over and above what can be derived from the system suppliers.

D. Program Elements

The program elements are outlined as follows:

1. Center/Institute for Capital Markets Management, Research, and Policy

Based out of the Asian Institute of Management (AIM):

- o Possibly involves other partners in joint or affiliated programs; e.g., FINEX, ASII, CMD Foundation
- o Capitalizes on AIM's credibility, track record, high professional reputation, outreach, facilities, talent and capabilities, experience working with other Philippine and asian organizations, "neutral" standing among capital market interest groups, alumni network
- o Has credibility in both the private and public sectors
- o Utilizes and leverages other private sector resources
- o Goal is revenue generating programs and services which meet a well identified and well served market need with a view to becoming self-sustaining and self-sufficient
- o Programs and services include:
 - Various core professional education programs
 - Periodic special focus workshop and seminars
 - Forums and conferences for the capital markets community
 - Case and learning materials development

- Training development, consultation, and facilitation services (needs assessment, design, training of trainers, organizational development and systems change, human resource development, process facilitation)
- Training materials development, packaging and marketing services to link users of training with providers of training or existing course materials
- Research to support policy analysis and dialogue
- Ongoing linkages and networking
- Shared experiential learning among Asian counterparts
- Infrastructure, support, and professional services for other organizations and groups (both private and public) that are involved in capital market development.

2. Benefits to Institutionalizing a Capital Markets Training Capability

- o Provides an ongoing, sustainable capability which is the strategic "missing piece" that will best leverage, multiply and "add value" to the currently available, yet fragmented and ad hoc private sector training related assets and resources
- o Creates a real-time/full-time/everyday mechanism for marshalling, marketing, distributing and deploying training resources, thus yielding synergy, continuity and cumulative impact
- o Deals with the "whole system" (versus only some of the parts) and the patterns of communication/working relationships among the various players which can foster a new, ongoing and more progressive "community of interests" that can drive (1) performance and execution, (2) vision and policy development, and (3) advocacy
- o Provides ongoing resources to develop institutional memory, networking and linkages that will benefit all the constituent parts
- o Can accelerate the development of the capital market by making it a more interactive, consultative process
- o Produces long-term benefits that can be relatively high

compared to resources required.

3. Key strategy and Design Factors

- o Capability development versus ad hoc units of training
- o Long-term approach
- o Leverage of private sector assets/resources
- o Building on strong existing organizations; single prime contractor and multiple subcontractor approach
- o Market responsive and revenue generating; fees-for-services orientation
- o Goal is sustainability after USAID's participation is phased out
- o Services and marketing approach throughout the capital marketplace
- o Services for the public sector where it cannot afford the costs
- o Private sector networking and collaboration
- o Private and public sector working and learning together
- o Financial multiplier through challenge grant, cost sharing, etc.
- o Fostering of policy dialogue and advocacy
- o Maximum use of cost-country talent, supplemented by U.S. and third-country expertise where necessary and appropriate
- o Build on existing leadership, "champions" and "entrepreneurs."

4. Program Outputs

The following are intended outputs, or outcomes, of the recommended program (not listed in order of priority):

- a. A strong dynamic private sector implementing organization that is a leading player in capital market development, not only through its own programs, but through an active network of other private sector

organizations to which it channels funds and technical support

- b. A well-established, highly-regarded, and self-sustaining institutional center and capability for capital market education, training, research and policy that is affiliated with a distinguished institution for higher learning
- c. An institutionalized private sector capability through a network of organizations--each in its own niche--for policy dialogue and advocacy which has successfully advanced progressive policies, strategies and programs for capital market development to the leadership in the public and private sectors
- d. Established and effective patterns of networking, dialogue and collaboration among private and public sector participants in the capital market
- e. Well-developed standards of professional development in capital market-related institutions
- f. A highly professional training and organizational development support capability which is serving private and public sector organizations on an economically viable basis
- g. Private securities market participants and an SEC which are functioning with reasonable and competitive professional standards and practices, and which have well-planned, ongoing education and training programs
- h. Significant additional private sector financial resources (or various financial equivalents) which reflect at least a dollar-for-dollar matching of funds contributed by USAID, and which are being directed into capital market education/training, policy development, and advocacy efforts.

5. Program Inputs

The following types of inputs are needed for the effective design and implementation of the program described above:

- o Sufficient funding must be made available over a 3 to 4 year period to support the various kinds of people, activities and training assistance discussed above.

- o This includes funding to support the primary recipient (e.g., technical assistance and commodities for the private sector implementing unit, or NGO), as well as the secondary recipients (subcontractors hired to implement various elements of the overall training program, as designed and coordinated by the primary recipient).

A key objective is to coordinate the utilization and application of these funds with other USAID investments in technical assistance, training and commodities for the SEC and the stock exchanges which are intended to effect those changes (policy, operational, systems and organizational) deemed necessary for the Philippine capital market to become regionally and globally competitive.

VII. FACTORS AFFECTING IMPLEMENTATION AND RESULTS

Various factors will influence the execution and implementation of this program's objectives and approach, and will significantly determine the nature, quality, and level of results achieved:

A. Underlying Assumptions

- o That this approach of building an institutionalized capability is needed, wanted and will make a bigger difference than infusions of conventional units of training.
- o That this philosophy of individual, organizational, and sector development/empowerment through application of training technology will work.
- o That the funding level and suggested allocations and applications will be an adequate "critical mass" for success.
- o That the private sector leveraging strategy of dollar-for-dollar matching contributions can and will work.

B. Other Factors and Issues

- o The nature of USAID's commitment must be clear and consistent up-front, with continuous follow-through and support being provided in accordance with agreed-upon plans and courses of action.
- o The implementing organizations and the people involved must be wisely and strategically selected and supported--a factor that will make or break this effort. Progress must also be monitored on an ongoing basis so that problems, needs and redirection can be identified with sufficient lead time and acted upon appropriately.
- o Within the framework of agreed-upon responsibilities and courses of action, USAID must remain interested, credible, relevant and "quality conscious" throughout.
- o USAID funding levels must be made available according to the agreed-upon plan.
- o USAID's comparative advantage of flexibility and a private sector development philosophy must be allowed to manifest itself.

- o The other parallel thrusts (i.e., technical assistance to the exchanges and the SEC regarding unification, automation, etc., along with progress on policy development) need to proceed in a satisfactory manner in order to permit the training strategy to be fully exercised.
- o An appropriate degree of coordination with other donors will need to be achieved to avoid mixed signals, confusion, redundancy or lost opportunity for a synergy of focus and resources.

APPENDIX E

Preliminary Logical Framework

APPENDIX F

Draft Terms of Reference for Long-Term Advisory Positions

1. Securities Market Institutions Specialist
2. Private Sector Training/Organizational Development Specialist
3. Regulatory Specialist
4. Organization & Methods/Automation Specialist
5. SEC Human Resource Development Specialist .
6. SEC Information Technology Advisor

TERMS OF REFERENCESECURITIES MARKET INSTITUTIONS SPECIALISTA. BACKGROUND

The Philippine capital market is characterized by a debilitating "crisis of confidence" whereby the Philippines finds itself falling further behind other emerging markets that at one time looked to its stock markets for leadership and example. There is also a fundamental lack of liquidity in the marketplace rooted in inefficient order execution and high transaction costs, among other factors. The inefficiencies in current trading, clearing and settlement procedures, which are based on antiquated processes and systems, represent a major factor holding back the development of the market.

