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# Country Report of the Philippines

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# OECD Round Table on Capital Market Reform
# Country Report of the Philippines

**Submitted by the Philippine Securities and Exchange Commission**
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Notwithstanding the fact that a high quotient of uncertainty continue to exists as a result of the political shock caused by the previous administration and the 911 (September 11) terrible acts of terrorism which deepened further the ill effects of the of the economic recession that started in CY 2000, the official statistics show that the Philippines displayed newfound strengths which enabled it to survive the serious onslaughts to its economy.

## MACROECONOMIC DEVELOPMENT

For the year 2001, Philippine Gross Domestic Product adjusted for inflation grew 3.4 percent. And as net factor income from abroad (NFIA) rose 9.2 percent, real gross national product increased 3.7 per cent for the same period. This performance surpassed the forecasts of most private analysts and multilateral agencies, which projected the Philippine economy to grow less than 3 percent in 2001.

The economy is now reaping the benefits of structural reforms designed to enhance productivity and market competition such as the Agriculture and Fisheries Modernization Act and the liberalization of the retail trade, telecommunication and utilities. Meanwhile, the government's deficit reduction program has enhanced macroeconomic stability and brought back investor confidence. As an indication of the recovery of investor confidence, the spread on 8 to 25 year sovereign bonds has narrowed considerably from about 600-800 basis points in October 2001 to about 465-535 basis points in January 2002.

Foreign exchange currency reserves are currently at the level of about US$ 15 Billion. One very significant development is the gas and oil production of the Malampaya Project, the output of which is estimated to meet a sizeable amount of the country's fuel needs. The offshore field near Palawan contains 2.7 trillion cubic feet of natural gas and 85 million barrels of "condensate". That is enough to power 25 percent of the country's energy needs. It will cut US$700 Million in oil imports for the Philippines every year. The gas facility, an investment of US$ 4.5 Billion, will provide US$ 13 Billion in royalties during the next two decades. This is the largest ever foreign investment in the country. The Philippine Government is planning to make a public offering of its 10 percent stake in the project, which will definitely benefit the capital market.

The agriculture and service sectors were the major sources of growth. Agriculture, fishery and forestry rose 3.9 percent in 2001 from 3.3. percent in 2000. In addition to good weather, government's revitalized support for agriculture through the distribution of certified seeds, rehabilitation of irrigation facilities and the use of modern equipment especially in the fisheries sector contributed to the strong growth in agriculture.

Services grew a robust 4.3 percent. Supporting the growth was the continued expansion in telecommunications (20.5%), trade (5.6%) and private services (4.4%). The latter rose on the strength of business services (7.9%), medical and health (5.6% and personal services (4.6%).

Industry, hit hard by the retreat of the high technology sector and by the September 11 attack, grew a mere 1.9 percent. Growth decelerated in manufacturing (2.2%) mining (-5.0%) and utilities (3.8%).

Net exports fell 39.9 percent, led by the fall in semiconductors and electronic microcircuits (-28%). This export decline was dampened somewhat by rising agriculture exports such as crude coconut oil (74.1%), banana and plantains meals (51.9%). This growth in agriculture exports also bolstered rural incomes, thereby contributing to the strong consumer demand.

Foreign direct investments (FDIs), in terms of paid-up capital in new and existing domestic stock corporations and partnerships reached Php 3.882 Billion in 2001. By major industry group, wholesale and retail trade and repair accounted for 56.06 percent of total FDI. Financial intermediation was a distant second at 14.50 percent, while real estate, renting and business activities came in third with 13.00 percent.

As the country's productive capacity remained intact after September 11, real GDP increased 3.8 percent in the fourth quarter.

## INFLATION/INTEREST RATE MOVEMENT

Inflation in February 2002 continued to decelerate to 3.4 percent year-on-year from 3.8 percent in January 2002 bringing the year-to-date inflation to 3.6 percent. The February inflation was lower than expected due to mainly to the sustained slowdown in the price increases across all commodity groups particularly, food, beverage and tobacco with the exception of clothing which maintained its year-on-year inflation of 2.8 percent in the previous month.

The inflation data for February affirms further the broad outlook of a benign inflation environment for the rest of the year consistent with the Bangko Sentral's current assessment of the direction of prices in 2002. Based on expectations of restrained demand-pull inflationary pressures as well as favorable supply-side trends particularly in food and energy prices, the average inflation rate for 2002 is expected to settle at least within, if not lower than, the government's target of 5-6 percent.

