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# Regulatory Measures Affecting Services Trade and Investment: Financial Services

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# Regulatory Measures Affecting Services Trade and Investment: Financial Services

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## Abstract

An efficient regulatory framework is a pre-requisite for developing a services market that supports competitiveness and offers opportunities for export diversification. Creating such a framework requires a comprehensive understanding of the laws, regulations, and practices affecting trade and investment in services currently in place (Molinuevo and Saez, 2014). The importance of an efficient regulatory framework in the financial services sector especially needs to be highlighted, given its systemic importance which makes it one of the most highly regulated sectors in the economy

The objective of this study is to foster the development of the Philippines' financial services sector by strengthening the regulatory framework for trade and investment. Based on an assessment of laws and regulations affecting trade and investment in financial services, the study provides recommendations to reduce the regulatory burden in, while ensuring adequate regulation of, financial services trade and investment.

In particular, this study provides the background on the state of the financial services sector in the Philippines; identifies the key issues related to its further development or deepening in order to meet the needs of consumers and businesses; analyzes the regulatory issues that impede its further development/deepening; and proposes reforms to reduce unnecessary regulatory burdens in the sector, in particular by highlighting the role of trade and investment agreements in helping to bring about necessary domestic regulatory reforms.

Key recommendations that flow from the review of the state of the industry and regulations include among others:

1. There is a need to correct the inconsistencies in individual legislations covering the financial services sector (e.g., inconsistency between ownership and management structures) and inconsistencies across legislations;
2. Overall, there is a need to align domestic regulations, as well as mindset, with the objectives of financial liberalization;
3. Domestic regulations also need to be aligned with the country's FTA/regional commitments particularly with respect to national treatment, as detailed in Annex I of the report;
4. Review and rationalize/streamline the taxes and other fees imposed on financial instruments and transactions;
5. Promote the regulatory sandbox approach by other financial regulators, together with BSP.
6. Develop the BSPs vision of an inclusive financial system, which builds on the vision presented in the Philippine Development Plan 2011-2016, into a full-fledged long-term strategic action for the Philippine financial sector.
7. Finally, while not directly addressed by the study, the role of prudent fiscal policy is also important in the development of the financial sector.

**Keywords:** financial services, trade, investment, regulations, regulatory barriers to competition, unnecessary regulatory burdens, financial inclusion, financial technology

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***Geminiano L. Sandoval Jr. and Melanie S. Milo[1]***

## 1. Introduction

### *1.1. Brief description of the study*

The services sector is the biggest sector in the economy and is recognized as the "glue that binds all sectors together" in the government's Comprehensive National Industry Strategy (CNIS). Efficient and competitive services are critical for improving the agricultural sector and supporting the continued growth of the industrial sector. Services are also emerging as a new driver of global trade, which could provide additional export opportunities especially for developing countries like the Philippines.

An efficient regulatory framework is a pre-requisite for developing a services market that supports competitiveness and offers opportunities for export diversification. Creating such a framework requires a comprehensive understanding of the laws, regulations, and practices affecting trade and investment in services currently in place (Molinuevo and Saez, 2014). The importance of an efficient regulatory framework in the financial services sector especially needs to be highlighted, given its systemic importance which makes it one of the most highly regulated sectors in the economy.

Thus, this study will:

a. Update the horizontal or cross-cutting laws and regulatory measures affecting trade and investment in the services sector undertaken in an earlier study on the regulatory measures affecting services trade and investment in the distribution, multimodal transport, and logistics services (Barcenas et al 2017);
b. Map laws and regulatory measures affecting trade and investment in financial services;
c. Identify: (i) legal, regulatory, and administrative restrictions to trade and investment in financial services; (ii) potential inconsistencies between existing laws and regulations and obligations in World Trade Organization (WTO) or other trade agreements; and (iii) missing laws and regulations needed to ensure the adequate functioning of the financial services sector and implement commitments in trade agreements;
d. Propose guidelines and an action plan for implementing such policy measures by the relevant government agencies and other relevant actors; and
e. Propose reforms of existing laws and regulations where needed.

The mapping and assessment of the laws and regulatory measures aim to deepen our understanding of the rationale behind the various measures, enhance transparency and clarity on the regulatory regime in the Philippines, increase awareness on the extent of the barriers, and serve as a useful guide in identifying priorities for reform.

[1] Consultant/Legal Specialist and Consultant/Financial Sector Specialist, respectively, Philippine Institute for Development Studies. The usual caveat applies.

### *1.2. Objective and significance of the study*

This study is a follow-up to an earlier study on the regulatory measures affecting services trade and investment in the distribution, multimodal transport, and logistics services (Barcenas et al 2017).

The objective of this assessment is to foster the development of the Philippines' financial services sector by strengthening the regulatory framework for trade and investment. Based on an assessment of laws and regulations affecting trade and investment in financial services, the study will provide recommendations to reduce the regulatory burden in, while ensuring adequate regulation of, financial services trade and investment.

In particular, this study will provide the background on the state of the financial services sector in the Philippines; identify the key issues related to its further development or deepening in order to meet the needs of consumers and businesses; analyze the regulatory issues that impede its further development/deepening, including harnessing its export potential; and propose reforms to reduce unnecessary regulatory burdens in the sector, in particular by highlighting the role of trade and investment agreements in helping to bring about necessary domestic regulatory reforms. Ultimately, the goal is to help identify where the country's negotiating interests - both offensive and defensive - lie in the area of financial services. The role of advancements in information and communications technology (ICT) in the provision of and innovation in financial services, as well as its regulatory implications will especially be highlighted.

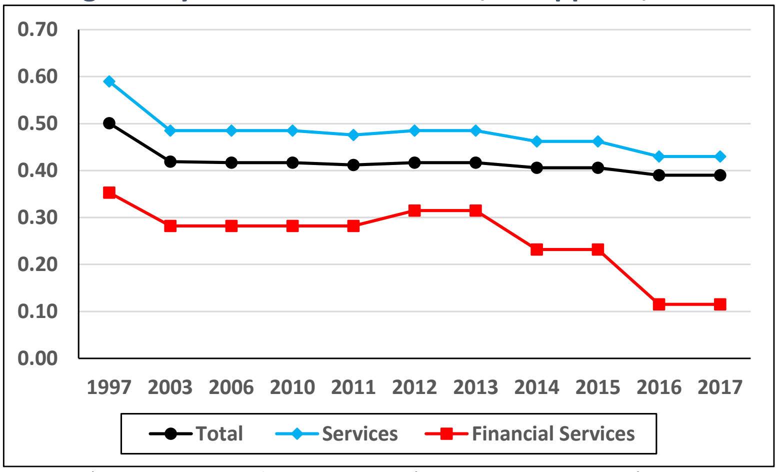
This study supports national priorities and complements other government initiatives. In particular, the Philippine Development Plan 2017-2022 articulated the necessity of removing restrictions in the economy to expand economic opportunities in the country. This will entail amending restrictive economic provisions in the Constitution; repealing or amending regulations that impose restrictions on foreign participation in certain economic activities; and enhancing the competitiveness of the industry and services sector by ensuring that regulations promote fair competition and trade. The Plan also recognizes the need to improve the business climate by implementing structural reforms to create more open, well-functioning, transparent, and competitive markets as well as by simplifying rules and regulation on business registration and licensing.

The study's regulatory mapping is also aligned with Project Repeal launched by the National Competitiveness Council (NCC) in March 2016. Project Repeal is a government-wide regulatory reform initiative to repeal outdated rules and reduce the cost of doing business. The mission is to review irrelevant, burdensome, and unnecessary laws/issuances imposed on businesses and citizens, which adversely affect the country's global competitiveness ranking and investment climate.

Barcenas et al (2017) noted that foreign direct investment (FDI) restrictions in the Philippines are high by both regional and global standards, based on the most recent FDI Regulatory Restrictiveness Index (FDI Index) calculations of the Organisation for Economic Co-operation and Development (OECD 2016). The FDI Index is a tool for measuring and benchmarking countries' statutory restrictiveness on FDI. If the FDI Index is broken down by sector or industry, the result indicates that FDI in the services sector is even more restricted compared to overall FDI restrictiveness. However, financial services in the Philippines is fairly open and even more so in recent years (Figure 1).

It should be noted that the FDI Index scores overt regulatory restrictions on FDI, but does not take into account other aspects of the regulatory framework that may also impinge on the overall FDI environment, such as the nature of corporate governance, the extent of state ownership, and other institutional or informal restrictions. That is, the objective of the methodology is to capture regulatory restrictiveness, but it does not attempt to assess the overall restrictiveness of the regulatory regime as it is actually implemented (Kalinova et al 2010). Thus, a more in-depth regulatory audit would help to clarify the true extent of openness of financial services in the Philippines.

**Figure 1. OECD FDI Regulatory Restrictiveness Index, Philippines, 1997-2017**




Note: The highest score is 1 (meaning FDI is fully restricted) and the lowest is 0 (meaning there are no regulatory impediments to FDI).
Source: OECD International Direct Investment Statistics: OECD FDI regulatory restrictiveness index (https://data.oecd.org/fdi/fdi-restictiveness.htm; Accessed on 1 December 2018).

### *1.3. Organization of the report*

**Chapter 2** reviews the different regulations which affect trade and investment in the services sector in general. It examines the various impediments that a firm faces, grouped according to 12 key policy and regulatory areas. **Chapter 3** focuses on the financial services sector. It provides an overview of the financial services covered, their economic significance, the institutional setting, and sector performance. The key regulations that affect trade and investment in this sector are then discussed, followed by a discussion of the critical issues and concerns arising from the review of the performance of the financial services sector and its regulatory framework. It concludes with some recommendations to address the issues and concerns identified.

## 2. Analysis of horizontal laws and regulations affecting trade and investment in the services sector

### *2.1. Business entities allowed to do business in the Philippines, in general*

Under Philippine laws, doing business, including in services trade, is generally subject to certain legal requirements to operate, and regulatory oversight to ensure that businesses are conducted in a manner that meets the State's policy objectives. Entities doing business in the Philippines may take the form of a single proprietorship, partnership, or corporation. The general characteristics, registration requirements and general requirements to operate for these entities are briefly discussed below.

2.1.1. Primary registrations

*2.1.1.1. Sole proprietorship.* A sole proprietorship is the oldest, simplest and most prevalent business enterprise. It is an unorganized business owned by one single person.[2] A sole proprietorship does not possess a juridical personality separate and distinct from the personality of the owner of the enterprise. But prior to doing business, the sole proprietor must first register a business name by which his business will be known with the Department of Trade and Industry (DTI).[3] Such registration is required to: (a) provide protection to the public dealing with a business establishment through disclosure of the identity of the identity and citizenship of the person owning the business; and (b) to prevent a business establishment from using a name that is identical or confusingly similar to the name of another business establishment.[4]

The law merely recognizes the existence of a sole proprietorship as a form of business organization conducted for profit by a single individual and requires its proprietor or owner to secure licenses and permits, register its business name, and pay taxes to the national government.[5]

Generally, a sole proprietor uses his own funds to finance his business. In the event he takes out a business loan in a bank or any other financing institution, he shall use his own properties for collateral, and shall be primarily liable for the payment of said loan. In addition, the sole proprietor is personally liable for all the debts and obligations of the business.[6] Hence, the personal properties of the sole proprietor shall answer for the debts and obligations of the business enterprise.

*2.1.1.2. Partnership.* By the contract of partnership two or more persons bind themselves to contribute money, property, or industry to a common fund, with the intention of dividing the profits among themselves.[7] The partnership has a juridical personality separate and distinct from that of each of the partners.[8] Generally, a partnership may be constituted in any form, whether verbally or in writing, except where immovable property or real rights are contributed. Where such assets are contributed, the partnership agreement must appear in a duly notarized document (i. e., a public instrument).[9]

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[2] *Excellent Quality Apparel, Inc. vs. Win Multi Rich Builders, Inc., represented by its President, Wilson G. Chua*, GR No. 175048, 10 February 2009.

[3] Act No. 3883, Sec. 1, as amended by Act No. 4147. It shall be unlawful for any person to use or sign, on any written or printed receipt, including receipt for tax on business, or on any written or printed contract not verified by a Notary Public, or on any written or printed evidence of any agreement or business transactions, any name used in connection with his business other than his true name, or keep conspicuously exhibited in plain view in or at the place where his business is concluded, if he is engaged in a business, any sign announcing a firm name or business name or style, without first registering such other name, or such firm name, or business name, or style, in the Bureau of Commerce (now Department of Trade and Industry) together with his true name and that of any other person having a joint or common interest with him in such contract, agreement, business transaction, or business.

[4] DTI Department Order No. 10-01, Series of 2010 (Revised Implementing Rules and Regulations of Act No. 3883, as Amended , Otherwise Known as the Business Name Law), Rule I, Sec. 1.

[5] *Ibid.*

[6] *Excellent Quality Apparel, Inc. vs. Win Multi Rich Builders, Inc., represented by its President, Wilson G. Chua,* GR No. 175048, 10 February 2009.

[7] Civil Code of the Philippines, Art. 1767.

[8] Civil Code of the Philippines, Art. 1768.

[9] Civil Code of the Philippines, Art. 1771.