There are also serious misconceptions on the part of the key parties--the exchanges and the SEC--regarding the costs associated with making a significant breakthrough in the development of the market. These misconceptions include the need for substantial investments in real estate and computer hardware and software--requiring significant donor subsidy--in order to convert to a new automated system for trading, clearing and settlement. There are also misconceptions regarding the need for an exchange floor, the value of the open-outcry system, and the value of physically merging the current organizations and systems of the exchanges.

Despite these difficulties, the exchanges and the SEC have defined similar objectives to developing the Philippine capital market: a unified national marketplace; automated trading, clearing and settlement (preferably on an integrated basis); professionalized exchange management; and strengthened SEC rules and regulations to permit the SEC to more effectively regulate the market. To date, however, despite a number of written resolutions and other various indications of intent, there has been remarkably little progress in working toward these objectives. This has been due, in large part, to a lack of hard, state-of-the art information, generated by an independent outside party, about automation options, system capabilities and associated costs upon which to make sound, economically viable and joint decisions of long-term importance to the development of the market.

The Private Enterprise Support (PESO) office of USAID/Philippines is currently in the process of designing a capital market development project which will, working primarily through the private sector, provide various types of assistance--technical assistance, training and equipment--to assist in developing the Philippine capital market. A major activity under the Private

Sector Component of this project is the development of a reorganized and automated securities market. A long-term securities market institutions specialist is needed to facilitate the development of this system

B. OBJECTIVES

The overall objective of the Securities Market Institution Specialist is to provide the key parties--the exchanges, other appropriate private sector intermediaries, and the SEC--with information upon which to base decisions on the soundest and most economically-viable course of action to develop a new Philippine securities market system. The intent is for all parties to establish a consensus and unified commitment to creating a single automated national trading system, consistent with the needs of the Philippine market, that most effectively serves the public interest and the needs of capital market participants--both domestic and international--and that facilitates the ability of the SEC to carry out its supervisory responsibilities.

The Securities Market Institutions Specialist will provide facilitative and resource expertise to the exchanges and the SEC to examine, evaluate, and make considered judgments about the kind of system they want, what they want it to do, and how to implement the system of their choice, with the aim of encouraging a consensus that would best serve the growth of the Philippine capital market, the interests of the public, and the objectives of the exchanges and the SEC.

The long-term advisor will be in direct communication with the SEC, the upper management of the stock exchange(s), the securities industry, the banking sector, etc. He will provide advises and recommendations on day to day management of the exchange, helping it in its decision making process.

C. SCOPE OF WORK/METHODOLOGY

The long-term advisor will be responsible for providing advice on an as-needed basis to the management of the exchange. Other responsibilities will include:

- o providing assistance to the exchange on day to day management/operations issues
- o initiating, developing and monitoring communication with other participants in the securities industry (SEC, broker/dealers, etc.)
- o providing the exchange management with a detailed workplan for the implementation of a fully integrated trading system

- o preparing operational plan, including the role of and the relations with a central custodian
- o maintaining consensus for the implementation of a fully integrated system
- o assisting in defining necessary upgrades for the specifications and requirements of the integrated trading system
- o defining contract requirements for the implementation of the automated system
- o assisting in the preparation of the request for proposals for the procurement of the system
- o assisting in the design and implementation of the proposal evaluation process, participating in evaluation process
- o drafting the contract for the selected vendor and participating in final negotiations
- o supervising the system acquisition process by maintaining close contact/relationship with the selected vendor
- o advising the Operational Vice President on the system implementation and operation supervision
- o assisting in the reorganization of the exchanges; developing listing/delisting criteria, trading rules and practices, market surveillance standards and promotion of the securities market
- o defining areas where short-term technical assistance are needed
- o preparing scopes of work for ST-TA
- o preparing on a regular basis operational reports to be reviewed by the exchange management
- o supervising and participating in all short-term TA activities

D. DELIVERABLES

The principal deliverable for the long-term advisor is the overall improvement of operation and management of the stock exchange and full implementation of the automated system. More specific and tangible deliverables include:

- o Occasional presentations to the stock exchange management and USAID on the progress/issues on the development of the Philippine Securities Market
- o Occasional memos as requested by private sector participants
- o Scopes of work and short-term technical assistance activities.
- o Draft RFP for system implementation
- o Proposal evaluation recommendations
- o Draft contract for the installation of the integrated system
- o Training plan for the Operational Vice President to enable him to continue supervising the operation of the service company after the long-term advisor's assignment is completed.

E. STAFFING REQUIREMENT AND LEVEL OF EFFORT

1. Securities Market Institutions Specialist: (36 months)

The long-term securities market institutions specialist should have significant experience in stock exchange management and operations. Additionally, the long-term advisor should be familiar with state-of-the-art trading systems. Prior experience with USAID and developing country is desirable.

As a key connecting point between the Exchange and the other participants in the industry, the advisor should be able to initiate and deepen dialogues between the different entities.

The long-term advisor should possess an advanced degree in finance and management and prior experience in project management in similar setting.

2. Short-term technical assistance

The first short-term technical assistance activity is described in appendix G and will focus on the feasibility and design of the integrated trading system. This engagement will be one of the initial responsibilities of the long-term advisor.

This engagement will require a complementing, multi-disciplinary blend of domestic and international specialists. Domestic consultant staffing requirements include:

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- o Legal Specialist (2.5 months)
- o Securities Industry Specialist (2.5 months)
- o Regulatory Specialist (2 months)
- o Automation Specialist (3 months)
- o Investment Banking/Finance Specialist (2.5 months)
- o Senior Advisor (0.75 month)
- o Technical Support (6 months)

International consultant staffing requirements include:

- o Team Leader/Planning Specialist (6 months)
- o Stock Market Specialist (5 months)
- o Regulatory Specialist (1.30 months)
- o Automation Specialist (3.75 months)
- o Investment Banking/Finance Specialist (2.5 months)
- o Financial Planner/Technical Support (6 months)

3. Administrative/Secretarial Support: (36 months)

As team leader of the short-term technical assistance activities, the long-term advisor will need administrative/secretarial support. A full-time secretary/administrative assistant with background experience in the securities market is needed.

TERMS OF REFERENCEPRIVATE SECTOR TRAINING/ORGANIZATION DEVELOPMENT SPECIALISTA. BACKGROUND

Building and institutionalizing a long-term capital market training capability will require two channels of technical assistance:

- o The primary channel will be through a designated NGO to another private sector organization who will sponsor, possibly with one or two co-sponsors, the development of the Center/Institute for Capital Market Management, Policy, and Research.
- o A secondary channel will be in the public sector-- directly to the SEC, where the internal capacity building and training needs far outstrip the available resources.

