

PHILIPPINES

SECURITIES

SUMMARY

Generally, the Philippine securities market is small compared to markets of the West, and has not grown as fast as its Asian neighbors. Trading tends to be concentrated in government securities, with about half of government paper carrying maturities of less than one year. Other, smaller markets exist for equities, corporate bonds, and mutual and pension funds. There is no futures market and the futures exchange was closed in 1996 due to fraud.

Primary regulatory and oversight responsibility is granted to the Philippines Securities and Exchange Commission, which was established in 1936 and modeled after its U.S. counterpart. Primary responsibility for the oversight of the government securities market, however, is granted to the Department of Finance and the Philippine central bank. There are no restrictions on access to international markets.

Several branches of U.S. banks are active in the foreign exchange and government securities markets, and four U.S. brokerage firms hold seats on the Philippine Stock Exchange, the oldest such exchange in Asia. Restrictions on foreign firms exist in the areas of entry, ownership, and the domestic underwriting and distribution of Philippine securities by firms not domestically licensed. Foreign firms operating in the Philippines participate fully in the legislative process.

DESCRIPTION OF THE MARKET

The markets for private debt and equity are not well developed. Government securities and private sector equities are the dominant instruments in the Philippines' securities market. Long-term commercial paper and corporate bonds have not yet developed into important sources of capital.

Financial institutions in the Philippines include universal banks, which are licensed to broker, deal, and underwrite bonds and equities directly, without the need to establish separate subsidiaries to sell those services. In practice, however, many universal banks maintain separate investment houses for securities-related operations and activities. A few also have separate entities to handle brokerage activities.

Before the law liberalizing the entry of foreign banks was signed in May 1994, universal banking was confined to domestic banks. Since the law took effect, only one foreign bank has started providing securities-related services, although a second has applied.

PHILIPPINES – SECURITIES

Government Securities Market

The Philippine government finances the bulk of its budgetary deficits with short-term debt instruments, usually 91-, 182-, and 364-day T-bills. It has, however, recently begun to issue 2-, 5-, 7-, 10-, and 20-year obligations denominated in pesos; 10-, 20-, 30-, and 100-year obligations denominated in U.S. dollars; and 5- and 7-year securities in yen. All have sold well, despite the Asian financial crisis and the Philippines' recent economic downturn. Some of the bonds carry below-market coupon rates but are reserve eligible and, thus, appeal to institutions with reserve requirements.

Commercial banks dominate both the primary and secondary markets for trading of public sector securities. Since 1986, the government has issued securities by auction. Only accredited dealers can participate in the auction, and most of the 46 dealers are commercial banks. All three U.S. branch banks (Citibank, Bank of America, and Chase Manhattan) are primary dealers.

Possibly because it commands higher interest rates, the over-the-counter secondary market is relatively inactive. The secondary market that does exist is dominated by the top six commercial banks. U.S. financial institutions, such as commercial banks, investment banks, and mutual funds are active investors in Philippine T-bills.

Equity Market

Founded in 1927, the Manila Stock Market is one of Asia's oldest. In 1963, some brokers from the Manila exchange set up a rival exchange in the newer Manila business center, Makati. In 1993, the two exchanges were merged as the Philippines Stock Exchange (PSE).

Although older, the PSE has not progressed as rapidly as the exchanges of other ASEAN member countries. However, the Philippine Central Depository, Inc. (PCDI) has recently taken over the custody of shares being traded at the PSE, permitting scripless trading to take place. In addition, the Securities Clearing Corporation of the Philippines is expected to commence operations in fourth quarter of 1998, thereby facilitating the cash clearing/delivery amongst brokers of the PSE.

As of June 1998, 223 Philippine companies are listed on the PSE, of which some 50 are actively traded. Four firms account for over one-third of the market's US\$30 billion capitalization and dominate the Philippine stock index. Historically, a relatively small number of Filipino families and family-owned/controlled firms have owned the majority of the shares of the listed and actively traded stocks. This leads to a market that is rather thin and susceptible to insider information. Control by a handful of individuals and families is still present through vast cross-holdings over listed and non-listed companies. As such, even a corporate decision to move a large block of shares among themselves is in itself market influencing even without the benefit of insider information. The entry of more IPOs in the market, however, has expanded the breadth of the market and

increased competition to the traditional stocks. And the PSE, through its Compliance, Disclosure, and Surveillance Department, has recently begun to step up efforts trying to control insider trading.

All firms undergo an independent external audit before they are allowed to be listed. An assessment is performed in accordance with Philippine Generally Accepted Accounting Practices (GAAP), which are patterned after U.S. GAAP. Of late, the PSE has vigorously campaigned for transparency, requiring timely and complete disclosures from listed firms.

Participants in the equity market include universal banks, broker-dealers, and investment houses. Universal banks can offer a full range of securities activities. Broker-dealers are limited to brokerage and dealing, and must have minimum net capital (capital minus certain non-liquid assets) of 5 million pesos (US\$125,000), or at least 5 percent of total indebtedness, whichever is higher. Investment houses can participate in a broader range of activities, such as securities underwriting and the provision of consultancy and advisory services. Amendments made to the Investment Houses Act in 1997 require existing investment houses to increase their capital from 100 million pesos to 300 million pesos by November 1999. New investment houses are automatically subject to the 300 million peso minimum capital requirement. Subject to prior Bangko Sentral ng Pilipinas (BSP, or Central Bank) authorization, these entities can also act as investment and portfolio managers. The major underwriters in the domestic market are investment house affiliates of the universal banks.