In addition, a partnership with a capital of three thousand pesos (P3,000.00) or more, whether in money or property, must be registered with the Securities and Exchange Commission (SEC).[10]
The partnership assets shall answer for the contractual obligations of the partnership, entered into in its name and for its account. After all the partnership assets have been exhausted, and the partnership debts have not yet been fully settled, the partners shall be liable pro rata with all their properties.[11] However, in a limited partnership, the limited partners are not personally liable for the obligations of the partnership.[12] The limited partner shall be liable only up to his capital contribution.

As to its object, a partnership may either be universal or particular. A universal partnership may either refer to all present property or to all the profits. In universal partnership of all present property, the partners contribute all properties belonging to them to a common fund, with the intention of dividing the same and all profits earned from them, among themselves. All the properties owned by the partners at the time of the constitution of such partnership, and all profits earned from them, become the common property of all the partners. On the other hand, a universal partnership of all profits consists all the properties or earnings that the partners may acquire from their industry or work during the existence of the partnership. If the articles of partnership do not indicate its nature, it is considered a universal partnership of all profits.[13]

A particular partnership has for its object determinate things, their use or fruits, or specific undertaking, or the exercise of a profession or vocation.[14] Among the most common type of particular partnership are general professional partnerships, which are partnerships formed by persons for the sole purpose of exercising their common profession.[15] Another is a joint venture.

The legal concept of a joint venture is of common law origin. While it has no precise legal definition, it has been generally understood to mean an organization formed for some temporary purpose. Under the common law, a partnership contemplates a general business with some degree of continuity, while a joint venture is intended to execute a single transaction. This make joint ventures temporary in nature. However, under Philippine law, since the laws of partnership include a particular partnership that may be created for a specific undertaking, it covers joint ventures. Thus, joint ventures are governed by the law on partnerships.

A joint venture is the most common entity formed to execute large infrastructure contracts either for the government or as a private undertaking. In some instances several partners form a consortium, where one party provide the financing, another the industry, and another the operation and maintenance of the finished works. For these types of arrangement, the parties either execute a joint venture agreement (or consortium agreement) or form a joint venture corporation. While generally, corporations cannot form partnerships, the Supreme Court has held that a corporation may engage in a joint venture.[16] This means that the relationship between the joint venture partners as well as their relationship with the rest of the world is governed by the law on partnership. However, if a joint venture corporation is formed, it will need to comply with the provisions of the Corporation Code with respect to, among others, the

[10] Civil Code of the Philippines, Art. 1772.
[11] Civil Code of the Philippines, Art. 1816.
[12] Civil Code of the Philippines, Art. 1843.
[13] Civil Code of the Philippines, Art. 1777 to 1781.
[14] Civil Code of the Philippines, Art. 1783.
[15] Tax Code, Section 22(B).
[16] Information Technology Foundation of the Phil. V. Commission on Elections, G. R. No. 159139, January 13, 2004, citing Aurbach, et al. v. Sanitary Wares Manufacturing Corporation, et al, G, R. No. 75875, 15 December 1989, 180 SCRA 130

requirements for incorporation (such as the requirement to have at least 5 incorporators), reporting requirements after incorporation, and meeting requirements.

*2.1.1.3. Corporation.* A corporation is an artificial being created by operation of law, having the right of succession and the powers, attributed, and properties expressly authorized by law or incident to its existence.[17] It has a personality separate and distinct from its stockholders. It may be established either by registering with the Securities and Exchange Commission (SEC) in accordance with the provisions of the **Corporation Code**, or by **special law**. [18] Those created by special laws are governed by the provisions of these laws and supplemented by the Corporation Code, as may be applicable.[19]

Corporations created under the Corporation Code may either be stock or non-stock. Stock corporations are corporations with capital stock divided into shares and authorized to distribute to the holders of such shares dividends or allotments of the surplus profits on the basis of the shares held. [20]

While there are generally no minimum authorized capital stock required for stock corporations (except as specifically provided for by special law),[21] they are required to subscribe to at least 25% of their authorized capital stock and paid at least 25% of such subscription, which should in no case be less than PhP5,000.00.[22] However, various laws regulating certain specific industries impose minimum paid-in capital requirements to entities operating within these industries. These will be discussed in greater detail below on the analysis of existing regulatory barriers to services trade.

The incorporators of a corporation should not be not less than five (5) but not more than fifteen (15) natural persons. They must all be of legal age and a majority should be residents of the Philippines. Each of these incorporators must own or be a subscriber to at least one (1) share of the capital stock of the corporation.[23]

The board of directors of the corporation is authorized to exercise all the powers granted by law to the corporation, conduct its business and control its assets. The stockholders of the corporation periodically elect such board.[24] The powers of the board to oversee the operations of the corporation include the election and appointment of its officers. Such officers may consist of the president, who should be a director; a treasurer who may or may not be a director; and a secretary, who must be a resident and citizen of the Philippines. The corporate by-laws may provide for other officers designated to manage the corporation. The officers of the corporation may hold any two more positions concurrently, except that no one shall act as president and secretary or as president and treasurer at the same time.[25]

Non-stock corporations, on the other hand, are corporations whose capital are not divided into shares and are not authorized to distribute surplus profits to its members on the basis of shares held are non-stock corporations. [26] These corporations are usually non-profit corporations

[17] Corporation Code of the Philippines (BP Blg. 68), Sec. 2.
[18] Corporation Code of the Philippines (BP Blg. 68), Sec. 14.
[19] Corporation Code of the Philippines (BP Blg. 68), Sec. 4.
[20] Corporation Code of the Philippines (BP Blg. 68), Sec. 3.
[21] Corporation Code of the Philippines (BP Blg. 68), Sec. 12.
[22] Corporation Code of the Philippines (BP Blg. 68), Sec. 13.
[23] Corporation Code of the Philippines (BP Blg. 68), Sec. 10.
[24] Corporation Code of the Philippines (BP Blg. 68), Secs. 23 and 24.
[25] Corporation Code of the Philippines (BP Blg. 68), Sec. 25.
[26] Corporation Code of the Philippines (BP Blg. 68), Sec. 3.

formed or organized for charitable, religious, educational, professional, cultural, fraternal, literary, scientific, social, civic service, or similar purposes, like trade, industry, agricultural and like chambers, or any combination thereof.[27] For purposes of this report, we will only focus on stock corporations organized for profit or public corporations mandated to perform public functions.

#### 2.1.2. Secondary registrations

After securing their primary registrations, to lawfully do any business, these business entities are required to secure a barangay clearance[28] and a mayor's permit[29] from the local government where their principal businesses are located. They are also required to register as taxpayers with the Bureau of Internal Revenue (BIR).[30] In addition they are required to register as employers and their respective employees with the Social Security System (SSS),[31] Philippine Health Insurance Corporation (PHIC),[32] and the Home Development Mutual Fund (HDMF) for Pag-IBIG Fund,[33] for purposes of securing for their employees the mandatory social benefits provided by law.

### *2.2. Analysis of Philippine horizontal laws and regulations affecting business entities engaged in services trade*

To operate in the Philippines, business entities need to meet various regulatory requirements, some of which apply to specific industries to meet certain State policy objectives. Among the objectives that regulations aim to achieve is to safeguard against market failures, such as imperfect and asymmetric information, lack of competition, and natural barriers to entry. This is true for the services sector. However, such regulations have, in some instances, created barriers to entry to certain market players and been used as protectionist measures, which in turn prevent the Philippines from fully benefiting from market competition and productive market activity. Thus, the challenge to Philippine regulators is to adopt the best regulatory approach to accomplish legitimate policy objectives, without unnecessarily impeding services trade.

This section will analyze regulations generally affecting services trade and determine whether they pose a barrier to entry even if applied equally among market players or whether different treatment among these market players pose a barrier to entry. Where the service involve foreign market players, we will view the regulations as they affect the four modes of supply of services, namely:

a. Mode 1 or **cross border trade** is defined under the WTO Trade in Services Agreement as the supply of a service from the territory of one Member to the territory of another Member.[34] It is analogous to goods traded and involves producing services in one country to be consumed in another;

[27] Corporation Code of the Philippines (BP Blg. 68), Sec. 88.
[28] Local Government Code of 1991 (LGC), Sec. 152 (c) which states, "Barangay Clearance – No city or municipality may issue any license or permit for any business or activity unless a clearance is first obtained from the barangay where such business or activity is located or conducted. For such clearance, the sangguniang barangay may impose a reasonable fee. The application for clearance shall be acted upon within seven (7) working days from the filing thereof. In the event that the clearance is not issued within the said period, the city or municipality may issue the said license or permit.
[29] Local Government Code of 1991 (LGC), Sec. 455 (b)(3)(iv), which states, "Issue licenses and permits and suspend or revoke the same for any violation of the conditions upon which said licenses or permits had been issued, pursuant to law or ordinance;"
[30] National Internal Revenue Code (NIRC), Sec. 236 (A)(2).
[31] Republic Act No. 8282 (Social Security Law), Secs. 2, 9 and 9-A.
[32] Republic Act No. 7875, as amended by RA 9241 and RA 10606, Sec. 5.
[33] Republic Act No. 9679, Sec. 6.
[34] WTO Trade in Services Agreement, Art. I:2(a).

b. Mode 2 or **consumption abroad** is defined as the supply of a service in the territory of one WTO Member to the service consumer of another WTO Member.[35] It occurs when consumers travel across borders to consume services;
c. Mode 3 or **commercial presence** is defined as the supply of service by a service supplier of one WTO Member, through commercial presence in the territory of any other WTO Member.[36] It occurs when the producer of a service establishes a local presence in the country where the consumer is located; and
d. Mode 4 or **temporary movement of labor** is defined as the supply of service by a service supplier of one WTO Member, through presence of natural persons of a WTO Member in the territory of any other Member.[37] It occurs when the producer travels across borders to provide a service. (Molinuevo and Saez 2014).[38]

Our review of these horizontal laws and regulations is divided into 12 policy and regulatory areas. To better understand how regulation and its implementation impact the entry and operation of the various business entities, Appendix A outlines the binding authority of various laws, rules and regulations, the authority to issue the same and the power to implement them.

#### 2.2.1. Business registrations

The World Bank in its Doing Business reports measures the impact of business registration requirements on businesses, among others. In particular the Starting a Business indicator records all procedures officially required or commonly done in practice, for an entrepreneur to start and formally operate an industrial or commercial business, as well as the time and cost to complete these procedures and the paid-in minimum capital requirement.[39] The Philippines is 171st out of 190 economies in the Starting a Business indicator in 2017. This is extremely low and indicates how difficult it is to start and operate a business in the Philippines compared to the other surveyed economies.

While the methodology for the Starting a Business indicator covers only limited liability companies, the procedures that takes the most time to complete cover common registration requirements among the different business entities discussed above, i. e., single proprietorship, partnership and corporation. These are for registrations with: (a) the local government, which takes an average of 8 days; and (b) the BIR, which takes 12 days. As a result, the number of procedures and the time it takes to complete these in the Philippines totaled 16 procedures and 28 days, respectively. This is lower than the numbers for the East Asia and Pacific, which are 7 procedures and 23.9 days respectively. These procedures by themselves pose a barrier to entry into the services trade sector, particularly with respect to Mode 3, in relation to cross-border services trade.

#### 2.2.2. Number of incorporators

As noted above, a corporation needs to have at least five (5) incorporators who are natural persons before it can be established and organized. This poses certain difficulties to new entrants that may deter entry and expansion into the services trade sector in the Philippines for

[35] WTO Trade in Services Agreement, Art. I:2(b).
[36] WTO Trade in Services Agreement, Art. I:2(c).
[37] WTO Trade in Services Agreement, Art. I:2(d).
[38] *See* Molinuevo, M. and S. Saez. 2014. *Regulatory Assessment Toolkit: A Practical Methodology for Assessing Regulation on Trade and Investment in Services (*2014). Washington, D. C.: International Bank for Reconstruction and Development/World Bank. 1.
[39] Starting a Business Methodology, Doing Business, World Bank, Available at: http://www.doingbusiness.org/Methodology/Starting-a-Business. Accessed May 17, 2017.

the following reasons:

a. Single investors, whether individual or corporate, face the added difficulty of looking for at least 4 nominee shareholders to meet the incorporation requirement, even if these shareholders are not necessary either for e financing or business operations.
b. Foreign investors intending to invest in the Philippines, and who are unfamiliar with Philippine culture and its business environment may be exposed to untrustworthy nominee shareholders who have easy access to confidential business matters and could potentially cause damage to the investors, whether financial or otherwise. This affects Mode 3 in the modes of supply of services.
c. It discourages entrepreneurs from establishing corporations, which will allow them to enter the formal sector and gain better access to financing. By default, entrepreneurs, especially small entrepreneurs choose a single proprietorship. This places them at greater financial risk, as single proprietors are personally liable for business debts unlike corporations or limited partnerships where the shareholders or partners are liable only up to the extent of their capital contribution in the corporation or partnership.

#### 2.2.3. Rules on shareholder and board meetings

Section 51 of the Corporation Code provides that "stockholders' or members' meetings, whether regular or special, shall be held in the city or municipality where the **principal office of the corporation is located**, and if practicable in the **principal office of the corporation**." The Securities and Exchange Commission interpreted this to mean that the shareholders must be in the **same** place during the meeting.