Two long-term, full-time training specialists are anticipated. One located in the Center/Institute serving the Center, other private organizations, and on an external basis the SEC; the other located in the executive staff of the Chairman of the SEC, serving the internal needs of the SEC.

In addition, a third person who would be a combination project manager/administrator and training generalist, could be strategically located as a full-time staff person in the NGO where the private sector funds will be received, allocated and monitored. The leaders of the designated NGO should have a voice in whether training expertise is a priority component of the project manager/administrator's job.

The rationale for having two full-time specialists supplemented by a project administrator with some training experience includes several factors:

- o The magnitude and diversity of the training challenge is beyond one person
- o Meeting the training needs of the private sector and the SEC requires two full time jobs with differences in scope and requirements.
- o Gaining "critical mass" and obtaining continuity, as well as leveraging other potential resources, will be more attainable with two positions.

The Terms of Reference for the Training/Organizational Development Specialist follows.

B. OBJECTIVES

The primary objective in having a Training/Organizational Development Specialist working under the auspices of the NGO is to help create a long-term, private-sector based, self-sustaining and economically-viable training and advocacy capability to serve both the private and public sectors in developing the skills of capital market participants. This person will counsel, lead, promote and support the development of a sector-wide training capability in his area of professional expertise. These areas of expertise will include: needs assessments, training of trainers, program design and development, training delivery, organizational systems and development, human resource development, process facilitation, training packaging, marketing, and promotion, and awareness of training resources and state-of-the-art technologies.

C. SCOPE OF WORK/METHODOLOGY

The Training/Organizational Development Specialist will be one of the core staff of the Center/Institute, so that he will have full access to the talents, resources, and environment of the Center and sponsoring educational institutions. This will also give the Specialist a position from which to develop a credible network and understand the needs, resources, and organizations in the private sector, the SEC, and other pertinent public sector organizations.

The Training/Organizational Development Specialist will focus on the following areas:

1. Working with the exchanges and the SEC to help define needs, challenges, and opportunities for training and organizational development.
2. Accessing and leveraging existing training resources, and matching them with well defined needs in the capital markets sector.
3. Working with the Center/Institute to apply training technology and processes wherever it will help build quality programs and institutionalized capability.
4. Serving as a senior training advisor/entrepreneur who provides counsel and technical assistance wherever needed, as well as promotes the value and possibilities of training.

5. Serving as a catalyst/facilitator throughout the capital markets sector to help build more productive dialogue and relationships among the various organizations.
6. Helping to create synergy, continuity, cumulative impact and value, and institutional memory and capability.
7. Assisting the constituent organizations in strengthening their internal training capabilities.
8. Helping the capital market sector and constituent organizations, including but not limited to the Exchanges and the SEC, to define their need for outside short-term experts or TA, and then helping organize and manage the delivery of such short term TA.

D. STAFFING REQUIREMENTS/LEVEL OF EFFORT

Training/Organizational Development Specialist (International, est. 36 months). This person should have 10-15 years experience in the areas mentioned in Section B above and should have a professional training experience. Critical skills include: some familiarity with financial institutions; characteristics of an excellent coach/teacher; a detailed knowledge of training organization; broad vision; a grasp of the interrelation of people, teams, and organizations; excellent consulting and counseling skills; entrepreneurial and marketing skills; exceptional interpersonal skills; and the ability to relate to senior leaders and managers as well as the technical and mid-level people.

E. DELIVERABLES

The primary deliverable requirement is the establishment of a center or institution for capital market development which will handle training and advocacy efforts under the project. Other deliverables can take the form of the following:

- o Needs assessments
- o Program development plans
- o Networking and facilitation plans for private and public sector dialogues
- o Internal training development plans
- o Resources leveraging plans
- o Fund sourcing plans.

TERMS OF REFERENCEREGULATORY SPECIALISTA. OBJECTIVES

The overall objective of providing the SEC with technical assistance is to:

- o Enhance the institutional capability of the SEC to regulate the securities industry in a manner that provides appropriate investor protection and promotes fairness and efficiency without over-regulating the securities industry
- o Strengthen the technical capital market skills of SEC staff, as required for their regulatory role
- o Create a compatibility of automation with the stock exchange(s) in terms of market surveillance
- o Promote a productive relationship between the SEC as regulator and the private securities industry as executor/promotor
- o Instill confidence in the Philippine and foreign investor community through improved regulatory and enforcement effectiveness.

In the area of implementing rules and regulations, the objective of USAID technical assistance is to promote the efficiency and effectiveness of the SEC's influence on capital markets through rule-making.

The objective of this advisor is to serve as an "invisible aide" or resource to assist the SEC in the rationalization of its implementing rules and regulations, as they relate to the securities industry.

Efforts under this activity should result in a set of rationalized and updated rules (preferably in codified form), drafted with the SEC and issued by the SEC itself.

B. SCOPE OF WORK/METHODOLOGY

The technical advisor will ideally work directly under the Chairman of the SEC and draft rules in conjunction with the Director of the Brokers and Exchanges Department, as well as any other Directors whose Departments have activities relating to public offerings of securities and transactions in such securities. Since the advisor will be USAID-sponsored, he will have the autonomy to draft rules and regulations directly to the SEC Chairman in cases of disagreement by the affected departments. The scope of these rules and regulations is limited to those which regulate the securities industry. To attempt to draft rules which, for example, also affect the registration of companies or the administration of the SEC would exceed the scope of this project.

The long-term advisor could be expected to focus on the following categories of rules:

- a. Evaluations: Assist in reviewing the appropriateness of and possibly removing SEC rules that deal with evaluations by the SEC, such as maximum commissions for public offerings, whether a security is a safe investment, whether the issuer's business is sound, clearance or approval of listed companies' news reports and certification of financial statements.
- b. Streamlining: All rules related to or that deal with offering or trading of securities, by brokers, dealers and investment houses, should come under the jurisdiction of the Brokers and Exchanges Department (BED). Review of all rules should be executed with careful detail to overlap and duplication. The advisor should closely coordinate with the Organization Advisor in completing this task.
- c. Automated Trading, Clearing and Settlement: Assist in drafting rules pertaining to trading, clearing and settlement, particularly if the private securities industry institutions move toward the automation and integration of these functions.
- d. Underwriting/Issuing: Assist in reviewing and recommending changes in rules and regulations to carry out the SEC's responsibilities and functions pertaining to underwriters and issuers (e.g., underwriter contracts, allotment, oversubscription, underwriting records and procedures, price stabilization, registration of offerings, registration of public companies, prospectus definition, public company disclosure, insider disclosure, reporting requirements, underwriting results, suspension of offerings).

