The Philippine Capital Market: Issues and Challenges

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I. INTRODUCTION

A capital market is defined as "the market for financial instruments with an initial life of one year or more."[1] The trade in capital markets occurs either in the primary market, usually through an initial public offering (IPO), or in the secondary market, where securities are sold to the public after having been bought by investors through their IPO.[2] Distinguished from money

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1. THOMAS H. MCINISH, CAPITAL MARKETS: A GLOBAL PERSPECTIVE 1 (2000). Some examples of these financial instruments are stocks, bonds, hedge funds, and derivatives.

2. PHILIPPINE STOCK EXCHANGE, INC., KNOWING THE PHILIPPINE MARKET: A GUIDE FOR INVESTORS, INVESTOR'S PRIMER 1: THE PHILIPPINE FINANCIAL

markets, which involve short-term securities (i.e., with a life span of less than a year), capital markets involve the raising of funds through the use of long-term financial instruments in either the bond market or the stock market.[3] The appeal of capital markets lies in the fact that it presents itself as an avenue by which an individual or an institution may raise money at "competitive costs" and "precisely shift risk" through various financial instruments, as opposed to the traditional means of raising funds for capital (i.e., bank loans).[4]

This type of market was born out of major, economically-developed cities[5] and, initially, the products that were traded in them were "limited to primarily stocks and bonds."[6] Currently, however, more complex and sophisticated financial instruments are being traded on an international level.[7] Due to its characteristic growth and the appeal of having the ability to isolate risks in trade, the promise of capital markets to developing countries is therefore unquestionable.[8] Andrew T. Guzman, in his Article[9] on capital market regulation in developing countries, relates the attractiveness of the presence of well-developed capital markets, in this wise:

> Contemporaneously, the size of capital markets has undergone rapid growth. From 1986 to 1997, for example, global stock market capitalization grew from [$4.7 trillion to $15.2 trillion.] In addition, the share of global

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MARKET (1999), *available at* http://fglinc.tripod.com/knowfinmkt.htm (last accessed Aug. 31, 2011).

3. *Id.*

4. Pamela B. Gann, *Foreword for Symposium: International Issues in Cross-Border Securitization and Structured Finance*, 8 DUKE J. COMP. & INT'L L. 229, 229-30 (1998) (citing Thomas K. Hahn, *Commercial Paper*, 79 ECON Q. NO. 2 (Federal Res. Bank of Richmond, Va.), Spring 1993).

5. Gann, *supra* note 4, at 229. *See also* Andrew T. Guzman, *Capital Market Regulation in Developing Countries: A Proposal*, 39 VA. J. INT'L L. 607, 608-09 (1999).

6. Gann, *supra* note 4, at 229.

7. *Id.*

8. Ronald J. Gilson, *Engineering a Venture Capital Market: Lessons from the American Experience*, 55 STAN. L. REV. 1067, 1068 (2003).

   > It is hardly surprising, then, that other countries have sought to emulate American success in developing an effective venture capital market. *At a time when developing countries are increasingly losing manufacturing jobs to low wage countries, and when low wage countries seek industries that depend on more than just cheap labor, creating a venture capital market has become the holy grail of economic development.*

   Id. (emphasis supplied).

9. Andrew T. Guzman, *Capital Market Regulation in Developing Countries: A Proposal*, 39 VA. J. INT'L L. 607 (1999).

> capital markets enjoyed by developing countries increased from less than 4% to 13% between 1986 and 1996. *Recognizing that the rapid growth in both the size of global capital markets and the role of developing countries in those markets represents a tremendous source of funds, many developing countries have sought to improve their local capital markets in order to attract a larger share of global portfolio investment.*[10]

Based on its role in economic growth, one can understand the appeal of having a well-developed capital market in the country. However, a clear picture of the issues to be faced needs to be laid down in order to properly proceed. This Essay aims to discuss the challenges to establishing a developed, well-regulated, competent, and efficient Philippine capital market.

Thus, Part II of this Essay is dedicated to surveying the current Philippine capital market landscape, which includes a look at its development, its strengths, its weaknesses, a survey of laws, pending bills, and government policies, and the institutional underpinnings which currently support its development.