In SEC Opinion No. 16-01, the SEC declared that teleconferencing, either through video conferencing, computer conferencing or audio conferencing, for shareholders' meetings do not meet the requirement for meeting in the location of the principal office of the corporation or in the principal office itself. It notes that in teleconferencing, the participants are in different places although their communication with each other is facilitated through an electronic medium. It can only facilitate the linking of people but it does not alter the complexity of group communication. Although it may be easier to communicate through teleconferencing, it may also be easier to miscommunicate. In the SEC's opinion, teleconferencing cannot satisfy the individual needs of every meeting.

In addition, the SEC also noted a previous opinion where it stated that, "in cases where the law requires a duly called meeting to carry out a corporate transaction, 'constructive' or 'electronic presence is not a substitute for 'actual presence.'"[40]

However, in the case of Board meetings, the SEC allows these to be conducted via teleconferencing or videoconferencing. It cites Section 53 of the Corporation Code, which allows Board meetings to be held anywhere in or outside the Philippines.[41]

This inconsistent treatment of corporate meetings creates additional cost to shareholders (who could also be the directors of the company) especially foreign or non-resident shareholders who may need to travel to the Philippines for annual shareholders' meetings. While these shareholders can assign proxies to attend these meetings, there is a greater risk of miscommunication when using proxies than if shareholders themselves attend via

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[40] Ltr. To Wilma M. Valdemoro-Cua dated September 10, 1993; SEC Opinion addressed to Ms. Ma. Pelita B. Donato-Viliran dated August 4, 1998, citing SEC Opinion addressed to Atty. Victo Africa dated March 25, 1981.

[41] *See* SEC Memorandum Circular No. 15, series of 2001 dated November 20, 2001.

teleconferencing.

This requirement may materially affect a foreign or non-resident investor's decision to invest in the Philippines if a comparable economy in Southeast Asia provides greater facility for corporate decision-making than in the Philippines.

#### 2.2.4. Foreign investment

The Foreign Investments Act of 1991 (Rep. Act 7042), as amended by Rep. Act No. 8179, allows 100% foreign equity ownership in Philippine industries that meet the following conditions:

a. Export enterprises that export at least 60% of their output or products purchased domestically;[42] and
b. Domestic enterprises with:
    - US$200,000.00 or more paid-in capital; or
    - US$100,000.00 or more paid-in capital, if they deal in advanced technology as determined by the Department of Science and Technology, or employs at least 50 employees.[43]

Foreign entities may establish a local presence through a subsidiary, branch, representative office, regional operating headquarters, and regional or area headquarters. These entities may do business in the Philippines by either registering a subsidiary domestic corporation, or securing a license to do business in the Philippines as a branch, representative office, regional operating headquarters or regional or area headquarters with the SEC.

There is no general rule or principle governing what constitutes "doing" or "engaging in" or "transacting" business in the Philippines under Philippine law with respect to a foreign corporation. Each set of acts or works of an enterprise must be judged by its own set of peculiar circumstances. The term, however, implies a continuity of commercial dealings and arrangements and contemplates the performance of acts or works or the exercise of some of the functions normally incident to, and in progressive prosecution of, the purpose and object of a foreign corporation's organization.[44] The FIA and its implementing regulations cites the following as examples:

a. Soliciting orders, service contracts, opening offices, whether liaison offices or branches;
b. Appointing representatives or distributors, operating under full control of the foreign corporation;
c. Domiciled in the Philippines or who in any calendar year stay in the country for a period or periods totaling one hundred eighty (180) days or more; and
d. Participating in the management, supervision or control of any domestic business, firm, entity or corporation in the Philippines.[45]

The FIA also cites the following acts, as not deemed to be "doing business" in the Philippines:

a. Mere investment as a shareholder by a foreign entity in domestic corporations duly registered to do business, and/or the exercise of rights as such investor;

[42] Rep. Act 7042, Secs. 3(e) and 6.
[43] Rep. Act 7042, Secs. 3(e), 7 and 8.b.2, 2nd par.

[44] Mentholatum Co., Inc. v. Mangaliman, G. R. No. 47701, June 27, 1941; *See* Rep. Act No. 7042, as amended by Rep. Act No. 8179, Section 3 (d); Implementing Rules and Regulations of Rep. Act No. 7042, Section 1(f).
[45] Rep. Act No. 7042, as amended by Rep. Act No. 8179, Section 3 (d); Implementing Rules and Regulations of Rep. Act No. 7042, Section 1(f).

b. Having a nominee director or officer to represent its interests in such corporation;
c. Appointing a representative or distributor domiciled in the Philippines which transacts business in the representative's or distributor's own name and account;
d. The publication of a general advertisement through any print or broadcast media;
e. Maintaining a stock of goods in the Philippines solely for the purpose of having the same processed by another entity in the Philippines;
f. Consignment by a foreign entity of equipment with a local company to be used in the processing of products for export;
g. Collecting information in the Philippines; and
h. Performing services auxiliary to an existing isolated contract of sale which are not on a continuing basis, such as installing in the Philippines machinery it has manufactured or exported to the Philippines, servicing the same, training domestic workers to operate it, and similar incidental services.[46]

For the acts that are not deemed "doing business" in the Philippines, as enumerated above, the foreign entity is not required to either register a subsidiary or secure a license to do business in the Philippines, even while they perform these acts in relation to transactions in the Philippines.

*2.2.4.1. Foreign-owned domestic corporation.* Under various Philippine statutes and regulations, a subsidiary or a majority-owned subsidiary is generally a corporation 50% or more than 50% of the voting stock of which is owned or controlled directly or indirectly through one or more intermediaries by another corporation, which thereby becomes its parent corporation.[47] It is established and registered to do business in the Philippines under Philippine corporation laws. Such subsidiary, even if owned by a foreign entity, is considered a domestic corporation.

These subsidiaries, if not operating in nationalized industries (See discussion in item F below), may operate either as an export enterprise as defined under the FIA at a minimum capitalization of PhP5,000.00[48] or as a domestic enterprise for a minimum capitalization of USD100,000 or USD200,000, as the case may be.

In contrast, domestic corporations owned by Philippine citizens need not comply with the export requirement for export enterprises or the minimum capitalization requirement for domestic enterprises owned 100% by foreign entities. This places a greater burden on foreign entities investing in the Philippines. This burden is justified by the FIA in its declaration of policy, to wit:

> "It is the policy of the State to attract, promote and welcome **productive investments from foreign** individuals, partnerships, corporations, and governments, including their political subdivisions, in activities, which **significantly contribute to national industrialization and socio-economic development to the extent that foreign investment is allowed in such activity by the Constitution and relevant laws**. Foreign investments shall be encouraged in enterprises that **significantly expand livelihood and**

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[46] Rep. Act No. 7042, as amended by Rep. Act No. 8179, Section 3 (d); Implementing Rules and Regulations of Rep. Act No. 7042, Section 1(f).
[47] Rep. Act 2629 (1960), or the Investment Company Act, Section 3(s), for publicly listed corporations; Revenue Regulations No. 17-10 (*Consolidated Regulations Implementing Republic Act No. 7646, An Act Authorizing the Commissioner of Internal Revenue to Prescribe the Place for Payment of Internal Revenue Taxes by Large Taxpayers and Prescribing the Coverage and Criteria for Determining Large Taxpayers*), Section 3.10, for tax purposes; Pres. Decree No. 2029 (1986), Defining Government-Owned or Controlled Corporations and Identifying their Role in National Development, Section 2, for government-owned and controlled corporations.
[48] *See* Corporation Code of the Philippines (BP Blg. 68), Sec. 13.

> **employment opportunities for Filipinos**; enhance **economic value of farm products**; promote the **welfare of Filipino consumers**; expand the scope, quality and volume of **exports and their access to foreign markets**; and/or **transfer relevant technologies in agriculture, industry and support services**. **Foreign investments** shall be welcome as a **supplement to Filipino capital and technology** in those enterprises serving mainly the **domestic market**.
>
> As a general rule, there are no restrictions on extent of foreign ownership of export enterprises. In domestic market enterprises, foreigners can invest as much as one hundred percent (100%) equity except in areas included in the negative list. Foreign owned firms catering mainly to the domestic market shall be encouraged to undertake measures that will gradually **increase Filipino participation in their businesses** by taking in Filipino partners, electing Filipinos to the board of directors, implementing **transfer of technology** to Filipinos, **generating more employment** for the economy and **enhancing skills of Filipino workers**."[49] (Emphasis Supplied)

Based on the above, the entry of foreign investments in the Philippines is intended to achieve the following policy objectives:

a. It significantly contributes to national industrialization and socio-economic development to the extent that foreign investment is allowed by the foreign ownership restrictions imposed by the Constitution and other applicable laws;
b. It significantly expands livelihood and employment opportunities for Filipinos, as well as enhance the skills of Filipino workers;
c. It enhances the economic value of farm products;
d. It promote the welfare of Filipino consumers;
e. It expands the scope, quality and volume of exports and their access to foreign markets;
f. It transfers relevant technologies in agriculture, industry and support services;
g. It supplements Filipino capital and technology in the domestic market; and
h. It increases Filipino participation in the businesses of the foreign entities.

Whether the policy tool adopted to achieve the objectives of the FIA, i.e., the requirements for foreign ownership in export and domestic enterprises, together with the Constitutional and statutory foreign ownership limitations in certain industries, effectively accomplishes the above policy objectives, must be assessed by examining their impact on the economy, including on labor market skills, technology development, export development, and consumer welfare.

As it is, the differences in treatment under the FIA of Philippine-owned enterprises and foreign-owned enterprises pose a significant barrier to foreign-owned enterprises.

*2.2.4.2. Foreign corporations.* A foreign corporation is an entity organized and existing under the laws of a foreign country whose laws allow Filipino citizens and corporations to do business in its own country or state.[50] Foreign corporations are allowed to do business in the Philippines by securing a license to operate in the Philippines through the SEC,[51] either as a: (a) branch office; (b) representative office; (c) regional or area headquarters; or (d) regional operating headquarters.

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[49] FIA, Section 2.
[50] BP Blg. 68, Section 123.
[51] Batas Pambansa Blg. 68 (1980), the Corporation Code of the Philippines, Sections 123, 125 to 126.

a. A branch office of a foreign company carries out the business activities of the foreign head office and derives income from the Philippines.[52] To do business and derive income in the Philippines through a branch office, such foreign company must secure a license to transact business with the SEC, subject to the following conditions:
   - The laws of the country of incorporation of the foreign corporation allow Filipino citizens and corporations to do business in such country;
   - The foreign corporation is in good standing;
   - The foreign corporation is solvent and in sound financial condition;
   - The foreign corporation has secured an authority from the applicable Philippine regulatory government agency having jurisdiction over the industry where foreign corporation intends to do business in the Philippines;[53]
   - Once it secures a license from the SEC, the branch office may continue to operate within the Philippines as long as its foreign head office retains its corporate registration in its country of incorporation; and
   - To provide reasonable assurance that the branch office is capable of settling its obligations incurred in the Philippines, a branch office is required to deposit and maintain securities (e. g., Philippine government securities, shares of stocks in domestic corporations) with the SEC at any given time amounting to 2% of the amount by which a licensee's gross income for a given fiscal year exceeds PhP5 million.[54]

   A branch office of a foreign company is an extension of such company in the Philippines. Thus, it is considered a 100% foreign owned enterprise. To operate in the Philippines, in addition to the securities it is required to deposit and maintain with the SEC, a branch must also comply with the FIA requirements for either an export or domestic enterprise for non-nationalized industries. As a 100% foreign owned enterprise, it cannot by itself engage in any of the nationalized industries, unless it enters into a joint venture with Philippine companies and maintain the percentage of foreign ownership allowed by the applicable law in such joint venture.

b. A representative or liaison office deals directly with the clients of the foreign corporation but does not derive income from the Philippines and is fully subsidized by such corporation. It undertakes activities such as but not limited to information dissemination and promotion of the company's products as well as quality control of products.[55] It is required to remit an initial capitalization of USD30,000.00 as working capital and maintain a resident agent in the Philippines.

   A representative office performs limited functions. It cannot engage in the operations of the foreign corporation's business in the Philippines, except for the activities indicated above.

c. A regional or area headquarters (RHQ) is an office whose purpose is to act as an administrative branch of a multinational company engaged in international trade which principally serves as a supervision, communications and coordination center for its subsidiaries, branches or affiliates in the Asia-Pacific Region and other foreign markets. It does not earn or derive income in the Philippines[56] and does not participate in the management or operations of any subsidiary or branch of its foreign head office in the Philippines. It is also required to remit and maintain a working capital of USD50,000.00 for operating expenses.