- e. Market Surveillance: Assist in drafting rules and procedures for the SEC in surveillance matters; assist in determining the computer systems requirements to carry out the surveillance function.
- f. Short-Term Technical Assistance: Areas where the long-term advisor may require access to specialists on a short-term basis include:
- (1) Inspections: Assist in reviewing and recommending changes in rules and regulations pertaining to the SEC's inspection of securities market institutions (e.g., broker/dealers, securities exchanges, investment managers, etc.) to determine compliance with their responsibilities and any new rules and regulations that may be established in a new automated exchange system. Develop criteria for the stock exchange(s) to fulfill their role as self regulators of members and listed companies.
 - (2) Legal/Administrative Appeal: Assist in reviewing standards and possibly drafting rules and regulations pertaining to administrative appeals (e.g., appeal procedures for the SEC to follow when a person believes that a sanction imposed either by the SEC or a self-regulatory organization is inappropriate appeal request, required records, appeal decision).
 - (3) Enforcement: Assist in reviewing rules and regulations pertaining to structuring an administrative action by the SEC to establish the basis for limiting a person's license, canceling a person's license, barring a person, assisting in a legal action for the purpose of a fine, imprisonment and/or restitution of ill-gotten gains.
 - (4) Stock Exchange Operations: Assist in reviewing rules and regulations pertaining to stock exchange operations (e.g., listing/delisting, rights offerings, trading and floor procedures, block trades, odd lot trades, floor trading procedures, floor trading personnel, commissions, member ethics and affairs, membership, member discipline, examinations, clearing and settlement).
 - (5) Clearing and Settlement: Assist in reviewing rules pertaining to clearing and settlement (e.g., inspection application, records, reports, licence application, stop/resume clearing, disciplinary action, inspection procedures).

In addition to his rulemaking function, this Advisor should be available to the Chairman of the SEC and other appropriate officials to respond to any other related issues that may arise, such as assistance in speech writing and in addressing specific issues coming before the Commission.

The methodology suggested for drafting these rules is to work closely with SEC staff on an interactive basis, assisted by Philippine consultants to the maximum extent possible. This would ensure that the rules and regulations implemented would be relevant in the Philippine context, and that they would be products of the SEC, and not of outside advisors. The advisor would begin his task with an overview of the rules applicable to the BED, and work with SEC staff to issue an initial regulatory strategy paper, detailing the areas of rules and functions which he/she will undertake to examine and draft. Thereafter, the drafting of rules will be issued on an interactive, consensus basis, with possible interim reports to USAID on the status of the implementing rule project at crucial points. The final result will be the successful implementation of the rules from the SEC.

C. STAFFING REQUIREMENTS AND LEVEL OF EFFORT

1. Regulatory Specialist (international, 36 months), with significant experience working at a senior management level in an SEC-type organization. The ideal candidate would have consulting experience with government agencies in a developing country context as well as a working knowledge of securities markets and management experience with an SEC-type organization. Familiarity with the Philippine capital markets and the current organizational status of the SEC would contribute greatly to focusing the skills of the short-term consultant teams on the needs of the SEC.
2. Technical support staff (domestic, 12 months), to assist in drafting rules and regulations under the direction of the Regulatory Specialist. Must have some knowledge of the capital markets and prior work experience. A knowledge of the Philippine governmental institutions is strongly recommended.
3. Short-term specialists (domestic and international; 30 months) in the following rule categories:
 - a. Inspections
 - b. Legal/Administrative Appeal
 - c. Enforcement
 - d. Stock Exchnage Operations
 - e. Clearing and Settlement
 - f. Other areas, as needed.

4. Home Office Support (4.5 months) provided by the Contractor's senior management to provide project oversight and quality control, and assist in sourcing short-term technical specialists.

D. DELIVERABLES

The principal deliverables will be in the form of actual rule changes and resulting improvements in the operation of the SEC and development of private sector self-regulation and decision-making. Other reports may take the form of:

- o Initial regulatory strategy
- o Draft rules, forms and implementing regulations
- o Occasional memos addressing regulatory issues as the pertain to the rule-making process
- o Periodic memos containing a detailed list of all major regulations which may be in process over the next year, indicating research needed
- o Scopes of work for short-term technical assistance.

TERMS OF REFERENCEORGANIZATION AND METHODS/AUTOMATION ADVISOR**A. BACKGROUND**

The SEC is headed by a Chairman assisted by four Associate Commissioners. The Chairman exercises general executive control, direction and supervision over the work and operation of the Commission and its members, board, units, personnel and all of its administrative business. Each of the four Associate Commissioners oversees and supervises the operations and activities of two departments on a rotation basis and makes necessary reports and/or recommendations to the Chairman and/or the Commission.

The Departmental Organization. The SEC is composed of 9 departments, namely:

- (1) Administrative and Finance Department (AFD)
- (2) Brokers and Exchanges Department (BED)
- (3) Corporate and Legal Department (CLD)
- (4) Examiners and Appraisers Department (EAD)
- (5) Investments and Research Department (IRD)
- (6) Money Market Operations Department (MMOD)
- (7) Prosecution and Enforcement Department (PED)
- (8) Securities Investigations and Clearing Department (SICD)
- (9) Supervision and Monitoring Department (SMD).

Each department is headed by a Director and divided into various divisions with specific and specialized areas of responsibility. Like the Associate Commissioners, Directors are also rotated from one department to another. The decisions, actions, orders or rulings of each department are appealable to the Commission sitting en banc. The records of the case are elevated to the Office of the Chairman, Commission En Banc (OC/EB) for review and thereafter presented to the Commission en banc for deliberation and resolution of the appeal.

Brokers and Exchanges Department. The Brokers and Exchange Department (BED) has been given the primary responsibility to oversee and regulate brokers', dealers' and stock exchanges' functions. However, other departments, except for the Administrative and Finance Department and the Securities Investigations and Clearing Department, also have some involvement with the latter department.

Areas of Overlapping Functions. The following are examples of overlapping functions among departments or divisions that might be shifted to another department to make each department's activities more homogenous:

- (1) Corporate Regulation Division under the Corporate and Legal Department (CLD) oversees and regulates the operation of investment houses which are defined in Decree #129 as "any enterprise which engages in underwriting securities of another person or enterprise." These functions could be more appropriate in the BED.
- (2) Investment Information Division under the IRD scrutinizes reports from listed companies. This might be more efficiently done by the Department that processes the original registration of the company's securities.
- (3) Division "D" of SMD supervises the operations of stock market and commodity futures market. This appears to overlap with responsibilities of BED and other SMD activities appear to overlap with those of other departments.
- (4) Registration and Licensing Division of the BED "processes applications for registration of securities and requests for exemptions from registration." The Securities Trading Regulation Division of BED "ensures that no unregistered securities are being floated to the public." These functions relate more to disclosures required of issuers than to securities industry participants and therefore are more similar to the other activities of EAD than those of BED.

Accordingly, the above functions of the other SEC departments in some way overlap or duplicate some of the functions of BED relative to the registration/licensing, regulation and supervision of stock exchanges, brokers, dealers, securities salesmen, futures commission merchants, floor brokers, commodity futures associations, commodity pool operators and commodity futures advisors/solicitors, as well as the registration of securities for public offering/sales and the listing thereof on the stock exchanges for trading. Thus, a rationalization of the functions of each department may be considered to avoid such overlap/duplication.