Part III of this Essay, on the other hand, will deal with the issues that the Philippine capital market faces. In this Part, the discussion of the issues being faced will be done on two levels: its competitiveness in relation to other financial markets and the responsiveness of the agencies and institutions tasked with its development.

10. *Id.* at 609 (citing Asli Demirgüç-Kunt & Vojislav Maksimovic, *Stock Market Development & Corporate Finance Decisions*, FIN. & DEV., June 1996, at 47; HAL S. SCOTT & PHILIP A. WELLONS, INTERNATIONAL FINANCE: TRANSACTIONS, POLICY, AND REGULATION 54 (5th ed. 1998); & Malcolm Knight, Developing Countries and the Globalization of Financial Markets 6 (International Monetary Fund Working Paper, July 1998)) (emphasis supplied). Additionally, Guzman writes:

> The development of a local capital market provides a developing country with greater access to both domestic and foreign capital. In addition, a domestic capital market facilitates the task of privatization that continues in many countries around the world. The creation of a well-functioning and liquid secondary market for the shares in newly privatized firms increases the value of the new shares and allows a privatization program to proceed more easily. A domestic capital market also offers domestic consumers a vehicle for savings — savings that can be then directed toward investment. By channeling savings to productive uses, the market encourages local economic activity and reduces the cost of local projects. Finally, the presence of a capital market may make the country more attractive for direct foreign investment.

Id. at 610.

Finally, in Part IV, an analysis of the appropriateness of the responses and solutions presented, in relation to the problems that it wants to resolve, will be done.

II. CAPITAL MARKETS IN THE PHILIPPINES

The Philippine capital market is considered as one of the "oldest in Asia."[11] The birth of capital markets in the Philippines began in the year 1927 through the exchange of mining stocks, followed by oil trade in the 1970s, and a marked growth in the 1980s.[12] Finally, following a merger of two competing stock exchanges in 1994, the Philippine Stock Exchange was born.[13]

In a 2005 World Bank Group study, the Philippine capital market has been described as having a "comparatively well-developed public bond market size ... but the stock market liquidity and efficiency have been very low since 2000."[14] The Philippines stood strong in the face of the 2008 global economic recession, with the Philippines' sovereign bond issue even having been oversubscribed.[15] Thus, the Philippine stock market has been criticized as lagging in "its ability to develop financial mechanisms that allow companies to secure funds from debt issuances."[16]

On the premise that the establishment of a developed capital market in the Philippines lies in the "[successful establishment of] a regulatory regime that meets the needs of investors and issuers will encourage investment in that country — generating capital inflows and encouraging development,"[17] it becomes necessary to discuss and analyze the laws governing and regulating capital markets and financial instruments being traded in the Philippines and the institutions which support and promote its growth, competitiveness, and efficiency.

A. Survey of Laws, Pending Legislation, and Policies

11. Trade Chakra, Capital Markets in the Philippines, *available at* http://www.tradechakra.com/economy/philippines/capital–markets-in-philippines-245.php (last accessed Aug. 31, 2011).

12. *Id.*

13. *Id.*

14. ANNETTE KLEINBROD, THE CHINESE CAPITAL MARKET: PERFORMANCE, PARAMETERS FOR FURTHER EVOLUTION, AND IMPLICATIONS FOR DEVELOPMENT 204 (2006).

15. Philippine Capital Market Conference, *available at* http://moneysense.com.ph/seminars/philippines-capital-markets-conference/ (last accessed Aug. 31, 2011).

16. GMA News Online, *Philippines ranks low in capital market development*, *available at* http://www.gmanews.tv/story/119148 (last accessed Aug. 31, 2011).