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[52] Implementing Rules and Regulations of Rep. Act No. 7042 (Foreign Investments Act), Section 1(c).
[53] Batas Pambansa Blg. 68 (1980), the Corporation Code of the Philippines, Section 125.
[54] Batas Pambansa Blg. 68 (1980), the Corporation Code of the Philippines, Section 126.
[55] Implementing Rules and Regulations of Rep. Act No. 7042 (Foreign Investments Act), Section 1(c).
[56] Executive Order No. 226, as amended by Rep. Act No. 8756, Section 2.2.

d. A regional operating headquarters (ROHQ) is a foreign business entity that is allowed to derive income in the Philippines by performing qualifying services to its affiliates, subsidiaries or branches in the Philippines, in the Asia-Pacific Region and in other foreign markets.[57] The services that an ROHQ may provide to its regional affiliates, subsidiaries and branches are:
   - General administration and planning;
   - Business planning and coordination;
   - Sourcing/procurement of raw materials and components;
   - Corporate finance advisory services;
   - Marketing control and sales promotion;
   - Training and personnel management;
   - Logistics services;
   - Research and development services, and product development;
   - Technical support and maintenance;
   - Data processing and communication; and
   - Business development.[58]

   An ROHQ is also required to remit an initial paid-in capital of USD200,000.00.

   Of the above foreign-owned corporations and foreign corporations licensed to do business in the Philippines, only subsidiary corporations and branches of foreign corporations may operate and derive income from the Philippine domestic market or operate as an export enterprise. An ROHQ may derive income but only for services provided to the foreign corporation's affiliates, subsidiaries and/or branches in the Philippines, the Asia Pacific region or in other foreign markets. All the other offices of foreign corporations are authorized to do specific services for the foreign corporation's affiliates, subsidiaries and/or branches in the Philippines, the Asia Pacific region or in other foreign markets but do not derive income from it.

   Based on the above, for foreign corporations intending to invest in the Philippines, it is a challenge to navigate the rules and requirements for Philippine corporate registrations and operations. This by itself poses a barrier to these corporations into the service trade sector in the Philippines.

If a foreign entity fails to secure a license to operate in the Philippines either as a branch office, representative office, RHQ, or ROHQ, it cannot sue before Philippine courts or administrative agencies. This means that it cannot enforce its rights under any contract before Philippine courts and/or administrative agencies. The corporation and/or its responsible officers will also be subject to criminal penalties of a fine ranging from PhP1,000 to PhP10,000 or imprisonment of not less than 30 days but not more than 5 years, or both.[59]

In relation to the above, the Supreme Court ruled though that contracts entered into by a foreign corporations doing business in the Philippines without first securing a license will still remain valid and enforceable. The requirement of registration affects only the remedy (that is, whether it can sue before Philippine courts to enforce its contracts).[60] However, foreign corporations that do not have the requisite license may still sue before Philippine courts in the following instances: (a) when a corporation seeks redress for an isolated transaction;[61] (b) to protect its

[57] Executive Order No. 226, as amended by Rep. Act No. 8756, Section 2.3.
[58] Executive Order No. 226, as amended by Rep. Act No. 8756, Section 59(b)(1).
[59] Corporation Code, Sections 123, 133 and 144.
[60] Home Insurance Company v. Eastern Shipping Lines, G. R. Nos. L-34382 and L-34383, July 20, 1983
[61] New York Marine Managers, Inc. v. Court of Appeals, et al, G. R. No. 111837, October 24, 1995.

corporate reputation, name and goodwill, such as an action for infringement and unfair competition;[62] (c) to enforce its right not arising out of a business transaction;[63] and (d) when a party is estopped to challenge the personality and capacity of a foreign corporation by having acknowledged the same by entering into a contract with it (principle of estoppel).[64]

### 2.2.5. Foreign ownership in business enterprises

As discussed above, foreign entities can maintain commercial presence in the Philippines either through a domestic subsidiary, branch, representative office, regional or area headquarters and regional operating headquarters. However, the Constitution and various laws also impose specific limitations on foreign ownership of business enterprises in certain industries. These are as follows:

*2.2.5.1. Constitutional foreign ownership limitations.* Table 1 presents the Constitutional limitations on foreign participation in certain industries.

**Table 1. Constitutional limitations on foreign participation in certain sectors**

| Sector | Allowed % of foreign ownership | Source |
|---|---|---|
| | | |
| Mass media | 0% | Art. XVI, Sec.11.1 |
| Practice of profession | 0% | Art. XII, Sec. 14 |
| | | Rep. Act No. 5181 (1967)[65] |
| | | Rep. Act No. 8981 (2000), Section 7j(PRC Modernization Act) |
| Pharmacy | | Rep. Act No. 5921 |
| Radiology and x-ray technology | | Rep. Act 7431 |
| Criminology | | Rep. Act 6506 |
| Forestry | | Rep. Act 6239 |
| Law | | Constitution, Art. VIII, Section V; Rule 138, Sec. 2 of the Rules of Court |
| Manufacture, repair, stockpiling and/or distribution of nuclear weapons | 0% | Art. II, Sec. 8 |
| Advertising | 30% | Art. XVI, Sec. 11.2 |
| Exploration, development and utilization of natural resources | 40% | Art. XII, Sec. 2. |
| Public utilities | 40% | Art. XII, Sec. 11 |
| Operation and management of public utilities | 40% | Com. Act 146 (1936),[66] Sec. 16 |
| Project proponent and facility operator of a BOT project requiring a public utilities franchise | 40% | Rep. Act No. 6957 (1990)[67] as amended by Rep. Act No. 7718 (1994),[68] Sec. 2a |

[62] Western Equipment & Supply Co. v. Reyes, 51 Phil 115 (1927).
[63] Swedish East Asia Co., Ltd. v. Court of Appeals, G. R. No. 97816, October 26, 1968.
[64] Merril Lynch Futures, Inc. v. Court of Appeals, G. R. No. 97816, July 24, 1992.
[65] An Act Prescribing Permanent Residence and Reciprocity as Qualifications for any Examination or Registration for the Practice of any Profession in the Philippines.
[66] The Public Service Law.4
[67] An Act Authorizing the Financing, Construction, Operation and Maintenance of Infrastructure Projects by the Private Sector, and for Other Purposes.
[68] An Act Amending Certain Sections of Republic Act No. 6957.

| Sector | Allowed % of foreign ownership | Source |
|---|---|---|
| Ownership/establishment and administration of educational institutions | 40% | Art. XIV, Sec. 4 |

Source: Foreign Investments Negative List 2015; Author's compilation.

*2.2.5.2. Statutory foreign-ownership limitations.* The Constitution also mandates Congress and the government to:

a. Reserve certain areas of investment to Philippine citizens, or a certain percentage of interest in corporations or associations to Philippine citizens, as dictated by the national interest;
b. Enact measures that will encourage the formation and operation of enterprises whose capital is wholly owned by Filipinos; and
c. Regulate foreign investments in accordance with the country's national goals and priorities.[69]

The regulated sectors, as provided by statute, are summarized in Table 2.

**Table 2. Statutory limitations on foreign participation in certain sectors**

| Sector | Allowed % of foreign ownership | Source |
|---|---|---|
| Retail trade enterprises with less than PhP2.5 million paid-in capital | 0% | Rep. Act. No. 8762, Sec. 5 |
| Cooperatives | 0% | Rep. Act No. 6938, Art. 26 |
| Private security agencies | 0% | Rep. Act No. 5487, Sec. 4 |
| Small-scale mining | 0% | Rep. Act No. 7076, Sec. 3 |
| Ownership, operation and management of cockpits | 0% | Pres. Decree No. 449, Sec. 5 |
| Manufacture, repair, stockpiling, and/or distribution of biological and radiological weapons and anti-personal mines | 0% | Various treaties and international conventions to which the Philippines is a party |
| Manufacture of firecrackers and other pyrotechnic devices Manufacture of firecrackers and other pyrotechnic devices | 0% | Rep. Act No. 7183 Sec. 5 |
| Small and medium-sized domestic enterprises with paid-in capital of less than US$200,000.00 or US$100,000.00, as the case may be | 0% | Rep. Act No. 7042, Sec. 8.b.2 |
| Private radio communication network | 20% | Rep. Act No. 3846 |
| Private recruitment, whether for local or overseas | 25% | Pres. Decree No. 442, Art. 27 |
| Contracts for construction of defense-related structure | 25% | Com. Act No. 541, Sec. 1; |
| Contracts for the construction and repair of locally-funded public works, with certain exceptions under the BOT Law (Rep. Act No. 7718) | 25% | Letter of Intent 630 |

[69] Art. XII, Sec. 10, Philippine Constitution. The Congress shall, upon recommendation of the economic and planning agency, when the national interest dictates, reserve to citizens of the Philippines or to corporations or associations at least sixty per centum of whose capital is owned by such citizens, or such higher percentage as Congress may prescribe, certain areas of investment. The Congress shall enact measures that will encourage the formation and operation of enterprises whose capital is wholly owned by Filipinos.
In the grant of rights, privileges and concessions covering the national economy and patrimony, the State shall give preference to qualified Filipinos.
The State shall regulate and exercise authority over foreign investments within its national jurisdiction and in accordance with its national goals and priorities.

| Sector | Allowed % of foreign ownership | Source |
|---|---|---|
| Culture, production, milling, processing, trading excepting retailing, of rice and corn and acquiring by barter, purchase or otherwise, rice and corn and the by-products thereof | 40% | Pres. Decree No. 194, Sec. 5 |
| Contracts for the supply of materials, goods and commodities to government-owned or controlled corporations, company, agency or municipal corporations | 40% | Rep. Act No. 5183, Sec. 1 |
| Operation of deep sea commercial fishing vessels | 40% | Rep. Act No.8550, Sec. 27 |
| Adjustment companies | 40% | Rep. Act No. 10607, Sec. 332, amending Pres. Decree No. 612 |
| Ownership of condominium units where the common areas in the condominium projects are co-owned by the owners of the separate units or owned by a corporation | 40% | Rep. Act No. 4726, Sec. 5 |
| Manufacture, repair, storage and/or distribution of products and/or ingredients requiring clearance from the Philippine National Police (PNP), Department of National Defense (DND) | 40% | Rep. Act 7042, as amended by Rep. Act 8179 |
| Manufacture and distribution of dangerous drugs | 40% | Rep. Act 7042, as amended by Rep. Act 8179 |
| Sauna, steam bathhouses, massage clinics and other like activities regulated by law because of risks posed to public health and morals | 40% | Rep. Act 7042, as amended by Rep. Act 8179 |
| All forms of gambling, with certain exceptions | 40% | Rep. Act 7042, as amended by Rep. Act 8179 |

Source: Foreign Investments Negative List 2015; Author's compilation.

*2.2.5.3. Foreign Equity Limitations on Contractors' Industry.* In addition to the Constitutional and statutory limitations mentioned above, and through an administrative regulation, the contractors' industry is also subjected to foreign ownership limitations.

The industry is governed by Republic Act No. 4566 (1965),[70] otherwise known as the Contractors' License Law. Under such law, applicants for contractors' licenses are required to take the examinations required, have at least two years' experience in the construction industry, and knowledgeable of the building, safety, health and lien laws of the Philippines and the rudimentary administrative principles of the contracting business. A partnership or corporation may qualify as a contractor through its responsible managing officer after the latter presents certain requirements to qualify.[71]

The Philippine Contractors Accreditation Board (PCAB), formerly the Philippine Licensing Board for Contractors (PLBC), exercises supervision and regulatory functions over the contractors industry. It is authorized to issue contractors' licenses as mandated by law. When the Contractors' License Law was passed in 1965, the PLBC was under the jurisdiction of the Board of Examiners, now the Professional Regulation Commission (PRC).[72]

In 1980, then President Ferdinand E. Marcos issued Presidential Decree No. 1746, "Creating

[70] An Act Creating the Philippine Licensing Board for Contractors, Prescribing its Powers, Duties and Functions, Providing Funds Therefor, and For Other Purposes.
[71] RA 4566, Sections 19 and 20.
[72] RA 4566, Section 2.

the Construction Industry Authority of the Philippines," which abolished the PLBC and transferred its authority to the PCAB. PCAB was brought under the jurisdiction of the Construction Industry Authority of the Philippines (CIAP), an agency under the authority of the Department of Trade and Industry.[73]

In the same year (1980), President Marcos issued the Implementing Rules and Regulations of RA 4566, as amended by PD 1746 (IRR 1746). The regulations imposed an additional requirement for the issuance of a regular license, which does not appear in either RA 4566 or PD 1746. It provided that such license may be issued only to partnerships or corporations with at least 60% Filipino equity participation and existing under Philippine laws.[74] IRR 1746, which was intended to implement PD 1746, does not specify the rationale behind this rule and neither does this appear in PD 1746.

When the PCAB issued Board Resolution No. 605, Series of 2011, entitled "Imposition of at Least 60%-40% Filipino-Foreign Equity Participation (Peso Value) and Equivalent Management Control as Prerequisite Requirements for the Grant of the Regular Contractors' License by the PCAB," it cited as its rationale that construction contracting is a practice of profession and therefore must comply with the provisions of the Constitution.

This rationale suffers from the following defects:

a. The PCAB is now under the authority of the Department of Trade and Industry and not under the Professional Regulation Commission. Thus, the construction industry cannot be described as a practice of profession, as it is not governed by the professional regulation body; and
b. The imposition of the 60% Filipino equity requirement was made under an implementing rule and not a statute. While this was issued by President Marcos while he possessed both executive and legislative powers, it can be argued that the issuance of the rules and regulations implementing PD1746 constitutes an exercise of executive power. As such, the exercise of such power must be in accordance with the law being implemented, and cannot go beyond the parameters of such law. As PD1746 does not impose a foreign equity limitation in the contractors' industry, its implementing rules cannot do so, as well.