## CAPITAL MARKET DEVELOPMENT

New historic lows were reached in year 2001 as listless trading persisted in the stock market. Uncertainties over the prospects of the global economy in the aftermath of September 11 terrorist attacks, the continued threat of a global recession, and adverse domestic developments, all conspired to keep investors on the sidelines and caused the market to hit a new, ten-year low.

The 30-stock Composite index, the main barometer of market performance, ended the year at 1,169.08 points, downward trend of 280.41 points or 21.84 percent from the previous year's close of 1,494.50 points. The broader all shares index ended at 682.87 points from the previous year's 829.93 points, a decrease of 17.71 percent.

All sub-indices declined except for the oil sector, which went up by 200 points or 11.56 percent; Banks and Financial services shed 49.06 points or 8.85 percent, to end at 505.02 points. Commercial-Industrial was down to 1,579.39 points, shedding 525.15 points or 24.95 percent. Mining shed 1,308.90 points or 56.41 percent to end at 1,011.29 points, while Property decreased 6.87 points or 1.35 percent to 501.30 points.

Total volume traded decreased to 164.43 billion shares in CY 2001, a decrease of 75.06 percent from the 659.42 billion shares traded last year. Value turnover fell by 55.39 percent to Php 198.10 billion, from Php 367.66 Billion in CY 2000.

Notwithstanding the downtrend in the PSE composite index, the Commission registered capital market instruments amounting to Php 11.30 Billion consisting of the following:

1. Equity securities amounting to Php 3.54 Billion;
2. Commercial papers worth Php 2.50 Billion;
3. Other types of securities (proprietary/nonproprietary membership certificates or shares, timeshares) valued at Php 5.26 Billion.

The top three gainers for the year were:

1. Cosmos Bottling Corporation 5% Conf. Pref. after gaining 185.71 percent or Php 6.50 to close Php10.00.

2. International Container Service, Inc. (ICT) which increased 183.78 percent or Php 1.36 to end at Php 2.10.

3. Cosmos Bottling Corporation (CBC) which rose 154.39 percent or Php 3.52 to settle at Php 5.80.

Other gainers were: Atlas Construction Mining and Development Corp.; RFM Corporation; Republic Cement Corporation; Republic Glass Holdings Corporation and Primetown Property Group, Inc., among others.
The biggest losers were: Waterfront Philippines, Inc. “Warrants”; Fil-Estate Corporation; and Music Corporation which slipped by 98.40 percent, 88.33 percent and 88,21 percent, respectively.

The most actively traded stocks were: Philippine Long Distance Telephone Co. (TEL) closing at Php 417.00; Manila Electric Company “B” (MERB) ending at Php 29.50; and Ayala Land, Inc. (ALI) closing at Php 4.85 with total value traded at Php 20.011 Billion, Php 10.356 Billion and Php 10.356 Billion, respectively.

As of January 21, 2002, the composite index of the PSE shot up to a six-month high of 1,361.94 points, the highest level it reached since July 31, 2001.

## DEVELOPMENT OF MARKET INFRASTRUCTURE

The Philippines Securities and Exchange Commission has pursued a program of corporate governance reforms that ensures the enforcement of best practices standards in the capital market industry.

An Executive Order for signature by her Excellency President Gloria Macapagal-Arroyo has been submitted to Malacanang. Said Executive order institutionalizes the adoption of a policy for the promotion of governance reforms in the Philippine corporate sector and directing the formulation and implementation of corporate governance reform measures. It mandates the Securities and Exchange Commission to do the following:

1. Institute reforms to improve protection of minority shareholders’ rights;
2. Institute reforms to improve internal corporate governance systems;
3. Institute reforms to improve transparency, disclosure and external audits

In line with this program, the Commission made amendments to SRC (Securities and Regulation Code) Rule 68, the Special Accounting Rules, to conform to International Accounting Standards (IAS). Phased amendments in the SRC Rules to incorporate accounting and auditing standards will be made annually until these standards are fully complaint with IAS by 2003.

It is likewise developing a Rating System called SEC MILEAGE, for initial implementation among listed companies, which will warn investors about companies that have weak fundamentals and that rate poorly in corporate governance.