17. Guzman, *supra* note 5, at 609.

The first piece of registration to regulate the sale of securities in the Philippines was the Blue Sky Law.[18] In view of the growth of the local stock market at the time, Commonwealth Act (C.A.) No. 83[19] was enacted primarily to "curb fraud, manipulation, and excesses in the stock market, and protect the investing public from exploitation"[20] through a regulatory body called the Securities and Exchange Commission (SEC).[21] C.A. No. 83, which repealed certain provisions of the Blue Sky Law,[22] was, in turn, amended by Batas Pambansa (B.P.) Blg. 178[23] or the Revised Securities Act. Today, the governing law on capital markets in the Philippines is Republic Act (R.A.) No. 8799[24] or the Securities Regulation Code, which aims to

> establish a socially conscious, free market that regulates itself, encourage the widest participation of ownership in enterprises, enhance the democratization of wealth, *promote the development of the capital market,* protect investors, ensure full and fair disclosure about securities, minimize if not totally eliminate insider trading and other fraudulent or manipulative devices and practices which create distortions in the free market.[25]

Other laws have been passed in order to aid the development of the Philippine capital market through "legal and regulatory framework[s]" governing its varied yet interconnected aspects such as providing for "the securitization and [creation] of a favorable market environment for a range of asset-backed securities,"[26] "retirement plans for persons, comprised of

18. An Act to Regulate the Sale of Certain Corporation Shares, Stocks, Bonds and Other Securities, Act No. 2581 (1916).

19. An Act to Regulate the Sale of Securities, to Create a Securities and Exchange Commission to Enforce Provisions of the Same, and to Appropriate Funds Therefor [Securities Act], Commonwealth Act No. 83 (1936).

20. Asia Pacific Economic Cooperation, Securities and Exchange Commission, *available at* http://www.apeccp.org.tw/doc/Philippines/Organization/phorg2.html (last accessed Aug. 31, 2011).

21. Securities and Exchange Commission, Historical Background, *available at* http://www.sec.gov.ph/index.htm?history (last accessed Aug. 31, 2011).

22. Securities Act, § 42.

23. The Revised Securities Act [Revised Securities Act], Batas Pambansa Blg. 178 (1982).

24. The Securities Regulation Code [SECURITIES REGULATION CODE], Republic Act No. 8799 (2000).

25. *Id.* § 2.

26. An Act Providing the Regulatory Framework for Securitization and Granting for the Purpose Exemptions from the Operations of Certain Laws [The Securitization Act of 2004], Republic Act No. 9267, whereas cl. (2004).

voluntary personal savings and investments,"[27] and real estate investment trusts.[28] Additionally, laws in order to amend existing laws[29] and grant additional powers to government institutions[30] have been legislated in order to achieve the same end.

Finally, pending legislation on the development of capital markets include a proposed bill by Senator Eduardo J. Angara on the regulation of collective investment schemes, such as mutual funds and unit investment trust funds, seeking primarily to eliminate regulatory arbitrage[31] and amendments to existing laws on banking,[32] insurance,[33] and land administration.[34]

In keeping with its declared policy to "promote the development of the capital market,"[35] the SEC published a blueprint of objectives and action plans entitled *Capital Market Development Plan: Blueprint for Growth and Expanded Contributions to the Philippine Economy* (CMDC Blueprint). This document aimed to

27. An Act Establishing a Provident Personal Savings Plan, Known as the Personal Equity and Retirement Account [Personal Equity and Retirement Account of 2008], Republic Act No. 9505, whereas cl. (2008).

28. An Act Providing the Legal Framework for Real Estate Investment Trust and for Other Purposes [The Real Estate Investment Trust (REIT) Act of 2009], Republic Act No. 9856, whereas cl. (2001). Real estate investment trusts or REITs are defined as "entities formed for the sole purpose of investing in income-producing real-estate assets and real estate-related securities, such as commercial and residential properties and real estate-secured mortgages." *Id.*; Sylvette Y. Tankiang, *REITs: Key to Philippine capital-market development*, On Firm Ground, BUS. MIRR., A 10 (Dec. 4, 2007) [hereinafter Tankiang]. Viewed as a means of "democratizing the capital market," REITs are intended to "allow [the man on the street] to invest along with the big guys and the landed families." *Id.*; & Mary Ann LL. Reyes, *Democratizing the capital market*, PHIL. STAR, June 11, 2010, *available at* http://www.philstar.com/Article.aspx?articleId= 583232&publicationSubCate goryId=76 (last accessed Aug. 31, 2011).

29. An Act Liberalizing the Philippine Investment House Industry, Amending Certain Sections of Presidential Decree No. 129, as Amended, Otherwise Known as the Investment Houses Law, Republic Act No. 8366 (1997).