Despite these defects, the PCAB continues to implement Board Resolution No. 605. Given the current state of the law as outlined above, these are issues that need to be resolved for clarity both for Philippine policymakers and negotiators. As long as the 60-40 ownership requirement remains in the regulations, even while it is not justified under existing laws, this creates an environment of unpredictability in the interpretation of Philippine laws, which, in turn becomes a barrier to entry of potentially more efficient market players.

*2.2.5.4. Interpretation of Foreign Equity Participation in Nationalized Industries.* In the case of *Gamboa v. Teves*,[75] the Supreme Court ruled that the term "capital" in the Constitution refers to controlling interest or shares entitled to vote the board of directors of a corporation. The Court read the Section 11 with Section 19, Article II of the Constitution, which enunciates the State policy to develop a self-reliant and independent economy **effectively controlled by Filipinos**.[76] In this context, the term "capital" in Section 11, Article XII of the Constitution means that "**full beneficial ownership of 60 percent of the outstanding capital stock,**

[73] PD 1746, Section 3.
[74] Implementing Rules and Regulations of PD 1746 (IRR 1746), Section 3.1(a), as amended by the Omnibus Investment Code of 1987, Chapter III, Book II, Article 48.
[75] G. R. No. 176759, June 28, 2011.
[76] Constitution, Section 19, Article II.

**coupled with 60 percent of the voting rights, is constitutionally required for the State's grant of authority to operate a public utility**."

In implementing the *Gamboa* decision to all nationalized industries, SEC Memorandum Circular No. 8, series of 2013, required that "the required percentage of Filipino ownership shall be applied to BOTH (a) the total number of shares of stock entitled to vote in the election of directors; AND (b) the total number of shares of stock, whether or not entitled to vote in the election of directors."[77] That is, both the **Voting Control Test** and the **Beneficial Ownership Test** must be applied to determine whether a corporation is a "Philippine national." This means, that 60% of the common shares (entitled to vote the board of directors), and 60% of all outstanding common and preferred shares must be maintained to meet the nationality requirement for public utility corporations and other nationalized industries.

Unless justified by legitimate policy objectives that are the least restrictive to trade, these foreign ownership limitations unnecessarily impedes the entry of more efficient and productive market players in the services trade industry.

In considering investments in public utilities, it may be important to note the distinction made by the Supreme Court. The right to operate a public utility may exist independently and separately from the ownership of the facilities thereof. One can own said facilities without operating them as a public utility, or conversely, one may operate a public utility without owning the facilities used to serve the public. The devotion of property to serve the public may be done by the owner or by the person in control thereof who may not necessarily be the owner thereof.[78]

#### 2.2.6. Local business registration

Apart from the primary registration of a company, usually with the SEC, and the acquisition of licenses to operate a business in a specialized industry, an enterprise also needs to register with the local government where its business has some form of establishment, be it the head office, an extension office, branch or merely a garage or warehouse.

Municipalities, for instance, have the power to grant a franchise to any person, partnership, corporation, or cooperative to establish, construct, operate and maintain ferries, wharves, markets or slaughterhouses, or such other similar activities within the municipality.[79] It also has the power to regulate any business, occupation, or practice of profession or calling which does not require government examination within the municipality and the conditions under which the license for said business or practice of profession may be issued or revoked.[80]

#### 2.2.7. Differences in tax treatment on income

*2.2.7.1. Tax on Individuals/Single Proprietors.* The National Internal Revenue Code (NIRC or the Tax Code) imposes varying income tax rates for different classes of taxpayers. With the enactment of Republic Act No. 10693, new rates of taxes are now imposed on taxpayers. Individuals are still generally taxed at graduated tax rates, but with new prescribed brackets. Meanwhile, there has been no change in corporate income taxes and corporations still

[77] SEC. Memorandum Circular No. 8, series of 2013, Section 2.
[78] Tatad, et al. v. Garcia, et al., G.R. No. 114222, 06 April 1995.
[79] Section 447 (3) (vii), Local Government Code.
[80] Section 447 (3) (ii), Local Government Code.

are generally taxed at a lower tax rate of 30% of taxable income. Different tax rates are also imposed on non-resident foreign individuals and corporations, as well as on certain income payments.

a. Resident individuals

Individual citizens or individual foreign residents used to be taxed at graduated rates from 5% to 32% of their taxable income. Those earning the minimum wage were exempt from paying income taxes. As R.A. No. 10963 is now in effect, the graduated rates now range from 0% to 35%.

While the top rate of taxes is now 35%, only individual taxpayers who earn in excess of Php8,000,000.00 are subject to this rate. It should be pointed out that the rate of 32% previously applied to those who earn over Php500,000.00 annually. Whereas now, the rate of 32% only applies when the income exceeds Php2,000,000.00.

In addition, the tax exemption given to minimum wage earners while a 0% rate applies to those earning not more that Php250,000.00 annually so that not only minimum wage earners enjoy the benefit. Those who do not earn more than Php250,000.00 are also exempt from filing income tax returns.[81]

These rates show that progressively increasing tax rates continue to be imposed on higher taxable income.[82] Taxable income is the items of gross income defined by the Tax Code less the deductions and/or personal exemptions and additional exemptions, if any, authorized for such types of income by the Tax Code or other special laws.[83]

An exception to the progressive tax rates is the new provision under R.A. No. 10693 allowing individuals, who are self-employed or are in the practice of their profession, the option of paying 8% on their gross sales instead of paying the rates prescribed for their taxable income.[84]

Individual citizens are taxed on their taxable income from all sources, whether from within or without the Philippines.[85] Foreign individual residents, on the other hand, are taxed only on their taxable income sourced from within the Philippines.[86] If the country where the individual foreign resident is a citizen imposes income tax rates on taxable income lower than that imposed by the Philippines, an individual Philippine citizen will be at a disadvantage even if its foreign sourced income is from the same country of citizenship of the individual foreign resident. Because, while the individual foreign resident enjoys the lower income tax rates of its country of citizenship, the individual Philippine citizen will still apply the 32% income tax rate on its foreign-sourced income.

This disadvantage may, to some extent be mitigated by the rules on foreign tax credit. Under the Tax Code, a Philippine citizen who pays income tax in a foreign jurisdiction for income

[81] Section 51, Tax Code, as amended.
[82] Tax Code, Section 24(A)
[83] Tax Code, Section 31. The business deductions referred to may either be substantiated expenses allowed as deductions under the Tax Code (Section 34(A) to (K) and (M)), or the optional standard deduction of 40% of gross income if the expenses cannot be substantiated (Section 34(L)).
[84] Section 24 (h), Tax Code, as amended.
[85] Tax Code, Section 24(A)(1)(a) and (b).
[86] Tax Code, Section 24(A)(1)(c).

earned in such jurisdiction will be allowed to deduct the tax paid or accrued from its income tax due in the Philippines.[87]

However, the actual tax paid on foreign income must not be higher than the proportionate share of the total foreign taxable income in the individual citizen's global taxable income (total income from sources within and without the Philippines) applied to his Philippine income tax liability (the "Allowable Limit).[88] If the actual tax paid or accrued exceeds the Allowable Limit, the excess cannot be claimed as a loss. This is because the foreign tax credit is allowed as a deduction only up to the extent of the foreign taxable income in relation to a company's global income. Thus, only the percentage of such foreign taxable income to the company's global income as applied to the Philippine income tax liability shall be effectively credited the foreign tax credit.

This means that even with the deduction for foreign tax credit allowed by Philippine tax laws, a Philippine citizen may still find itself in a position where it pays tax twice in one item of income in two taxing jurisdictions. This rule is a disincentive for Philippine citizens to invest and earn income or expand their businesses abroad.

b. Non-Resident Foreign Individual

Non-resident foreign individuals are taxed depending on the length of their stay in the Philippines or in the industry they are employed. The tax treatment of these individuals are summarized in Table 3.

**Table 3. Income tax rates for non-resident foreign individuals[89]**

| No. | Taxable Entity | Conditions | Tax Rates | Tax Base |
|---|---|---|---|---|
| 1 | Non-Resident Foreign Individual Engaged in Trade or Business in the Philippines | Comes to the Philippines and stays for an aggregate period of more than 180 days during any calendar year | Graduated rates of 0% to 35%[90] | Taxable income from all sources within the Philippines |
| 2 | Non-Resident Foreign Individual Not Engaged in Trade or Business in the Philippines | Comes to the Philippines and stays for an aggregate period of 180 days or less during any calendar year | 25% | All income received within the Philippines |
| 3 | Foreign Individual employed by: | Regional or Area Headquarters and Regional Operating Headquarters of Multinational Companies | 15% | Gross income as salaries, wages, annuities, compensation, remuneration and other emoluments |
| | | Offshore Banking Unit | 15% | Gross income as salaries, wages, annuities, compensation, remuneration and other emoluments |
| | | Petroleum Service Contractor and Subcontractor | 15% | Gross income as salaries, wages, annuities, compensation, |

[87] Tax Code, Section 34(C)(3)(a).
[88] Tax Code, Section 34(C)(4).
[89] Tax Code, Section 25.
[90] As amended by R.A. 10963.

| No. | Taxable Entity | Conditions | Tax Rates | Tax Base |
|---|---|---|---|---|
| | | | | remuneration and other emoluments |

Source: Author's compilation.

It should be noted, however, that the Tax Code, as amended by R.A. 10963 no longer extends the preferential income taxes for foreigners employed by Regional Headquarters, Regional Operating Headquarters, Offshore Banking Units, and Petroleum contractors, which registered with the Securities and Exchange Commission after 01 January 2018. The benefit, nevertheless, remains with those who have been enjoying the preferential tax prior to when R.A. 10963 came into effect.[91]

*2.2.7.2. Tax on Partnerships/Corporations.* The National Internal Revenue Code (NIRC or the Tax Code) imposes varying income tax rates for different classes of taxpayers. With the enactment of Republic Act No. 10693, new rates of taxes are now imposed on taxpayers. Individuals are still generally taxed at graduated tax rates, but with new prescribed brackets. Meanwhile, there has been no change in corporate income taxes and corporations still are generally taxed at a lower tax rate of 30% of taxable income. Different tax rates are also imposed on non-resident foreign individuals and corporations, as well as on certain income payments.

Under the Tax Code, partnerships, no matter how created or organized are taxed as corporations. However, general professional partnerships and joint ventures[92] or consortia formed for the purpose of undertaking construction projects or engaging in petroleum, coal, geothermal and other energy operations pursuant to an operating consortium agreement under a service contract with the Government are exempt from corporate income tax. General professional partnerships are partnerships formed by persons for the sole purpose of exercising their common profession, no part of the income of which is derived from engaging in any trade or business.[93]

Since the partnership and joint venture is not subject to the corporate income tax, each partner of the general professional partnership and co-venturer in the joint ventures mentioned above are taxed on their taxable income during each taxable year from income derived from the partnership or joint venture.[94] Taxable corporations and partnerships are taxed at the following rates (Table 4):

**Table 4. Income tax rates on corporations and taxable partnerships[95]**

| No. | Taxable Entity | Conditions | Tax Rates | Tax Base |
|---|---|---|---|---|
| 1 | Domestic Corporation | In general | 30%; or | Taxable income |
| | | Imposed on the 4th taxable year after the start of the commercial operations of the corporation (the "minimum corporate income tax" or MCIT) when the MCIT is higher than the normal income tax | 2% | Gross income |

[91] Section 25 (F), Tax Code, as amended.
[92] Revenue Regulations No. 10-12.
[93] Tax Code, Section 22(B).
[94] Tax Code, Section 26; *See* BIR Ruling No. 340-16, June 29, 2016; BIR Ruling [DA-392-05], September 16, 2005; BIR Ruling 475-14, November 26, 2014; BIR Ruling No. 176-14, June 9, 2014.
[95] Tax Code, Sections 27(A) (B) and (E); 28(A)(1) to (6) and (B)(1) to (4).

| No. | Taxable Entity | Conditions | Tax Rates | Tax Base |
|---|---|---|---|---|
| | | applying the 30% tax rate; the excess of the MCIT over the normal income tax shall be carried forward and credited against the normal income tax for 3 immediately succeeding taxable years | | |
| | • Proprietary educational institution and hospitals (non-profit) | In general | 10% | Taxable income |
| | | If gross income from "unrelated trade, business or other activity"[96] exceeds 50% of the total gross income derived by such educational institutions or hospitals from all sources | 30% | Entire taxable income |
| 2 | Resident Foreign Corporations (i. e., branch of a foreign head office) | In general | 30%; or | Taxable income from all sources within the Philippines |
| | | Same MCIT imposed on domestic corporations under the same conditions | 2% | Gross Income from all sources within the Philippines |
| | a. International carrier (both air and shipping) | May be exempt or subject to preferential rate under an applicable tax treaty, international agreement or on the basis of reciprocity with the come country of the international carrier | 2.5% | Gross Philippine billings |
| | b. Offshore banking units (OBUs) | Income from foreign currency transactions with nonresidents, other offshore banking units, local commercial banks, including branches of foreign banks authorized by the BSP to transact with offshore banking units | Exempt | |
| | | Interest income derived from foreign currency loans granted to residents other than offshore banking units or local commercial banks authorized by BSP to transact business with offshore banking units | 10% | Interest income |
| | c. Branch profit remittance | | 15% | Total profits applied or earmarked for remittance |
| | d. Regional or area headquarters | | Exempt | |
| | e. Regional operating headquarters | | 10% | Taxable income |
| 3 | Non-resident foreign corporation | In general | 30% | Gross income from Philippine sources |

[96] This means any trade, business or other activity the conduct of which is not substantially related to the exercise or performance by such educational institution or hospital of its primary purpose or function. Tax Code,Section 27(B).

| No. | Taxable Entity | Conditions | Tax Rates | Tax Base |
|---|---|---|---|---|
| | | Non-resident cinematographic film owner, lessor, or distributor | 25% | Gross income from Philippine sources |
| | | Non-resident owner or lessor of vessels chartered by Philippine nationals | 4 ½ % | Gross rentals, lease or charter fees |
| | | Non-resident owner or lessor of aircraft, machineries and other equipment | 7 ½ % | Gross rentals or fees |

Source: Author's compilation.