Corporate Bond Market

Several top-tier corporates have issued Long-Term Commercial Paper (LTCP). LTCPs are typically 3-5 year maturity, with floating interest rates. LTCPs generally are pegged to the 91-day T-bill rate, although some issues are fixed for the term of issue. LTCPs are the primary instruments issued in the domestic capital markets and are an alternative source of funding from commercial banks. A larger number of firms have issued bonds in overseas markets, particularly in the United States, Europe, and Japan.

Mutual Funds and Pension Funds

Mutual funds are available in the Philippines, although they have yet to become popular and the total asset value is relatively small. Broker-dealers are prohibited from managing mutual funds and pension funds. Banks, investment houses, and financial institutions authorized by the BSP to engage in trust, other fiduciary or investment management activities may manage such funds. The minimum capital required for a financial institution to engage in trust activities is 250 million pesos (US\$62 million). Philippine residents may invest freely in offshore mutual funds.

PHILIPPINES – SECURITIES

Futures Market

There is no futures exchange in the Philippines. The Manila International Futures Exchange was closed in June 1996 because of the prevalence of fraud in the market. The Philippines Securities and Exchange Commission (see below) is formulating plans to reestablish a futures exchange under tighter regulations, and has received some design assistance from the U.S. CFTC. It is unlikely an exchange will be formed before 2000. The BSP regulates universal banks who trade over-the-counter derivatives products.

Introduction of New Financial Products

Although new financial products face few legal constraints to their introduction, the Philippine market is relatively unsophisticated and there is little interest in such instruments. The BSP recently granted derivatives licenses to a few foreign and local banks, which will help pave the way to greater risk management in the market.

Regulatory Agencies

Patterned after the American regulatory model, the Philippines Securities and Exchange Commission (SEC) was established in 1936. In addition to its regulatory responsibilities, the SEC registers companies and corporations, keeps and examines records of annual financial statements, and investigates and prosecutes breaches of the Corporation Code. Oversight responsibility extends to underwriters, brokers and dealers, financing companies, and mutual funds. The Department of Finance (through its Treasury Bureau) and the Central Bank oversee the government securities market.

Access to International Capital Markets

Philippine residents not sourcing foreign exchange from the banking system may freely invest offshore without government-imposed limits or approval. If the foreign exchange for investment is obtained from the banking system, the limit is US\$6 million per investor per year. There are no restrictions on the issuance of equity overseas, except for limits on foreign ownership of certain industries prescribed by the Philippine Constitution.

U.S. PRESENCE IN THE MARKET

Branches of U.S. banks operating in the Philippines are active traders of foreign exchange and government securities, including futures. Citibank, a major player in the government securities market, together with Bank of America, are accredited to deal in government securities. Citibank,

Merrill Lynch, Bankers Trust, and Ackerman and Company are U.S. companies with brokerage firms that own seats on the PSE.

TREATMENT OF U.S. FINANCIAL INSTITUTIONS

Securities broker/dealers incorporated under foreign laws are not allowed to operate as branches in the Philippines. They may enter the Philippine securities markets as a wholly-owned, locally incorporated, broker/dealer. In the case of investment houses, which are allowed a broader range of securities activities (i.e., underwriting), foreign participation is limited to 60 percent ownership or less. The foreign ownership limit on firms engaged in trust activities and mutual fund management is 40 percent. After entry, there are no further distinctions made between wholly or partially-owned foreign and domestic firms.

Subject to certain restrictions in the Constitution and the 1991 Foreign Investment Law, foreigners are allowed to own shares in Philippine companies. Before 1991, Philippine law limited foreign ownership in most sectors to 40 percent. Publicly listed companies enforced these limits through the use of two classes of stock: A shares reserved exclusively for Philippine investors and B shares that were available to both Philippine and foreign investors (and traded at a premium). Since 1994, few firms have issued separate classes of shares to restrict foreign ownership and some listed firms have merged their share classes. Some firms operating in industries where foreign ownership is limited (banking, utilities, real estate, etc.) still find the issuance of A and B shares a useful tool for complying with the law.

Foreign financial firms (that is, firms not licensed to operate in the Philippines) can participate in the underwriting and distribution of Philippine security issues in foreign markets, but may not do so in the domestic market. U.S. firms are also able to provide cross-border advisory and brokerage services.

U.S. and other foreign financial service providers operating in the Philippines participate fully in the processes leading to changes in laws and regulations pertaining to such services. Their opinions are solicited and on some occasions they have been asked to testify before the Philippine Congress and to make their views known to legislators and administration officials.

Under the Philippine-U.S. Tax Treaty, the maximum tax rate on interest income that can be imposed on American investors is 15 percent. However, U.S. investors report that, when investing in Philippine government securities, a withholding tax of 20 percent is applied. Obtaining rebate of the 5 percent excess tax withheld is often extremely difficult.

In its schedule of commitments under GATS, the Philippines bound foreign ownership levels that are generally below those allowed under current laws. For investment houses (securities

PHILIPPINES – SECURITIES

underwriting), the Philippines' bound foreign ownership limit is 51 percent (60 percent under existing law). For factoring and financial leasing, the bound limit is 40 percent (60 percent under current law). In insurance (both life and non-life) the bound limit is 51 percent (up to 100 percent allowed under existing law).

Philippine Securities Market		
As of December 31, 1997		
Type of Security	Value (US\$ millions)	Percent of Total
Government Securities	17,757	65.6
<i>of which: Short-Term</i>	9,776	36.1
Capital Market Instruments	9,215	34.0
<i>of which:</i>		
<i>Shares of Stock</i>	7,934	29.3
<i>Long-Term Commercial Paper</i>	1,251	4.6
<i>Bonds, Warrants, and Asset-Backed Securities</i>	30	0.1
Short-Term Commercial Paper	117	0.4
TOTAL	27,089	100

Sources: Philippines Securities and Exchange Commission; Bangko Sentral ng Philipinas; Department of Finance, Treasury Bureau.