30. Authorizing the Central Bank of the Philippines to Engage in Special Borrowing and Lending Operations, Presidential Decree No. 1309 (1978).

31. S.B. No. 49, 15th Cong., 1st Sess., explan. n. (July 1, 2010).

32. S.B. No. 131, 15th Cong., 1st Sess. (July 5, 2010).

33. S.B. No. 53, 15th Cong., 1st Sess. (July 1, 2010).

34. H.B. No. 44, 15th Cong., 1st Sess. (July 1, 2010).

35. SECURITIES REGULATION CODE, § 2.

> [articulate] a series of eleven strategic objectives (and the relevant steps to achieve them) that are intended to stimulate the growth, efficiency, and competitiveness of the Philippine capital market over the next five years (2005-2010) ... [hoping] to create a positive momentum extending well beyond 2010.[36]

These 11 strategic objectives, intended to be viewed and implemented in relation to each other, are grouped into four parts:

> (1) Those requiring primary support from the Philippine Government (e.g., through the implementation of its strategic objectives and encouraging personal savings and private sector investments to the capital market);
>
> (2) Those requiring primary support from private sector market institutions and related operators of the capital market infrastructure (e.g., raising long[-]term[]capital through financial instruments offered to the public and contingency plans for market crashes to ensure its continued operations);
>
> (3) Those requiring primary support from the SEC and other financial sector regulators (e.g., establishing a coordinated, disclosure-based, internationally competent government structure); and
>
> (4) Those requiring joint support from financial regulators and key capital market institutions (e.g., coordinated efforts to establish programs to encourage long-term investments in the Philippines and guard against corporate fraud.[37]

B. Institutional Underpinnings

The CMDC Blueprint indicates that a well-developed Philippine capital market needs coordinated, competent action among institutions in the public and private sector. The discussion in this Part of the Essay shall be limited to the SEC, as the primary regulatory body of capital market transactions, and the Capital Market Development Council (CMDC), as a joint public and private sector initiative on policy reform, and their purpose and powers and functions.

1. Securities and Exchange Commission

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36. SECURITIES AND EXCHANGE COMMISSION, CAPITAL MARKET DEVELOPMENT PLAN: BLUEPRINT FOR GROWTH AND EXPANDED CONTRIBUTIONS TO THE PHILIPPINE ECONOMY 9 (2005), *available at* http://www.sec.gov.ph/blueprint/CMDP%20Blueprint.pdf (last accessed Aug. 31, 2011) [hereinafter BLUEPRINT].

37. *See* BLUEPRINT, *supra* note 36.

The SEC was created in 1936 through C.A. No. 83,[38] with the objective to "strengthen the corporate and capital market infrastructure of the Philippines, and to maintain a regulatory system, based on international best standards and practices, that promotes the interests of investors in a free, fair and competitive business environment"[39] and is tasked to administer the provisions of the Securities Regulation Code.[40] The powers and functions of the SEC include:

...

> (b) Formulate policies and recommendations on issues concerning the securities market, advise Congress and other government agencies on all aspect of the securities market and propose legislation and amendments thereto;
>
> ...
>
> (d) Regulate, investigate or supervise the activities of persons to ensure compliance; [and]
>
> (e) Supervise, monitor, suspend or take over the activities of exchanges, clearing agencies and other SROs[.][41]

These powers and functions of the SEC are reflected in its organizational chart. Its Capital Markets arm is composed of the Market Regulation Department, the Corporate Finance Department and the Non-traditional Securities and Instruments Department[42] with the following directives under the Amended Implementing Rules and Regulations of the Securities Regulation Code:[43]

> (A) The Market Regulation Department develops the registration criteria for all market participants and supervises them to ensure compliance with registration requirement and endorses infractions of the Code and rules and regulations to the Compliance and Enforcement Department.
>
> (B) The Corporation Finance Department registers securities before they are offered for sale or sold to the public and ensures that adequate information is available about the said securities. It also

38. C.A. No. 83, § 3 (a).

39. Securities and Exchange Commission, Mission, Values, and Vision, *available at* http://www.sec.gov.ph//mission,values,vision.htm (last accessed Aug. 31, 2011).