*2.2.7.3. Tax on Certain Income.* The Tax Code also imposes a final income tax on certain types of passive income or transactions. These are summarized in Table 5.

**Table 5. Tax rates on certain income[97]**

| No. | Income/Gain | Conditions | C&IFR | NRFI ETBP | NRFI NETBP | DC | RFC | NRFC |
|---|---|---|---|---|---|---|---|---|
| 1 | Interest from bank deposits | Includes any yield from or any other monetary benefit from deposit substitutes and from trust funds and similar arrangements | 20% | ✓ | RITR | ✓ | ✓ | RITR |
| 2 | Royalties | In general | 20% | ✓ | RITR | ✓ | ✓ | RITR |
| | | on books and other literary works and musical compositions | 10% | ✓ | RITR | 20% | 20% | RITR |
| 3 | Lease of cinematographic films and similar works | | RITR | 25% | RITR | RITR | RITR | RITR |
| 4 | Prizes | Except those amounting to PhP10,000 or less, which shall be taxed at the applicable regular tax rate | 20% | ✓ | RITR | RITR | RITR | RITR |
| 5 | Other winnings | Except PCSO and lotto winnings, which is exempt | 20% | ✓ | RITR | RITR | RITR | RITR |
| 6 | Earnings under the expanded foreign currency deposit system | Interest from foreign currency deposits | 15%[98] | 20% | RITR | 15% | ✓ | RITR |
| | | Income by depository banks from foreign currency transactions with non-residents, OBUs in the Philippines, local commercial banks including branches of foreign banks that may be authorized by the Bangko Sentral ng Pilipinas (BSP) to transact business with foreign currency deposit system | N/A | N/A | N/A | Exempt | Exempt | N/A |

[97] Tax Code, Sections 24(B), 25(A)(2) and (3), (B) to (E), 27(D), 28(A)(7), (B)(5).
[98] As amended by Section 7, R.A. No. 10963.

| No. | Income/Gain | Conditions | C&IFR | NRFI ETBP | NRFI NETBP | DC | RFC | NRFC |
|---|---|---|---|---|---|---|---|---|
| | | Interest from foreign currency loans granted by depository banks under the expanded to residents other than OBUs in the PHL or other banks under the expanded system | N/A | N/A | N/A | 10% | 10% | N/A |
| | | Any income from transactions with depository banks by non-residents under the expanded foreign currency deposit system | N/A | Exemp t | Exempt | Exemp t | Exem pt | Exemp t |
| 7 | Interest on foreign loans | | N/A | N/A | N/A | N/A | N/A | 20% |
| 8 | Interest from long-term deposits or investments to be held for a minimum of 5 years | If pre-terminated: | Exempt | ✓ | RITR | 20% | 20% | RITR |
| | | Less than 3 years | 20% | ✓ | RITR | 20% | 20% | RITR |
| | | 3 years to less than 4 years | 12% | ✓ | RITR | 20% | 20% | RITR |
| | | 4 years to less than 5 years | 5% | ✓ | RITR | 20% | 20% | RITR |
| 9 | Dividends, including share in partnership income | Inter-corporate dividends: | 10% | 20% | RITR | N/A | N/A | RITR |
| | | between domestic corporations or received by a resident foreign corporation from a domestic corporation | N/A | N/A | N/A | Exemp t | Exem pt | N/A |
| | | received by a non-resident foreign corporation from a domestic corporation | N/A | N/A | N/A | N/A | N/A | 30% |
| | | • if the country of domicile of the non-resident foreign corporation allows a tax credit on the tax due from such corporation taxes deemed paid in the Philippines equivalent to 15% | N/A | N/A | N/A | N/A | N/A | 15% |
| 10 | Capital gains on sale of shares of stock not traded in the stock exchange | On any gain. | 15%[99] | ✓ | ✓ | ✓ | ✓ | ✓ |

[99] As amended by Section 5, R.A. 10963.

| No. | Income/Gain | Conditions | C&IFR | NRFI ETBP | NRFI NETBP | DC | RFC | NRFC |
|---|---|---|---|---|---|---|---|---|
| | | On any gain in excess of PhP100,000 | N/A | ✓ | ✓ | N/A | ✓ | ✓ |
| 11 | Capital gains from sale of real property | Gross selling price or current fair market value, whichever is higher | 6% | ✓ | ✓ | ✓ | N/A | N/A |

Notes: C&IFR – Citizen and Individual Foreign Resident
NRFI ETBP – Non-Resident Foreign Individual Engaged in Trade or Business in the Philippines
NRFI NETBP - Non-Resident Foreign Individual Not Engaged in Trade or Business in the Philippines
DC – Domestic Corporation
RFC – Resident Foreign Corporation
NRFC – Non-Resident Foreign Corporation
✓ - the same tax rate as C&IFR
RITR – Regular Income Tax Rate

Source: Author's compilation.

For domestic corporations and resident foreign corporations, under the Tax Code, interest income from long-term deposits or investment is subject to a final withholding tax of 20%, as indicated in **Table 3** above.[100] However, the Bureau of Internal Revenue (BIR) issued Revenue Regulation No. 14-2012[101] where it made a distinction between interest income from long term deposits or investments issued by banks and investment certificates considered deposit substitutes ("Bank Issuances"), and those not issued by banks and investment certificates not considered deposit substitutes ("Non-Bank Issuances).[102] Interest income from Bank Issuances are subject to final withholding tax of 20% while those earned from Non-Bank Issuances are subject to the 30% regular income tax rate. This is an example of a conflict between law and regulations created by erroneous interpretations of regulatory agencies. Such interpretation creates uncertainty in the enforcement of tax laws and discourages investment in long-term deposits or investments in non-bank financial institutions.

*2.2.7.4. Local Government Taxation.* Local governments, having the power to establish sources of revenue, have certain powers of taxation and likewise of charging fees.[103] Each local government unit is given the power to impose only certain taxes.

In the case of provinces, they have the power to tax the transfer of real property.[104] It may impose a tax of not more than 50% of 1% of the total consideration or the fair market value of the real property.[105] The province also has the power to tax business in the following manner (Table 6):

**Table 6. Taxing power of provinces under the Local Government Code**

| Section | Type | Base | Rate |
|---|---|---|---|
| 136 | Tax on Business of Printing and Publication | gross annual receipts for the preceding calendar year | Not exceeding 50% of 1% |
| 137 | Franchise Tax[106] | gross annual receipts for the preceding calendar year | Not exceeding 50% of 1% |

[100] See Tax Code, Sections 27(D)(1) and 28(A)(7)(a).
[101] Entitled, "*Proper Tax Treatment of Interest Income Earnings on Financial Instruments and Other Related Transactions*."
[102] Revenue Memorandum Circular No. 77-2012, "Clarifying Certain Provisions of Revenue Regulations No. 14-2012 on the Proper Treatment of Interest Income Earnings on Financial Instruments and Other Related Transactions."
[103] Section 132, Local Government Code.
[104] Section 135, Local Government Code.
[105] *Id.*
[106] Imposed on businesses enjoying a franchise.

| Section | Type | Base | Rate |
|---|---|---|---|
| 138 | Tax on Sand, Gravel and Other Quarry Resources | fair market value in the locality per cubic meter | Not more than 20% |
| 139 | Tax on Practice of Profession | On each person | Not more than Php300.00 |
| 140 | Amusement Tax | gross receipts from admission fees | Not more than 30% |
| 141 | Annual Fixed Tax For Every Delivery Truck or Van of Manufacturers or Producers, Wholesalers of, Dealers, or Retailers in, Certain Products. | On each vehicle | Not more than Php500.00 |

Source: Author's compilation.

Cities may also impose the above taxes.[107] However, except the rates of professional and amusement taxes, cities are given the power to impose taxes at rates exceeding the maximum rates allowed for the province by not more than fifty percent (50%).[108] Cities may also impose taxes municipalities collect.

#### 2.2.8. Exploration of natural resources and real property ownership

The Philippine Constitution and applicable laws also places limitations on the exploration of natural resources and ownership of land and certain real property.

*2.2.8.1. Natural resources.* Lands of the public domain, waters, minerals, coal, petroleum and other mineral oils, all forces of potential energy, fisheries, forests or timber, wildlife flora, and fauna, and other natural resources are owned by the State. Except for agricultural land, these resources cannot be alienated. As such, under the Constitution, the State has full control and supervision of the exploration, development, and utilization of natural resources. This means that it may:

a. Directly undertake the exploration, development, and utilization of the natural resources;
b. Enter into co-production, joint venture, or production-sharing agreements with Filipino citizens, or corporations or associations.
    - Such corporation or associations must be at least 60 percent owned by Filipino citizens;
    - Co-production, joint venture, or production-sharing agreements shall be for a maximum period of twenty-five years, renewable for not more than twenty-five years, and under such terms and conditions as may be provided by law; and
c. Enter into technical or financial assistance agreements for large-scale exploration, development, and utilization of minerals, petroleum, and other mineral oils with foreign-owned corporations, subject to the following conditions:
    - According to the general terms and conditions provided by law,
    - Based on real contributions to the economic growth and general welfare of the country; and
    - It is necessary for the agreement to promote the development and use of local scientific and technical resources.[109]

As indicated above, the exploration, development and utilization of natural resources is fully controlled by the State, but it may do so in partnership with private entities, preferably

[107] Section 151, Local Government Code.
[108] Section 151, Local Government Code.
[109] Art. XII, Sec. 2 Philippine Constitution

Philippine entities. Any involvement of foreign-owned corporations in any venture with the government with respect to these natural resources are conditioned on their real contribution to economic growth and general welfare of the country and its promotion of the development and use of local scientific and technical resources. These conditions and restrictions to foreign participation in the exploration, development and utilization of natural resources are by themselves barriers to entry to foreign-owned corporations. To determine whether these are justified by the underlying policy objectives for these limitations, its effectiveness in achieving the objectives must be assessed.

It cannot be helped that issues pertaining to Natural Resources are closely linked to environmental protection. In this regard, it is significant to point out that the Supreme Court has relaxed the rule on legal personality when any suit is brought to question the environmental impact of exploration and extraction of natural resources. In a case where environmentalists questioned the oil exploration activities of a foreign company, the Supreme Court recognized the personality of environmentalists representing the resident marine mammals and cetaceans in the area. The Supreme Court decided to allow any Filipino citizen, as a steward of nature, to bring a suit to enforce Philippine environmental laws.[110]

*2.2.8.2. Land ownership.* Meanwhile, the Constitution limits land use and ownership to the following (Table 7):

**Table 7. Limits to land use and ownership**

| Type of land | Private corporations of associations | Individuals |
|---|---|---|
| Inalienable land of the public domain | • Cannot be alienated<br>• Subject to the provisions on natural resources in (a) above | • Cannot be alienated<br>• Subject to the provisions on natural resources in (a) above |
| Agricultural land (alienable land of the public domain) | • Lease for a maximum period of 25 years, renewable for another 25 years<br>• Not to exceed 1,000 hectares | • Philippine citizens<br>• Lease up to a maximum of 500 hectares<br>• Acquire up to a maximum of 12 hectares |
| Private lands | • may acquire private lands<br>• at least 60% of the capital stock or any interest therein must be owned by Philippine citizens | • May acquire private lands<br>• May be owned by an alien, if acquired by hereditary succession<br>• Includes former Philippine natural-born citizens |

Source: Author's compilation.

Limitations on land use and ownership minimizes its productive use, as well as discourages investment in service industries where the use of land and other real property is necessary for its operations.

*2.2.8.3. Condominium ownership.* Section 2 of the Condominium Act, as amended,[111] defines a condominium as, "an interest in real property consisting of separate interest in a unit

[110] *See* Resident Marine Mammals v. Secretary Angelo Reyes, et al., G.R. No. 180771, 21 April 2015.
[111] Condominium Corporation, Section 2. "A condominium is an interest in real property consisting of separate interest in a unit in a residential, industrial or commercial building and an undivided interest in common, directly or indirectly, in the land on which it is located and in other common areas of the building. A condominium may include, in addition, a separate interest in other portions of such real property. Title to the common areas, including the land, or the appurtenant interests in such areas, may be held by a corporation specially formed for the purpose (hereinafter known as the 'condominium corporation') in which the holders of separate interest shall automatically be members or shareholders, to the exclusion of others, in proportion to the appurtenant interest of their respective units in the common areas."

in a residential, industrial or commercial building and an undivided interest in common, directly or indirectly, in the land on which it is located and in other common areas of the building," and may include "a separate interest in other portions of such real property."