B. OBJECTIVES

The primary way in which USAID can assist the SEC at this time is by providing advisors who can work with SEC personnel to make recommendations of specific actions to resolve problems that have been discussed in prior reports and of which the SEC is already aware. The overall objective of providing the SEC with technical assistance is to:

- o Enhance the institutional capability of the SEC to regulate the securities industry in a manner that provides appropriate investor protection and promotes fairness and efficiency without over-regulating the securities industry
- o Strengthen the technical capital market skills of SEC staff, as required for their regulatory role
- o Create a compatibility of automation with the stock exchange(s) in terms of market surveillance
- o Promote a productive relationship between the SEC as regulator and the private securities industry as executor/promotor
- o Instill confidence in the Philippine and foreign investor community through improved regulatory and enforcement effectiveness.

The two most critical areas to improve the effectiveness of the SEC in the development of the Philippine Capital Markets are in Implementing Rules and Regulations and in Organization and Methods/Automation.

In the area of organization and methods/automation, the objective is to assist capital market development through the more efficient operation of the SEC, the foremost objective of this advisor is to enhance the institutional capability to effectively regulate the securities industry via strengthening the Commission's organizational and procedural functions, with a view to automating those functions, as appropriate. This advisor's goal should be to work within the SEC to review and make recommendations to remove overlap and duplication of functions while ensuring coordination of the complementing activities between departments.

C. SCOPE OF WORK/METHODOLOGY

The technical advisor will ideally work directly under the Chairman of the SEC, and have her support in developing and recommending organizational and functional changes. The advisor will work directly with the Executive Director to review and draft changes, as well as with the Directors of Departments that will be affected by the organizational/functional changes. Since the advisor will be USAID-sponsored, he/she will have the autonomy to present organization/procedural/automation improvements directly to the SEC Chairman, in the case of disagreement.

The scope of this organization, methods and automation component should focus on the following areas:

- a. Operational Strategy: Assist the SEC in reaching a consensus on a master strategy by (1) analyzing the operational goals of the SEC and providing comparative information on the structure of securities market supervisory agencies in other countries; and (2) assisting with the planning for the reorganization or restructuring of internal procedures.
- b. Procedures: Develop a procedures manual would specify operating procedures for all SEC tasks listed in the master plan. This procedural manual would be part of the SEC rulebook and would contain organization charts, job descriptions and operation flow diagrams.
- c. Records and Automation: Develop a records and automation plan which specifies SEC record keeping requirements and determines how they are to be stored and accessed. It would cover external, as well as internal, SEC documents. This plan would describe the SEC's needs for automation--current and future. These specifications and review would serve as the basis for further implementation.
- d. Human Resource Development Plan: After making an assessment which compares job requirements and existing staff skills, develop a human resource plan which determines how any gaps between requirements and existing skills are to be bridged in the short run, as well as recommend a long-term strategy for developing and maintaining the human resources which the SEC needs to operate effectively. This plan would be the basis for specific training programs which could then be implemented under the overall training component.

D. STAFFING REQUIREMENTS AND LEVEL OF EFFORT

1. Organization and Methods Specialist (international; resident 36 months), with at least eight years' experience in consulting on administrative organization and methods, and at least two years' at the project manager level. Critical skills include: analytical ability, writing and developing manuals, ability to access quantitative work needs and manpower requirements, and the ability to conceptualize work flows and organizational interaction. The ideal candidate would have consulting experience with government agencies and the private sector, with a working knowledge of securities markets and the regulatory procedures of the SEC.

2. Technical support staff (domestic; 12 months), with some experience in information systems and/or human resources consulting. A knowledge of the Philippine government institutions and the capital markets would be ideal.
3. Home Office Support (4.5 months) provided by the Contractor's senior management to provide project oversight and quality control, and assist in sourcing short-term technical specialists.
4. Short-term technical assistance (domestic and international; 30 months)
 - a. Organization Specialist(s)
 - b. Procedures Specialist(s)
 - c. Human resource Specialist(s)
 - d. Automation Specialists(s)
 - e. Other specialists, as needed.

E. DELIVERABLES

The principal reports or deliverables that could result from this technical assistance would primarily be internal SEC documents, such as:

- o Procedures manual
- o Human resource plan
- o Data resource plan
- o Document management plan
- o Automation plan.

TERMS OF REFERENCESEC HUMAN RESOURCES DEVELOPMENT SPECIALIST**A. BACKGROUND**

As noted in the Background Section for the Training/Organizational Development Specialist, there is a need for a human resource development and training specialist to serve on the executive staff of the Chairman of the SEC. This specialist will serve the internal needs of the SEC, where the internal capacity building and training needs far outstrip the available resources.

B. OBJECTIVES

The objectives of this position are to assist the SEC in developing serious, ongoing and progressive training, organizational development, and human resources capabilities. The goals of these capabilities are to support and facilitate the major transitions that lie ahead for the SEC, including those regarding systems, automation, rules and regulations, procedures, self-regulation, verification, and other appropriate areas. This will:

- o Raise the level of execution, performance and organizational effectiveness of the SEC
- o Foster greater pride and professionalism throughout the organization
- o Improve technical information and analytical skills
- o Provide incentives for advancement and professional growth
- o Create an environment where people and performance are challenged and supported
- o Develop a client/customer/market/service orientation that will promote constructive relationships in the capital market.

C. SCOPE OF WORK/METHODOLOGY

This specialist should work as part of the Chairman executive staff because a serious training effort requires credibility, top management commitment, and access to leaders at the highest levels. An effective training program will have to be tied into the main agenda of the SEC. A strategic position on the Chairman's executive staff can give the specialist a clear view of what is happening within the SEC, and will facilitate

communication and cooperation within the various sectors of the organization.

This person should:

1. Identify and empower internal training talent and resources
2. Identify, access, and involve outside training resources and capabilities, working closely with the partnership of the Training/Organizational Development Specialist housed in the NGO-sponsored Center/Institute for Capital Market Management, Policy, and Reseach.
3. Evaluate the training needs of the SEC
4. Develop appropriate programs based on the needs assessment and resource availability
5. Train trainers
6. Work on organization and development issues
7. Develop the SEC's human resource capacities
8. Define training needs related to the areas of transition anticipated in the next few years, and develop and manage training programs to meet these needs.

D. STAFFING REQUIREMENTS/LEVEL OF EFFORT

SEC Human Resources Development Specialist (international or domestic; 36 months). This specialist must possess 5-10 years experience in the range of required areas as noted above and must have advanced training or education in training program design and development and in the training of trainers. Key skills include: experience in organizational systems, development, and change process; familiarity with public sector and government organizations; an understanding of contemporary training technologies, especially those related to "services" and an organizations external marketplace; and an ability to work well on a consulting, coaching, and counselling basis.

E. DELIVERABLES

The primary deliverable for this Specialist will be an overall training program that contributes towards the improvement of the SEC's organization, capabilities, and quality of service. Other deliverables may include the following:

- o A training needs assessment
- o Capacity building plan
- o A "transitions" training plan and program
- o A human resources development plan
- o An organization development plan
- o A process facilitation plan
- o Various training materials.