40. SECURITIES REGULATION CODE, § 4.

41. *Id.* § 5.

42. Securities and Exchange Commission, New SEC Organizational Chart (as of December 2001), *available at* http://www.sec.gov.ph/New_SEC_Org.htm (last accessed Aug. 31, 2011).

43. Securities and Exchange Commission, Amended Implementing Rules and Regulations of the Securities Regulation Code (2003).

ensures that investors have access to all material disclosures regarding the said offering and the securities of public companies. The department also monitors compliance by issuers with the Code and rules and regulations adopted thereunder and endorses infractions thereof to the Compliance and Enforcement Department.

(C) The Non-[T]raditional Securities and Instruments Department registers and licenses non[-]traditional securities and instruments including, but not limited to, pre-need plans, commodity futures contracts, proprietary or non-proprietary membership certificates and other similar instruments. It monitors compliance with related rules and endorses infractions thereof to the Compliance and Enforcement Department.[44]

2. Capital Market Development Council

The CMDC is "a public-private sector partnership focused on recommending policy and legislative reforms toward the development of the Philippine capital market."[45] Created through a memorandum of agreement, it is composed of a "consultative group" of different agencies, institutions, and organizations both from the public and the private sector, which include, among others, the SEC, the Department of Finance, the Bangko Sentral ng Pilipinas, the Bankers Association of the Philippines, the Philippine Stock Exchange, the Financial Executives Institute of the Philippines, and the Investment House Association of the Philippines.[46] It is organized in order to "recommend policies for the development of the capital market, and translate such policies into concrete actions and results." In 2008, the CMDC has actively supported seven legislative reforms pending with the 14th Congress which it believe is responsive to the demand of a sustainable investment growth.[47] Currently, four out of these seven reforms are now laws with two pending bills in the Senate.

III. PRESENT ISSUES IN THE PHILIPPINE CONTEXT

A. The Competitiveness of the Philippine Capital Market

In the 2010 Financial Development Report (FDR) of the World Economic Forum, the Philippines ranked 50th out of 57 countries in terms of its

44. *Id.* rule 4.1 A-C.

45. Capital Market Development Council, About Us, *available at* http://cmdc-phil.net/aboutus.htm (last accessed Aug. 31, 2011).

46. Capital Market Development Council, Memorandum of Agreement, *available at* http://cmdc-phil.net/moa.htm (last accessed Aug. 31, 2011).

47. Capital Market Development Council, Statements/Articles, *available at* http://cmdc-phil.net/event.htm (last accessed Aug. 31, 2011).

financial system and capital market development.[48] This ranking is based on an over-all index computed on the basis of the following factors: institutional environment, business environment, financial stability, non-banking financial services, financial markets, and financial access.[49] With the Philippines' strong suits lying in its stable financial currency, mergers and acquisitions, and securitization, the FDR recommends: "improvement is necessary in order to fully translate these strengths into broad financial access."[50]

With regard to its bond market development, the Philippines has an advantage in its public domestic and international bond capitalization to gross domestic product and local currency bond issuance to gross domestic product scores.[51] The FDR, however, cites the scores obtained with regard to equity market development, derivatives markets, and participation in the foreign exchange market as placing the Philippines at a disadvantage to its capital market development.[52]

In comparison to its Southeast Asian neighbors, the Philippine capital market is characterized as "small" and "lagging" in terms of market capitalization to gross domestic product ratio, dealing with high transaction costs and low liquidity rates.[53] Following public debt securities, the Philippines is still heavily reliant on banking deposits as reflected by its financial assets in 2008.[54] In other words, the bulk of "developmental finance" is actually leveraged from short-term funds."[55] This financial challenge to developing the local capital market is presented in this wise:

> Today, the Philippines' debt securities market remains almost synonymous with the market for government securities, since public debt issues capture over 90 [%] of the market for debt instruments. The corporate bond market

48. WORLD ECONOMIC FORUM, THE FINANCIAL DEVELOPMENT REPORT 2010 11 (2010), *available at* http://www.weforum.org/reports/financial-development-report-2010 (last accessed Aug. 31, 2011).

49. *Id.* at 12-13.