Filipinos and Filipino-owned corporations may own and acquire condominium units or one hundred percent (100%) ownership interest in a condominium corporation. Foreign nationals and foreign-owned Philippine corporations, on the other hand, may own and acquire real estate through the purchase of condominium units under the condominium principle defined under the Philippine Condominium Act, Rep. Act No. 4726.[112] However, such ownership is subject to certain rules and limitations, to wit: [113]

a. Every transfer or conveyance of a condominium unit, which may be an apartment, office, store or other spaces in such unit, includes an undivided interest in the common areas of the condominium, or in the proper case, membership or shareholdings in the condominium corporation;
b. Ownership of condominium units and consequently, ownership of the common areas, by foreign nationals and foreign-owned corporations must not exceed forty percent (40%), unless ownership is acquired through hereditary succession by intestacy; and
c. If the common areas are owned by a condominium corporation, the foreign membership or shareholdings over the same must not exceed forty percent (40%).

The reasons for the limitations on foreign ownership in a condominium corporation are not clear. Note that the Constitution only limits foreign ownership of land. Buildings that are not condominiums and built on these lands may be owned 100% by foreign entities. Thus, foreigners may own warehouse buildings, and office buildings, but not condominium buildings. This rule places an unnecessary barrier to foreign entities intending to invest in condominium buildings and deal in property rental and management.

#### 2.2.9. Rental of land and real estate

The Philippines has a rent control law, the Rent Control Act of 2009, or Rep. Act No. 9653 that applies to certain residential units. It placed limits on rental price increases on residential units to a maximum of 7% per year until December 31, 2015 over the following:

a. Those with a total monthly rent that ranges from One Peso (PhP1.00) to Ten Thousand Pesos (PhP10,000.00) for units located in the National Capital Region and other highly urbanized cities, and
b. Those located in all other areas with total monthly rent ranging from One Peso (PhP1.00) to Five Thousand Pesos (PhP5,000.00),

Beyond December 31, 2015, the Housing and Urban Development Coordinating Council (HUDCC) was granted the power to continue to regulate residential units and determine the appropriate measures necessary to carry out the law's legal mandate.

Pursuant to its mandate to regulate rentals on certain residential units, HUDCC issued

[112] *Jacobus Bernhard Hulst vs. PR Builders, Inc.*, G.R. No. 156364, 25 September 2008.

[113] *Id.*, Section 5. Any transfer or conveyance of a unit or an apartment, office or store or other space therein, shall include the transfer or conveyance of the undivided interest in the common areas or, in a proper case, the membership or shareholdings in the condominium corporation; Provided, however, That where the common areas in the condominium project are held by the owners of separate units as co-owners thereof, no condominium unit therein shall be conveyed or transferred to persons other than Filipino citizens or corporations at least 60% of the capital stock of which belong to Filipino citizens, except in cases of hereditary succession. Where the common areas in a condominium project are held by a corporation, no transfer or conveyance of a unit shall be valid if the concomitant transfer of the appurtenant membership or stockholding in the corporation will cause the alien interest in such corporation to exceed the limits imposed by existing laws.

Resolution No. 1, Series of 2015, approved on 08 June 2015 (the "HUDCC Resolution"). The HUDCC Resolution extended the effectivity of the Rent Control Act for two (2) years from January 01, 2016 to December 31, 2017. It also revised the coverage of the act to Ten Thousand Pesos (PhP10,000.00) and placed the following maximum limits on rent price increases:

a. Four percent (4%) annually for those paying a monthly rent/ ranging from PhP1.00 to PhP3,999.00 per month; and
b. Seven percent (7%) for those paying a monthly rent of PhP4,000.00 up to PhP10,000.00 for as long as the unit is occupied by the same lessee.

Note, however, that there are no limitations on rental on commercial and industrial buildings and other real estate. While there may be a social objective to rent control over residential units, such policy tool must be assessed as to its effectiveness in achieving the underlying objective. Otherwise, the limited profit that potential investors expect to earn from the rental of residential units would discourage further investment in these assets.

#### 2.2.10. Cross-border data flows

The E-Commerce Act, Rep. Act No. 8792, was passed in 2000. It aims to facilitate domestic and international transactions and exchanges, store information through electronic, optical and similar medium, recognize the authenticity and reliability of electronic documents, and promote the universal use of electronic transactions in the government.[114] The E-Commerce Act allows the legal recognition of electronic data messages, electronic documents, electronic signatures for purposes of enforcement of the content of such electronic communication, and their admissibility as evidence in court.

While the E-Commerce Act promotes the free flow of information through electronic means, the Data Privacy Act of 2012, Rep. Act No. 10173, seeks to secure and protect certain types of information to protect a person's right to privacy. It specifically protects:

a. Personal information, which refers to information from which the identity of an individual is apparent or can be reasonably and directly ascertained by the entity holding the information, or when put together with other information would directly and certainly identify and individual;[115] and
b. Sensitive personal information, which refers to personal information:
    - About an individual's race, ethnic origin, marital status, age, color and religious, philosophical or political affiliations;
    - About an individual's health, education, genetic or sexual life, or to any court proceedings for an offense or alleged offense of an individual and its disposition;
    - Issued by government agencies peculiar to an individual which includes, but not limited to, social security numbers, previous or current health records, licenses or its denials, suspension or revocation and tax returns; and
    - Specifically established by an executive order or an act of Congress to be kept classified.[116]

The Data Privacy Act applies to the above personal information and controllers and processors of the same who use equipment located in the Philippines (even if such controllers and processors are not located in the Philippines), or those who maintain an office, branch or agency

[114] Rep. Act No. 8792, Section 3.
[115] Rep. Act No. 10173, Section 3(g).
[116] Rep. Act No. 10173, Section 3(l).

in the Philippines.[117] It also applies to acts performed outside the Philippines if: (a) the act relates to personal information about a Philippine citizen or resident; (b) the entity has a link with the Philippines and processing personal information in the Philippines, or even if done outside the Philippines, the information pertains to Philippine citizens or residents.[118]

However, the Data Privacy Act expressly exempts from its protection personal information originally collected from residents of foreign jurisdictions pursuant to its laws, including any applicable data privacy laws, which is being processed in the Philippines.[119] With the country's booming business process outsourcing (BPO) industry, and demands for greater data protection from foreign clients, this exemption significantly increases the compliance costs of Philippine BPO firms.

Since personal information originally collected from residents of foreign jurisdictions are not covered by the protection of the Data Privacy Act, foreign clients usually require, through their service agreements with Philippine BPO firms, that such firms comply with their country's data privacy laws. This means setting up internal controls and data security measures sufficient to meet the requirements of the foreign client's country's data privacy laws, in addition to establishing a different set of controls and data security measures to comply with the Data Privacy Act.

### 2.2.11. Immigration and labor

Foreign nationals providing services in the Philippines may do so either as consultants, or as employees in foreign funded projects or, Philippine enterprises or foreign companies authorized to do business in the Philippines. They may do so as professionals or other skilled personnel. However, such provision of services is subject to the Constitutional policy of promoting the preferential use of Filipino labor,[120] and the sustained development of national talents through, among others, the limitation of the practice of profession to Filipino citizens, save in cases prescribed by law.[121] In implementing such State policy, Philippine laws and regulations impose conditions for the provision of services of foreign nationals in the Philippines. This covers limitations in the practice of profession, employment, and entry into the Philippines.

*2.2.11.1. Practice of profession.* The practice of profession by foreigners in the Philippines is limited primarily by Section 14, Article XII of the Philippine Constitution. The provision reserves the practice of professions to Filipinos, save for those which may be allowed by law. Nevertheless, when Republic Act No. 8981 passed into law, certain conditions became available in order for foreigners to practice their professions in the Philippines.

A professional duly registered and in good standing in his home country, where Filipinos are allowed to practice their profession and observes similar standards for admission to a profession, may be allowed to work in the Philippines. The Philippine Professional Regulation Commission may issue a certificate of registration, a license or a special temporary permit to foreign professionals who desire to practice their professions in the country under reciprocity and other international agreements; consultants in foreign-funded, joint venture or foreign-assisted projects of the government; employees of Philippine or foreign private firms or

[117] Rep. Act No. 10173, Section 4.
[118] Rep. Act No. 10173, Section 6.
[119] Rep. Act No. 10173, Section 4(g).
[120] Constitution, Art. XII, Section 12.
[121] Constitution, Art. XII, Section 14.

institutions pursuant to law; or health professionals engaged in humanitarian missions for a limited period of time.[122]

The practice of profession is defined by PRC Resolution No. 2012-668 as "an activity/undertaking rendered by a registered and licensed professional or a holder of a Special Permit as defined in the scope of practice of a professional regulatory law."[123] There are at least 43 regulated professions in the Philippines. Pursuant to the constitutional policy providing preference for Filipino professionals, foreign professionals may be allowed to practice their profession only under the circumstances mentioned in R.A. 8981. This policy is implemented by the Professional Regulation Commission:

a. Upon issuance of a **Certificate of Registration/License** and professional identification card upon recommendation of the Professional Regulatory Board (PRB) concerned and approval of the Professional Regulatory Commission (PRC), subject to certain conditions;[124] or
b. Upon issuance of a **Special Temporary Permit** (STP) by the PRC to foreign professionals, under reciprocity or other international agreements; to consultants in foreign-funded joint venture or foreign-assisted government projects; to employees of Philippine or foreign private firms or institutions as provided by law; and to health professionals engaged in humanitarian mission for a **limited period of time**;[125] or
c. Upon issuance of a special permit to former Filipino professionals who have acquired foreign citizenship but wish to practice their profession in the Philippines, who have their updated professional identification card from the applicable PRB and approved by the PRC, and have paid the appropriate permit and annual registration fees.[126]

*2.2.11.2. Authority to employ alien.* A foreign person employed as technical personnel in a wholly or partially nationalized industry is also required to secure an Authority to Employ Alien from the Department of Justice (DOJ).[127]

In addition to the above requirements, foreign professionals and non-professionals who wish to seek gainful employment in the Philippines need to secure an **Alien Employment Permit** (AEP) from the Department of Labor and Employment (DOLE). Gainful employment is defined in DOLE Department Order No. 146-15, series of 2015 as "a state or condition that creates an **employer-employee relationship** between the Philippine based company and the foreign national where the former has the power to hire or dismiss the foreign national from employment, pays the salaries or wages thereof and has authority to control the performance or conduct of the tasks and duties."[128]

The AEP is required pursuant to the State policy of giving preference to Filipino labor, and is mandated by the Philippine Labor Code after a determination of the non-availability of a person

[122] Section 7 (j), R.A. 8981.
[123] PRC Resolution No. 2012-668, Section 1(b).
[124] The professional license may be issued by PRC under the following conditions: (a) the concerned Professional Regulatory Board (PRB) recommends to the Professional Regulatory Commission (PRC) the issuance of a certificate of registration/license and professional identification card to a foreign professional, with or without a qualifying examination; (b) the foreign national is a registered professional under the laws of his country of origin; (c) such registration has not been suspended or revoked; and (d) the licensing requirements of the country where the foreign national is registered are substantially the same as that required under Philippine laws, and in accordance with the rule of reciprocity. (Rep. Act 8981 (PRC Modernization Act of 2000), Section 7(j)).
[125] Rep. Act 8981, Section 7(j).
[126] Presidential Decree No. 541, Section 1; Rep. Act 8981, Section 7(l).
[127] Commonwealth Act No. 108, as amended by Pres. Decree No. 715 (1975), Section 2-A; Anti-Dummy Ministry Order No. 210, December 1, 1980.
[128] DOLE DO No. 146-15, Section 1.

in the Philippines who is competent, able and willing at the time of application to perform the services required from the foreign person.[129]

The AEP requirement does not, however, apply to the following:

a. Members of the governing board with voting rights only and do not intervene in the management of the corporation or in the day to day operation of the enterprise;
b. Corporate officers of a corporation, such as President or Treasurer;
c. Those providing consultancy services who do not have employers in the Philippines;
d. Intra corporate transferee who is a manager,[130] executive[131] or specialist[132] and an employee of the foreign service supplier for at least one (1) year prior to deployment to a branch, subsidiary, affiliate or representative office in the Philippines;
e. Contractual service supplier who is a manager, executive or specialist and an employee of a foreign service supplier which has no commercial presence in the Philippines:
    - Who enters the Philippines temporarily to supply a service pursuant to a contract between his/her employer and a service consumer in the Philippines;
    - Must possess the appropriate educational and professional qualifications; and
    - Must be employed by the foreign service supplier for at least one year prior to the supply of service in the Philippines.[133]

The following foreign persons are also exempted from the coverage of the AEP requirement:

a. All members of the diplomatic service and foreign government officials accredited by and with reciprocity arrangement with the Philippine government;
b. Officers and staff of international organizations of which the Philippine government is a member, and their legitimate spouses desiring to work in the Philippines;
c. All foreign nationals granted exemption by law;
d. Owners and representatives of foreign principals of POEA-accredited companies who come to the Philippines for a limited period and solely to interview Filipino applicants for employment abroad;
e. Foreign nationals who come to the Philippines to teach, present and/or conduct research studies in universities and colleges as visiting, exchange or adjunct professors under formal agreements between the universities or colleges in the Philippines and foreign universities or colleges; or between the Philippine government and foreign government. Such exemption must be on a reciprocal basis;
f. Quota immigrants as defined in the Philippine Immigration Act of 1940.[134]

Based on the above, foreign nationals employed by domestic enterprises, either a sole proprietorship, partnership or corporation, and foreign corporations registered to do business in the Philippines (i. e., branch, representative office, regional area headquarters and regional operating headquarters), are generally required to secure AEPs before they can be employed

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[129] Pres. Decree No. 442, Art. 40.