TERMS OF REFERENCESEC INFORMATION TECHNOLOGY (I.T.) ADVISORA. BACKGROUND

Computerization at the Securities and Exchange Commission (SEC) was initiated in the mid-70's with the development of two application systems: the Corporation Registry System and the Financial Statements System. Not having its own computer resources, the SEC had the two systems developed by and processed at the National Computer Center. The state and cost of information technology prevalent at that time limited the SEC's capability and responsibility to data preparation functions in a batch processing-oriented automation environment.

Over a decade hence, no significant progress in automation was achieved despite advancements in the technology and the lower cost of computers. The SEC's applications portfolio consisted of only the two systems previously mentioned and a PC-based Corporation Name Verification System. The EDP Unit's staffing had increased but nonetheless it still had no capability to provide other information technology (I.T.) services, particularly systems development.

In 1987, the Commissioner recognized the impact of enhancing information technology applications in SEC's operations. Through the assistance of a consultant working for the Economic Development Foundation (EDF), an SEC MIS Plan was formulated. While it was hoped that the implementation of the Plan would be funded by Japan International Cooperation Agency (JICA), the National Economic Development Authority, in-charge of allocating the JICA funds, had placed the SEC on the long list, thus of lower priority.

A later request made to the Department of Budget and Management (DBM) eventually provided the SEC with P20M for its automation project. The Commission was able to acquire two minicomputer systems. The development of all new application systems is currently being done by the DBP Data Center, Inc. (DCIe).

The year 1992 will be crucial for the SEC's automation efforts. Most of the systems being developed by DCI will be delivered to the SEC by the end of this year. The EDP Unit will be elevated to a departmental level with the approval of ten new key information technology positions by DBM, although this is subject to allocations in the National Budget which has yet to be passed by Congress. Thus, automation at the SEC will be reviewed in the following sections by taking into consideration both current status and immediate plans.

B. OBJECTIVE

The SEC requires technical assistance in enhancing its readiness and capability to manage its hardware and software systems. The objective of these Terms of Reference is to provide the SEC with technical assistance to assist in the development and management of SEC's Strategic Information Systems Plan (SISP) which covers the following:

- o Applications Plan which emphasizes mission-critical functions of SEC, including those that relate to other entities such as the stock exchanges, DTI, investors, etc.
- o Documents Management for improving public-oriented systems services
- o Data Resource Plan to facilitate the integration and maintenance of systems
- o I.T. Management both from an internal and an external perspective
- o Technology Strategy to guide the development and enhancement of systems, including the requirements for linkages with stock exchanges.

The overall objective of the resident I.T. Advisor would be to provide directions for the SEC's automation efforts, and to guide the development of the SEC's overall I.T. capability.

C. SCOPE OF WORK/METHODOLOGY

The I.T. Advisor will provide directions for automation of both the SEC's internal systems and those that link with other external entities such as the stock exchange(s), Department of Trade, etc. He will also provide advice in I.T. management at the SEC. The scope of work includes the following specific tasks:

- o Formulate an SEC strategic information systems plan
- o Identify information linkages with other entities and determine the SEC's role and extent of participation in potential multi-entity systems projects
- o Develop innovative applications of I.T. in the most relevant areas
- o Define an enabling technology environment

- o Develop initial I.T. policies as well as guidelines for reviewing and adjusting them as the SEC progresses through maturity in I.T.
- o Provide technology transfer by advising the MIS Director, particularly if this individual has limited I.T. experience.

Drawing on the services of a Data Modelling Specialist, the I.T. Advisor will also perform a data planning function and facilitate a coordinated and controlled approach to defining and developing applications. A Data Modelling Specialist would provide the information engineering expertise needed for restructuring the SEC's current applications to achieve a cohesive integration of systems, and to facilitate the development of future systems. Specific tasks include:

- o Review current data
- o Develop an entity relationship model
- o Define subject areas
- o Develop data architecture down to the logical and physical design level.

C. DELIVERABLES

For the long-term advisor, specific deliverables include:

- a. Strategic Information Systems Plan (SISP) which defines:
 - (1) Areas of potential strategic advantage
 - (2) SEC applications portfolio
 - (3) Application development strategy for each application
 - (4) General technology options
 - (5) Implementation plan.
- b. Computer Configuration Study, including a needs assessment of:
 - (1) SEC Head Office

- (2) SEC Regional Offices
 - (3) Data communications requirements.
- c. I.T. Management Study, including:
- (1) Identification of management services and skills required to support target I.T. environment
 - (2) Recommendations regarding appropriate I.T. organizational structure and staffing level
 - (3) Specification of an I.T. training plan
 - (4) Recommended policies and standards for planning and management control, project management, system development and maintenance, end-user support, data administration and technical support.

In the area of data modelling, specific deliverables include:

- o Entity-relationship model
- o Logical and physical data models
- o Data dictionary
- o Evaluation and selection of computer-assisted software engineering tool (CASE) tools
- o Training of selected SEC I.T. staff on CASE tool.

APPENDIX G

Draft Terms of Reference

Pre-Project Short-Term Technical Assistance
to the Exchanges and the SEC
in Developing a New Automated Securities Market System

TERMS OF REFERENCE
TECHNICAL ASSISTANCE TO THE EXCHANGES AND THE SEC
IN DEVELOPING A NEW AUTOMATED SECURITIES MARKET SYSTEM

1. BACKGROUND

The Philippine capital market is characterized by a debilitating "crisis of confidence" whereby the Philippines finds itself falling further behind other emerging markets that at one time looked to its stock markets for leadership and example, and a fundamental lack of liquidity in the marketplace rooted in inefficient order execution and high transaction costs, among other factors. The inefficiencies in current trading, clearing and settlement procedures, which are based on extraordinarily antiquated processes and systems, represent a major factor holding back the development of the market.

There are also serious misconceptions on the part of the key parties--the exchanges and the SEC--regarding the costs associated with making a significant breakthrough in the development of the market. These misconceptions include the need for substantial investments in real estate and computer hardware and software--requiring significant donor subsidy--in order to convert to a new automated system for trading, clearing and settlement. There are also misconceptions regarding the need for an exchange floor, the value of the open-outcry system, and the value of physically merging the current organizations and systems of the exchanges.

Despite these difficulties, the exchanges and the SEC have defined similar objectives to developing the Philippine capital market: a unified national marketplace; automated trading, clearing and settlement (preferably on an integrated basis); professionalized exchange management; and strengthened SEC rules and regulations to permit the SEC to more effectively regulate the market. To date, however, despite a number of written resolutions and other various indications of intent, there has been remarkably little progress in working toward these objectives. This has been due, in large part, to a lack of hard, state-of-the art information, generated by an independent outside party, about automation options, system capabilities and associated costs upon which to make sound, economically viable and joint decisions of long-term importance to the development of the market.

The Private Enterprise Support (PESO) office of USAID/Philippines is currently in the process of designing a capital market development project which will, working primarily through the private sector, provide various types of assistance--technical assistance, training and equipment--to assist in developing the Philippine capital market. In view of the current, pressing need on the part of the exchanges and the SEC for information on reorganization and automation options in order to constructively move the process forward, USAID, at the request of the exchanges and the SEC, is considering funding an interim, pre-project technical assistance engagement, as described below.