50. *Id.* at 22.

51. *Id.* at 217.

52. *Id.*

53. Srinivasa Madhur, Capital Market Development in Emerging East Asia: Present Issues and Challenges (A Presentation for the 9th OECD–ADBI Roundtable on Capital Market Reform in Asia), *available at http://*www.oecd.org/dataoecd/61/17/40147105.pdf (last accessed Aug. 31, 2011).

54. WORLD ECONOMIC FORUM, *supra* note 48, at 214.

55. Johnny Roe E. Ravalo, Ph.D., The Philippine Capital Market Reform Agenda Module 1: Financial Market Core Principles and an Enabling Environment (A Techinical Report Submitted to the United States Agency for International Development) 1, *available at* http://pdf.usaid.gov/pdf_docs/PNADH617.pdf (last accessed Aug. 31, 2011) [hereinafter Ravalo].

is virtually non-existent. With the debt securities market mainly a fund-generating market for the government, and the equities market a virtual mirror of conditions from within and outside the system, the traditional loan market remains the market of choice for both providers and users of capital funds. *Due to the underdeveloped state of the domestic capital market, the banking system has been bearing a disproportionately large part of the burden of financing economic development as well as fiscal deficits, which has rendered the system highly vulnerable to changes in interest rates.*[56]

B. The Sovereign's Role: Is It Responsive?

1. Is there a sufficient legal framework?

In terms of contract enforcement, the Philippines still scored a development disadvantage with regard to the effectiveness of its law-making bodies.[57] Additionally, the country is faced with the challenge of globalization and its responsiveness and ability to regulate the influx of evolving types of market products.[58] Guzman underscores the importance of securities regulation in capital markets in developing countries by stating that, "[i]n order to attract capital, it is necessary to have a set of substantive legal rules in place that meets the needs of issuers and investors. In other words, a market needs a set of clear, well functioning, and reliable securities laws."[59]

Aside from market regulation, responsive financial governance and policies are imperative because

> [c]apital markets are particularly sensitive to the chosen framework of governance and policy. This is because this framework affects the structure of incentives — which in turn affects behavior — over a longer period of time. Furthermore, the same framework reflects the policy inclinations and

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56. Diwa C. Guinigundo, The Philippine financial system: issues and challenges (A Research Paper Submitted to the Bank for International Settlements) 302, *available at* http://www.bis.org/publ/bppdf/bispap28t.pdf (last accessed Aug. 31, 2011) [hereinafter Guinigundo] (emphasis supplied).

57. WORLD ECONOMIC FORUM, *supra* note 48, at 215.

58. Guinigundo, *supra* note 56, at 302. The failure to keep up with the influx of new market products through regulation exposes the system to an increased risk of regulatory arbitrage.

> Over time, innovation and globalization have given rise to new business structures and 'hybrid' products that no longer fit squarely with the traditionally regulated institutions. This has created significant scope for regulatory arbitrage that has also encouraged conglomerated financial organizations.

Id.

59. Guzman, *supra* note 5, at 617-18 (citing Gerhard Pohl et al., Creating Capital Markets in Central and Eastern Europe 125 (World Bank Technical Paper No. 295, 1995)).

priorities of the financial supervisors which itself outlines an actionable business agenda for market participants.[60]

In Part II.A of this Essay, a survey of Philippine laws, pending legislation, and policies was presented in order to ascertain the legal background under which the capital market operates. Operating on the established premise of the importance of regulations and financial policies to a well-developed capital market and the problems that an unresponsive legal framework presents, the question of the responsiveness and effectiveness of the laws and policies in the earlier enumeration simply follows.

The introduction of laws governing asset-backed securities, personal equity and retirement accounts (PERAs), and REITs and the pending bills on the regulation of collective investment schemes to minimize regulatory arbitrage signal an upswing in the responsiveness of the Philippine government in accommodating these new types of capital market products. The enactment of and support behind these laws indicate the recognition that there are more to capital markets than the securities[61] currently covered by the Securities Regulation Code and the need to open the market to accommodate not only institutions but individuals, as well.

Although the current legal framework indicates attempted responsiveness to the current state of the Philippine capital market, the question of its proper and effective enforcement remains.