The Commission is in the midst of preparation for an IT-driven and risk-oriented monitoring device called I-Mode. I-Mode tracks the extent to which corporations are complying with laws, policies and rules and regulations, including the recently enacted Anti-Money Laundering Act of 2001 (AMLA).

The AMLA's Implementing Rules and regulations have been approved by the Congressional oversight Committee last March 8, 2002. The Commission's Chairperson sits as member of the Philippines' Financial Intelligence Unit (FIU). As such, the Commission takes a very pro-active stance towards the implementation of the AMLA. In fact, all of the current enforcement actions being undertaken by the Council arose from investigations conducted by the Commission's Compliance and Enforcement Department against boiler room operators and illegal investment contracts operators.

The Commission issued its own Code of Corporate Governance for Registered Issuers and Public Companies. This issuance was made in line with the state policy to actively promote corporate governance reforms aimed to restore confidence, develop the capital market and help achieve high, sustained growth for the corporate sector and the economy. The Draft Code was reviewed in consultation with the public sector and is slated for implementation within the second quarter of the year. The Code prescribes, among others, higher qualification standards for directors, ethical standards for both directors and committees, requirements for accountabilities and reporting and the formation of board committees, such as the Audit and Compliance Committee, the Executive Compensation or Remuneration Committee and the Nomination Committee.

The Commission has likewise proposed the creation of an association of minority stockholders to ensure equitable treatment of shareholders and the prevention of discrimination against minority stockholders.

In reaction to the unusual interference made by the previous administration in the investments decision-making of Philippine institutional investors, the Commission fully supports the proposal that all fiduciary investors make a regular and full disclosure of their investment policies since their primary responsibility is to protect the interests of their members. These fiduciary investors include the Social Security System and the Government Service Insurance System, the two biggest institutional investors in the Philippines.

Still reeling from the effects of the BW case, the greatest market manipulation scandal that the Philippine capital market has ever seen, the Commission pursued violators of securities laws with great determination and fearlessness. The enforcement actions resulted in the collection of Php 30.05 Million in fines and penalties from the infraction of the SRC, the Corporation Code and related laws. Such resoluteness and bravado in the implementation of the laws are deemed crucial and indispensable as it shows the capability of the government to protect the interests of the investors and evokes the confidence that is the anchor for the full development of the capital market.

As of March 2002, the Department of Justice has charged criminally 4 brokers and 5 individuals for the BW market manipulation case. Administrative cases have been filed against other brokers involved in the case.

The Commission has put in its Web page an INVESTOR'S ALERT, warning prospective investors to be skeptical and wary about schemes promising quick high profits and extraordinary returns, invitational investments by phone or even personally from unknown companies. Disclosures by publicly listed companies are also now on SEC's web page and it is intended that financial reporting and disclosure fraud will soon be included.

The Philippine Stock Exchange (PSE) is now a demutualized exchange. This move was mandated by the SRC to ensure better corporate governance and address the "old boys club" image of the PSE through diversification of stock ownership. Each of the 184 PSE members now owns 50,000 PSE shares and trading rights. Any member can sell his shares and retain his trading rights or vice-versa. Members are now called stockholders and trading participants. To date, the provision of the SRC as to the requirement of having non-brokers as majority members of its Board of Directors and the additional requirement that three of them be independent directors are now fully implemented.

One aspect of corporate governance that has been seriously considered is the concept of a single regulator, following the practice of some countries like Singapore. The rationale for this proposal is that when there is more than one regulator over the same activity, "some fall within the cracks". It is expected though that it will take some time before this concept can be accepted since intensive studies and research must be done as to its applicability to the Philippine situation, the final decision of which rests with the Philippine Legislature.

## CONCLUSION

We are continuously reviewing and revisiting our laws and rules and regulations, to ensure effective implementation and enforcement. Several pending bills which have a direct impact on the liquidity and development of the capital market are now undergoing public hearings before our Congress. These bills include the Securitization Act, the Special Purpose Asset Vehicle Act, the Pre-Need Code and the Corporate Recovery Act. Amendments to the Securities regulation Code and the Charter of the Bangko Sentral ng Pilipinas (our Central bank) are likewise pending. All these bills, as well as the reforms already in place and under consideration are part and parcel of the challenge of corporate governance.