2. OBJECTIVES

The overall objective of this technical assistance engagement is to provide the key parties--the exchanges, other appropriate private sector intermediaries, and the SEC--with information upon which to base decisions on the soundest and most economically-viable course of action to develop a new Philippine securities market system. The intent is for all parties to establish a consensus and unified commitment to creating a single automated national trading system, consistent with the needs of the Philippine market, that most effectively serves the public interest and the needs of capital market participants--both domestic and international--and that facilitates the ability of the SEC to carry out its supervisory responsibilities.

This technical assistance would provide facilitative and resource expertise to the exchanges and the SEC to examine, evaluate, and make considered judgments about the kind of system they want, what they want it to do, and how to implement the system of their choice, with the aim of encouraging a consensus that would best serve the growth of the Philippine capital market, the interests of the public, and the objectives of the exchanges and the SEC.

Specific objectives include:

- o In full consultation with each party, to define the requirements and specifications of a single automated national trading system--including computer-based trading, clearing, settlement and back-office capability--that would serve the operational needs of both exchanges, and help the SEC carry out its regulatory responsibilities.
- o To provide the exchanges and the SEC with a full examination of the alternatives available and their associated costs, benefits, operational functions, and mechanics, including an analysis of which capabilities and features would be most responsive to the unique needs and opportunities of the Philippine capital market.
- o To evaluate alternative methods of organizing, financing and managing the provision of an automated system, including the possibility that all required systems, services, hardware and software could be financed on a self-paying, commercial basis; i.e., as a "for-profit" service company which provides a competitive return on investment.
- o To define the transition process (all key planning and action steps) that the exchanges and the SEC would need to undertake once they choose to convert to an automated system of their choice.

3. SCOPE OF WORK

Working Group. The TA Team will report to a specially-created workgroup composed of officially-designated officials of the stock exchanges, the SEC and possibly other private sector groups. The members of this working group will be responsible for making recommendations to and developing a consensus and commitment within their respective organizations regarding the most appropriate way to proceed. Once joint decisions are taken by the working group, as consented to by each organization's respective decision-making bodies, these would be fully binding.

Tasks. The scope of work contains the following three tasks:

1. Design: Define the system design and preliminary specifications
2. Organization: Define alternative organization and management structures and financing options
3. Action Plan: Define key planning and action steps to manage the transition process.

Task 1: System Preliminary Design and Specification

The objective of this task is to define the requirements and preliminary specifications of an integrated computerized trading, settlement, clearing and central depository system which is most responsive to the unique needs and opportunities of the Philippine capital market, is consistent with the recommendations of the Group of Thirty and the standards of other applicable international organizations, and best serves the members of both exchanges and the public. Specific subtasks and points of analysis required under this task include:

Subtask 1.1 Determine Legal/Business Feasibility. This includes a analysis of the following types of issues within the Philippine context:

- o Centralized custody
- o Dematerialized securities
- o Book-entry settlement
- o Fungibility of shares
- o Suitability of Philippine trust law

- o Transaction credit (to achieve pre-settlement)
- o Relationships between central custodian, service company, and exchanges
- o Relationships between brokers and securities accounts in the central custodian
- o Use of trading floor and communication limitations
- o Relationships with international and other domestic markets
- o Ways of broadening the product line of broker-dealers (e.g., underwriting services, fund management, trading in fixed-interest securities)
- o Conformance to international standards.

Subtask 1.2: Determine Technical Feasibility. This includes a preliminary system definition, specifications, software/hardware requirements, and costs for:

- o A new trading system
- o Central depository/clearance/settlement system(s)
- o The integration of the systems
- o A preliminary location/site analysis
- o A preliminary communications feasibility analysis.

Subtask 1.3: Define Regulatory Requirements/Compliance Needs. This includes:

- o Assessing current rules and regulations to determine which will be affected under the new system
- o Identifying new rules and regulations which will be required under the new system
- o Revising current affected rules and regulations
- o Drafting new required rules and regulations.

Subtask 1.4: Report/Briefing Preparation. The preliminary system specification and research results should be put in an appropriately-formatted report for consideration and decision by the working group.

Task 2: Organization, Financial, Business Plan Development

This task will evaluate the alternative methods of organizing, financing and managing the provision of a fully integrated and automated trading, settlement and back-office system capability, as jointly determined by the working group in Task 1. The objective is to present and develop a consensus on a professionally-designed business plan to implement this new system. To the maximum extent possible, the investment required in the new system should be financed by vendors, business interests, and participants on a commercial basis. Specific subtasks and points of analysis required under this task include:

Subtask 2.1: Define Exchange Organization and Management Structure. For the exchange(s), review/propose the most appropriate:

- o Structure/procedures of governing body
- o Structure/procedures of professional management group
- o Proposed articles of association including membership, administration, and self-regulatory functions
- o Other elements, as appropriate.

Subtasks 2.2: Define the Organization and Management Structure of the Central Depository. For the central depository and custodian, analyze/propose the most appropriate:

- o Ownership structure
- o Capitalization structure
- o Organization and management structure
- o Descriptions/staffing/training requirements
- o Broker compliance requirements and responsibilities
- o Operational rules
- o Guarantee system
- o Other elements, as appropriate.

Subtask 2.3: Define the Organization and Management Structure of the Service Company. For the service company, analyze/propose the most appropriate:

- o Ownership structure

- o Capitalization structure
- o Organization and management structure
- o Descriptions/staffing/training requirements
- o Broker compliance requirements and responsibilities
- o Operational rules
- o Guarantee system
- o Other elements, as appropriate.

Subtask 2.4: Develop a Financial and Operational Plan.

Develop a computer model that provides financial information on a cash-flow basis in order to justify the feasibility of, and define the options for financing a fully automated securities exchange system. The model should generate financial and operational statements for an autonomous exchange, an average brokerage firm, custodian bank and service company. Specific analytical steps include:

- o Define assumptions based on a review of the current operations and the proposed automated system as defined in Task 1.
- o Gather data through research and interviews with securities industry professionals, securities exchange staff, potential suppliers of computer systems, potential custodians, etc.
- o Develop a preliminary model based on specific assumptions regarding the operations and organizational structure of each entity under the proposed system
- o Refine the model based on presentations to the participating entities
- o Prepare a written explanation of the model and its assumptions
- o Prepare a range of financing options for the system and and the elements of an overall financial plan.

Subtask 2.5: Report/Briefing Preparation. Prepare a report containing the results of this overall task, including a proposed business plan/strategy.

Task 3: Define Action Program

Define the transition process (all key planning and action steps) that the exchanges, other private sector participants and the SEC would need to undertake in order to develop a consensus and manage the process of converting the current securities market arrangements into a mutually agreed-upon re-engineered, automated system. The objective is to define an action program designed to make the new system operational in the shortest possible timeframe in a manner consistent with the realities of implementing such a complex undertaking in the Philippine context. This would involve carrying out the following steps:

Subtask 3.1: Define the roles and responsibilities of each participant under the new system--including the exchanges, broker-dealers, the service company, the central custodian, the SEC, USAID and other donors, etc.