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60. Ravalo, *supra* note 55, at 56.

61. The Securities Regulation Code defines securities as:

> shares, participation or interests in a corporation or in a commercial enterprise or profit-making venture and evidenced by a certificate, contract, instruments, whether written or electronic in character. It includes:
>
> (a) Shares of stocks, bonds, debentures, notes evidences of indebtedness, asset-backed securities;
>
> (b) Investment contracts, certificates of interest or participation in a profit sharing agreement, certifies of deposit for a future subscription;
>
> (c) Fractional undivided interests in oil, gas or other mineral rights;
>
> (d) Derivatives like option and warrants;
>
> (e) Certificates of assignments, certificates of participation, trust certificates, voting trust certificates or similar instruments;
>
> (f) Proprietary or nonproprietary membership certificates in corporations; and
>
> (g) Other instruments as may in the future be determined by the Commission.

SECURITIES REGULATION CODE, § 3.1.

> In addition to the problem of choosing a strategy to develop a set of substantive rules, developing countries face the problem of funding the enforcement of these rules. Whatever rules are chosen, they must be enforced. An initial problem is that the institutions required to support the rules cost money. Developing countries may simply lack the funds to ensure that the rules remain effective. Furthermore, the public bodies charged with enforcing regulations may suffer from an understaffing of regulatory offices, a lack of expertise and training, or corruption. *The result in many developing countries is that the existing securities laws are systematically underenforced.* The enforcement of securities regulations in developed countries typically relies on sophisticated administrative oversight and review which requires considerable expertise and funding. Any attempt to develop local regulatory systems requires consideration of the administrative actions that are necessary to enforce the substantive laws.[62]

2. Are the regulatory bodies and public and private sector initiatives efficient?

In Part II.B of this Essay, the roles of the SEC, as a regulatory body, and the CDCP, as a joint public and private sector initiative, were underscored. The question of their effectivity as institutions geared toward the development of the Philippine capital market follows. One critique of Philippine regulatory bodies involved in capital markets is the lack of coordination among them.

> [T]here is a need for the major regulators (the [Bangko Sentral ng Pilipinas], the [SEC], the Office of the Insurance Commission (OIC), and the Philippine Deposit Insurance Corporation (PDIC)) to coordinate their policies and procedures more seamlessly and share information in order to effectively discipline financial markets and financial institutions. However, coordination is hampered by differences in institutional capacity among regulators.[63]

However, it should be important to note that from a change in its organizational structure,[64] a revision of "its overall approach to regulation"[65] and its lauded efforts in establishing a policy of "increased transparency and

62. Guzman, *supra* note 5, at 620-21 (citing Paolo Clarotti, *The EU as a Model for Financial Reform*, *in* JOSEPH J. NORTON & MADS ANDENAS, EMERGING FINANCIAL MARKETS AND THE ROLE OF INTERNATIONAL FINANCIAL ORGANIZATIONS 15, 22 (1996) and Steven M. Fries, *Financial Reform and Development in Transition Economies and the Role of IFIs*, *in* NORTON, *supra* note 62, at 65-66) (emphasis supplied).

63. Guinigundo, *supra* note 56, at 302.

64. USAID Center for Development Information and Evaluation, Developing the Philippines' Capital Market (A Report Submitted to the United States Agency for International Aid, *available at* http://pdf.usaid.gov/pdf_docs/PNACA 933.pdf (last accessed Aug. 31, 2011).

65. *Id.*

disclosure,"[66] the SEC has come a long way from its inception in 1936. Certainly, developing a well-regulated capital market in the Philippines in the face of all the issues hereinbefore presented is a daunting task. In view of the active steps taken by the SEC to respond to the task at hand, credit should certainly be given.

The CMDC, on the other hand, is criticized for a "lengthy" and "continuously expanding" inventory of reforms and policy measures.[67] In line with its publication of the CMDC Blueprint, the SEC has published annual progress reports on the objectives and corresponding action plans for the years 2005-2010.[68] However, it should be noted that the currently available progress reports only reach the year 2008. Despite this, recognition should be awarded to the fact that many of the legislative reforms the Council has actively pushed for were enacted into law. The fact that there are voluminous records of reforms and policy measures where the CMDC rallies behind seems to only underscore the fact that much still needs to be done with regard to capital market development in the Philippines.

IV. ANALYSIS OF THE CHALLENGES FACED IN ESTABLISHING A DEVELOPED PHILIPPINE CAPITAL MARKET

The CMDC Blueprint recognizes that many steps need to be taken in order to achieve the end goal of having a truly well-developed Philippine capital market. The challenges of developing the Philippine capital market seem to lie in the following areas: (a) a persistent, heavy reliance on bank deposits and the traditional loan market as a means for raising funds, with sovereign bond issue making up the most of the country's financial assets; (b) lack of

66. Ravalo, *supra* note 55, at 60. The steps that the SEC has taken towards reforms in the availability of information is well-received.

> It is still too early to tell what the full effect of this initiative will be towards developing a self-sustaining capital market. What is already clear though is that this approach is the most far-reaching of all capital market initiatives heretofore. Beyond the fundamental shift in market structure, it is by far the most visible signal of an organized effort for fixed income products. There is an explicit interest to develop the public market, carving out the organized venue to the level of retail investors. The specific responsibilities of the various market intermediaries, among themselves and to the investor base, have also been defined to establish universal standards in lieu of bilateral arrangements.

Id.

67. *Id.* at 1.

68. *See* Securities and Exchange Commission, Publications, *available at* http://www.sec.gov.ph/blueprint (last accessed Aug. 31, 2011).

financial mechanisms to encourage the trade of debt and equity issuances; and (c) underenforced regulations and policies.

The response to these challenges seems to be further legislation, to both introduce and accommodate new financial instruments in the market (such as the PERA, REITs, and collective investment schemes) and policy-making (such as the CDMC Blueprint). Although they ideally respond to the need for the creation of a well-regulated, competent, and efficient capital market, its effects in responding to the issues and challenges abovementioned are yet to be seen. However, it can also be argued that most of these laws and reforms were enacted only last year, with some still existing as pending bills.

Guzman points this out as a problem faced by many developing countries seeking to establish a developed capital market: "The development of a home grown regime, therefore, is a strategy that would take many years to bear fruit — a delay that developing countries would like to avoid."[69] He expounds:

> [T]he difficulty with developing a complete set of securities rules from scratch is obvious. It has taken developed countries many years to develop their capital market regulations and there is little reason to think that a developing country could develop its own rules more quickly or without confusion, uncertainty, and crises. Among the pitfalls for a country that seeks to develop an indigenous set of laws are: the risk that political forces within the country will lead to an outcome that is poorly suited to the needs of capital markets, the difficulty of getting market participants to expend the resources necessary to learn the new law, the danger that a lack of experience in the drafting of securities laws will lead to serious mistakes and oversights, and the problem of creating institutions for effective enforcement for a new and untested regime.[70]

It can be argued that the introduction of PERAs and REITs respond to the problem of a heavy and persistent reliance on traditional loan markets as the primary means of raising capital for it opens participation in the trade within the capital market and thus encourages local economic activity. On the other hand, the presence of the CMDC Blueprint and the pending bills for reform, particularly the introduction of the regulation of collective investment schemes, indicate a continued response to the need for providing legal frameworks and policies for new capital market products and their trade within the country. As regards the problem of underenforced regulations and policies compounded with the constraint of time, it seems that this is a problem that developing countries with relatively small capital markets cannot avoid. The actions of the SEC, particularly in its change of regulatory strategy and increased transparency, together with the CMDC, indicate a

69. Guzman, *supra* note 5, at 620.

70. *Id.*

continued, competent response to the challenge of establishing a well-developed Philippine capital market.

It is submitted that in order to aid in cultivating the presence of a well-developed Philippine capital market, a continued move away from reliance on traditional loan markets and sovereign bond issues is imperative. A "democraticized"[71] Philippine capital market is also necessary to encourage local economic growth. Finally, a continued cooperation between the SEC, the CMDC, and lawmakers is essential in achieving a regulatory regime and legal framework and policies that are both conducive to the establishment of a well-developed Philippine capital market and responsive to the issues it currently faces.

71. Tankiang, *supra* note 27.