Subtask 3.2: Delineate an overall plan and strategy to implement the system, including time-table and cost elements.

Subtask 3.3: Prepare a report/presentation containing the action program.

4. STAFFING REQUIREMENTS

This engagement will require a complementing, multi-disciplinary blend of domestic and international specialists. Domestic consultant staffing requirements include:

a. Legal Specialist: Will be involved in Task 1 (legal feasibility) and Task 2 (establishment of the exchange, central custodian, service company). Should possess a post-graduate or equivalent professional qualifications and significant experience at a senior level in a reputable firm.

b. Securities Industry Specialist: Will be involved in Task 1 (business feasibility and certain aspects of the technical feasibility), Task 2 (defining organization/management structures of the exchange, central depository and service company; developing the business plan), and Task 3 (defining roles and responsibilities; developing an implementation strategy). Should possess a post-graduate or equivalent professional qualifications and significant experience at a senior level in operating a major securities company in the Philippines.

c. Regulatory Specialist: Working in conjunction with the international regulatory specialist, will be involved in Task 1 (regulatory requirements and compliance needs), and Task 3 (defining roles and responsibilities of the SEC in the transition period). Should possess a post-graduate degree or equivalent

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professional qualifications, as well as senior level experience working in or with the SEC and the private sector.

d. Automation Specialist: Working in conjunction with the international automation specialist, will be involved in Task 1 (technical feasibility), Task 2 (operations of the exchanges, central custodian and service company), and Task 3 (developing an implementation strategy, particularly cost and timing aspects). Should possess a post-graduate degree or equivalent professional qualifications and significant experience in the area of automation/information technology and implementing large-scale information technology systems in the Philippines.

e. Investment Banking/Finance Specialist: Working in conjunction with the international finance specialist, will be involved in Task 2 ("packaging" the overall project/system, and defining financing options) and Task 3 (devising an implementation strategy, particularly the financial aspects). Should possess a post-graduate degree or equivalent professional qualifications in finance, and significant experience in the field of investment banking/finance, ideally in projects involving a high degree of automation.

f. Senior Advisor: It is desirable that a senior advisor respected by all parties participate in the project, primarily to facilitate the process of obtaining consensus. This person should ideally have held senior positions in government, and participated in private sector activities. He would participate in all tasks, particularly in key briefings and presentations, on an as-needed basis.

g. Technical Support: Will provide technical support to all project specialists across all tasks on an ongoing, as-needed basis. Should possess a college degree and prior similar experience on USAID engagements.

International consultant staffing requirements include:

a. Team Leader/Planning Specialist: Will plan, direct and manage the day-to-day activities of all project specialists across all tasks, and serve as the responsible point of contact of the TA team and contractor. Should possess a post-graduate degree (M.B.A.) in strategic planning, organization and/or finance, and significant experience in project management in a developing country context as well as in capital market development.

b. Stock Market Specialist: Working in conjunction with the domestic securities industry specialist, will be involved in Task 1 (business feasibility, some elements of the technical feasibility), Task 2 (defining organization/management structures of the exchange, central depository and service company; developing the business plan), and Task 3 (defining roles and

responsibilities of private sector participants, and developing an implementation strategy). Should possess a post-graduate degree or equivalent professional qualifications, as well as significant experience at a senior level in the general field of stock market management and operations.

c. Regulatory Specialist: Working in conjunction with the domestic regulatory specialist, will be involved in Task 1 (regulatory requirements and compliance needs), and Task 3 (defining roles and responsibilities of the SEC in the transition period). Should possess a post-graduate degree or equivalent professional qualifications and significant senior-level experience in the U.S. SEC, as well as familiarity with capital market regulation in a developing country setting.

d. Automation Specialist: Working in conjunction with the domestic automation specialist, will be involved in Task 1 (technical feasibility), Task 2 (operations of the exchanges, central custodian and service company), and Task 3 (developing an implementation strategy, particularly cost and timing aspects). Should possess a post-graduate degree or equivalent professional qualifications in EDP and significant experience at a senior level of systems analysis in the securities industry, as well as in trading, clearing and settlement systems.

e. Investment Banking/Finance Specialist: Working in conjunction with the domestic investment banking/ finance specialist, will be involved in Task 2 ("packaging" the overall project/system, and defining financing alternatives), and Task 3 (devising an implementation strategy, particularly the financing aspects). Should possess a post-graduate degree or equivalent professional qualifications in finance and significant experience in investment banking and finance, ideally in projects involving a high degree of automation.

f. Financial Planner/Technical Support: In addition to providing ongoing technical support to all team members across all tasks, will be specifically involved in Task 2 (developing a financial model/plan). Should possess an M.B.A. in Finance and have experience in devising a similar financial model and working on USAID engagements.

5. LEVEL OF EFFORT REQUIREMENTS

The estimated level of effort requirements (in person-months) are listed below by consultant category, specialist and task:

	Task 1: Design -----	Task 2: Orgnztn -----	Task 3: Plan -----	Total -----
Domestic consultants:				
Legal Specialist	1.50	1.00		2.50
Securities Industry Spec.	1.00	1.00	0.50	2.50
Regulatory Specialist	1.50		0.50	2.00
Automation Specialist	1.50	1.00	0.50	3.00
Inv. Banking/Finance Spec.	0.00	2.00	0.50	2.50
Senior Advisor	0.25	0.25	0.25	0.75
Technical Support	2.50	2.50	1.00	6.00

International consultants:

Team Leader/Planning Spec.	2.50	2.50	1.00	6.00
Stock Market Specialist	2.00	2.50	0.50	5.00
Regulatory Specialist	1.00		0.30	1.30
Automation Specialist	2.00	1.25	0.50	3.75
Inv. Banking/Finance Spec.	0.00	2.00	0.50	2.50
Fin. Planner/Tech. Support	2.50	2.50	1.00	6.00

6. DELIVERABLE REQUIREMENTS

The deliverable requirements for this engagement are categorized below:

a. Design: Report containing alternative and recommended preliminary system specifications and requirements based on the research results (legal/business feasibility, technical feasibility,, and regulatory needs assessment).

b. Organization: Report containing alternative and recommended organization and management structures for and linkages between the exchange, service company and central depository, as well as a proposed financial and overall business plan and strategy.

c. Action Program: Report containing a proposed action program including specific aaction steps required of each party and an overall plan/strategy to manage the transition to the new system.

d. Monthly Status Reports: Monthly status reports to the working group and USAID will be prepared.

Each report should be presented to the working group on a draft basis for comment prior to finalization. It is also anticipated that a number of interim presentations and memoranda will be required during the course of the engagement.

7. SCHEDULE

The design task should be completed in approximately 3 months, and commence on or about October 1991. The organization task should also be completed in approximately 3 months, and commence subject to the satisfactory completion the design task and a joint decision to proceed. The action plan will require approximately 1 month to complete.