[130] Defined as “a natural person within the organization who primarily directs the organization/department/subdivision and exercises supervisory control functions over other supervisory, managerial or professional staff; does not include first line supervisors unless employees supervised are professionals; does not include employees who primarily perform tasks necessary for the provision of the service.” (DO 146-15, Section 3(d)(ii)).

[131] Defined as “a natural person within the organization who primarily directs the management of the organization and exercises wide latitude in decision making and receives only general supervision or direction from higher level executives, the board of directors, or stockholders of the business; an executive would not directly perform tasks related to the actual provision of the service or services of the organization.” (DO 146-15, Section 3(d)(i)).

[132] Defined as “a natural person within the organization who possesses knowledge at an advanced level of expertise essential to the establishment/provision of the service and/or possesses proprietary knowledge of the organisation’s service, research equipment, techniques or management; may include, but is not limited to, members of a licensed profession.” (DO 146-15, Section 3(d)(iii)).

[133] DO 146-15, Section 3.

[134] DO 146-15, Section 2.

and perform services in the Philippines. Executive officers and specialists of these entities are, however, not considered employees subject to the AEP requirement.

The rule does not generally apply to individual consultants independently providing services in the Philippines, or employees of foreign service providers not doing business in the Philippines and temporarily providing services in the country as part of a contract between the foreign service provider and a Philippine service consumer.

*2.2.11.3. Alien entry into the Philippines.* Other than the limitations on the practice of profession, labor market test and reciprocity requirements imposed under professional regulatory, labor and corporate laws, Philippine laws also imposes conditions on the entry of foreign nationals into the Philippines for employment or engage in services trade.

Foreign nationals entering the country on a pre-arranged employment is required to secure a Working Visa under Section 9(g) of the Philippine Immigration Act of 1940. To eliminate the duplication of requirements for the issuance of work permits to foreigners, the DOLE and Bureau of Immigration (BI) agreed not to require AEPs from foreign nationals who will work in the Philippines for a period not exceeding 6 months. Instead, the BI shall issue Special Work Permits (SWP) to these foreign nationals. The application for AEP shall serve as Provisional Permit to Work (PPW) while the AEP is being processed for foreign nationals intending to work in the Philippines for more than 6 months but not more than 1 year.[135] If the foreign national continues to work in the Philippines for more than 6 months, he will be required to secure both an AEP from DOLE and a Working Visa (9(g) visa) from the BI.

Based on the survey of applicable laws above, it is clear that Philippine laws impose a significant amount of barriers to the entry of foreign nationals intending to engage in services trade in the Philippines. To illustrate an extreme example, a foreign professional temporarily employed as an architect in an architectural company, for example, will need to secure a STP from the PRC, an Authority to Employ Alien from the DOJ, an AEP from DOLE and a Working Visa (whether SWP, PPW, or a full Working Visa) from the BI to be able legitimately perform services in the Philippines. These barriers affect not only Mode 4, but also Mode 3, as it limits the ability of domestic corporations or foreign corporations registered to do business in the Philippines to employ foreign professionals they may deem qualified to perform the services required by Philippine customers.

#### 2.2.12. Competition law

Shortly after the adoption of the 1987 Constitution, the first competition bill was filed in the Philippine House of Representatives during the 8th Congress. However, the first bill and all subsequent bills filed languished in Congress for nearly 30 years, until the passage of Republic Act No. 10667,[136] otherwise known as the "Philippine Competition Act" (PCA) on July 21, 2015. The newly established Philippine Competition Commission issued its implementing regulations and regulations on June 3, 2016, and became effective on July 3, 2016.

The PCA recognizes that the past measures that were undertaken to liberalize key sectors in the economy needed to be reinforced by measures that safeguard competitive conditions in the

[135] BI Memorandum Order-AFFJr. No. 05-009, Sections 1 and 2; BI Memorandum Circular No. AFF-05-01.

[136] Entitled "*An Act for Providing for a National Competition Policy Prohibiting Anti-Competitive Agreements, Abuse of Dominant Position, and Anti-Competitive Mergers and Acquisitions, Establishing the Philippine Competition Commission and Appropriating Funds Therefor*."

Philippine economy. It recognizes that the provision of equal opportunities to all promotes the entrepreneurial spirit, encourages private investments, facilitates technology development and transfer, and enhances resource productivity. Market competition also promotes consumer welfare by allowing them to exercise their right of choice over goods and services offered in the market.

The PCA also undertakes to pursue the constitutional goals of the national economy to attain a more equitable distribution of opportunities, income and wealth, sustained increase and expansion of productivity to raise the quality of life for all, especially the underprivileged, and to regulate or prohibit monopolies when the public interest so requires and prohibit combinations in restraint of trade or unfair competition. To achieve this end, the State is mandated to:

a. Enhance economic efficiency and promote free and fair trade competition in trade, industry and all commercial economic activities, as well as establish a National Competition Policy;
b. Prevent economic concentration which will control the production, distribution, trade, or industry that will unduly stifle competition, lessen, manipulate or constrict the discipline of free markets; and
c. Penalize all forms of anti-competitive agreements, abuse of dominant position and anti-competitive mergers and acquisitions, with the objective of protecting consumer welfare and advancing domestic and international trade and economic development.[137]

The PCA applies to any person or entity engaged in any trade, industry and commerce within the Philippines. It also applies to international trade that have direct, substantial and reasonably foreseeable effects in Philippine trade, industry and commerce, and has extraterritorial application to acts done outside the Philippines, which has the same effect on Philippine trade, industry and commerce.[138]

The PCA created the Philippine Competition Commission (PCC) as an independent quasi-judicial body tasked to implement the national competition policy and attain its objectives. It has original and primary jurisdiction over the enforcement and implementation of the provisions of the PCA and its implementing regulations.[139] It has the authority to file criminal complaints for violations of the PCA with the Office for Competition of the Department of Justice (DOJ-OFC). The DOJ-OFC is empowered to conduct preliminary investigations and criminal prosecutions of offences under the PCA and other competition-related laws.[140]

In addition, where cases before sector regulators involving competition issues, the PCC will have original and primary jurisdiction to decide the same. Where such cases involve both competition and non-competition issues, the PCC is required to consult and afford the sector regulator concerned reasonable opportunity to submit its own opinion and recommendation on the matter before the PCC issues a decision. The PCC and sector regulators are also mandated to work together, where appropriate, to issue rules and regulations to promote competition, protect consumers, and prevent abuse of market power by dominant players within their respective sectors.[141]

The PCA identifies acts and agreements that are *per se* prohibited and those that are simply regulated to ensure that they do not have anti-competitive effects. These are acts and

[137] Philippine Competition Act (Rep. Act No. 10667), Section 2.
[138] Rep. Act No. 10667, Section 3.
[139] Rep. Act No. 10667, Section 12.
[140] Rep. Act No. 10667, Section 13 and 31.
[141] Rep. Act No. 10667, Section 32.

agreements are: (a) Anti-Competitive Agreements, which are in themselves prohibited, either because the agreements in themselves are anti-competitive or it is entered into with anti-competitive intent;[142] (b) Abuse of Dominant Position, where one or more entities are prohibited from abusing their dominant position by engaging in conduct that would substantially prevent, restrict or lessen competition;[143] and (c) Prohibited Mergers and Acquisitions that substantially prevent, restrict, or lessen competition in the relevant market.[144]

*2.2.12.1. Issues and challenges.* In order to effectively implement the PCA, the PCC and other stakeholders must look beyond simple behavioral barriers to entry, which are defined in Sections 14, 15 and 20 of the PCA. As the Philippines continue its process of market liberalization, firms are constantly faced with external challenges to the business environment. These constraints prevent them from fully maximizing their potential for productivity and innovation that will promote greater market efficiency.

Among these are the foreign ownership limitations in nationalized industries, and certain constraints in the national environment that affect Philippine firms' competitiveness, which were discussed above. There is also the added challenges arising from the provisions of the PCA which could limit the capacity of the PCA and the PCC to ensure the removal of barriers to entry in the services trade sector. These challenges are discussed in greater detail below.

a. Technical requirements of analysis and enforcement

The Declaration of Policy of the Philippine Competition Act mentions enhancing economic efficiency and preventing anti-competitive market concentration as a means of promoting the State's economic objectives, regulating or prohibiting monopolies and prohibiting unfair competition. In assessing whether an agreement, conduct or government action will promote efficiency gains to the market may require the regulator to assess both static and dynamic efficiency gains.

Static efficiency, referring to both allocative and productive efficiency, exists when producers and consumers' welfare is maximized at a particular point in time. Dynamic efficiency, on the other hand, refers to the extent to which a firm introduces new products or processes of production that improves efficiency over time.[145]

Determining static efficiency gains may be calculated, for example, by analyzing the effects of monopoly price on total welfare (i. e., consumer and producer surplus). However, calculating the dynamic efficiency gains of an agreement, conduct or merger may be more challenging, as the regulator will try to look into the future and determine its potential for improving efficiency through time, even if static inefficiencies may exist. This challenge will be much greater in a developing economy like the Philippines, with its share of structural market defects. How does one assess, for example, the dynamic efficiency gains of allowing a monopoly to engage in anti-competitive activities, such as imposing monopoly prices, in a technologically undeveloped market; where such act or conduct may allow the monopolistic firm to achieve economies of scale and earn enough profits to invest in research and development to further innovation and efficiency in the future?

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[142] Rep. Act No. 10667, Section 14.
[143] Rep. Act No. 10667, Section 15.
[144] *Id.*, Section 20.
[145] *See* Motta, Massimo, *Competition Policy, Theory and Practice*, Cambridge University Press, 2004: 39-55.

Another potential challenge is the determination of market concentration. Is it enough, for example, to adopt such methods of determining market concentration as the Herfindahl-Hirschman Index (HHI) or four-firm concentration ratios, without considering certain conditions in the Philippines, such as the archipelagic nature of its geography, in determining the relevant market?

All these require an emphasis on economic analysis, an understanding of the Philippine market and, the capacity to translate these into enforceable rules, regulations and decisions on matters involving competition. This means that the PCC will need to strengthen its capacity to conduct economic analysis, market surveys, policy and regulatory analysis, and regulatory impact assessments, among others. It should also be able to communicate the results in terms that make concrete action possible, and build a body of legal interpretation and jurisprudence that will make competition enforcement predictable.

b. Limited familiarity of local firms to the concept of competition

After its passage in July 21, 2015, the PCA will be implemented in an environment where local firms have been used to the presence of monopolistic and oligopolistic market structures; where monopolistic and oligopolistic firms succeeded by maintaining control over the market and limiting market competition; and where the growth of small and medium enterprises (SMEs) have stagnated and most are engaged in trading and low value services, with very little evidence of upgrading and innovation over the past decades.[146]

The experience of other countries first implementing competition laws indicates that there is very little effective enforcement activity during the first few years of implementation. Most often, the competition authorities focus on advocacy activities to inform and educate the public about their rights and obligations under the competition law, and to encourage voluntary compliance.[147]

Given the limited knowledge of Philippine firms on the concept of competition and how it can be harnessed to improve productivity and innovation that benefits the economy, as whole and individual firms, in particular, the PCC may need to place greater emphasis on competition advocacy during the first few years of the PCA's effectivity, even while it tries to discipline market behavior and prevent anti-competitive conduct.

c. Issues potentially affecting the independence of the PCC

While initial budgetary appropriation for the PCC is PhP300M, the amount is not fixed and PCC is required to ask for its budgetary appropriation from Congress every year. In addition, all funds collected by the PCC shall be remitted to the National Treasury and form part of the government's general funds. This means that all funds available to the PCC for its operations and advocacy activities are only those appropriated by Congress. This makes the PCC vulnerable to the whims of political influence and regulatory capture.

d. Potential conflict between sector regulators and the PCC

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[146] *See* Barcenas, Lai-Lynn Angelica, Maria Theresa M. Bautista, Joan P. Serrano, "Promoting Coherence in Philippine Policies, Laws, Rules and Regulations that Encourage the Growth and Development of Small and Medium Enterprises into Active Participants in the Global and Regional Economy," APEC 2015 Policy Studies, Department of Foreign Affairs, Vol. II, 2015: 125 – 181.

[147] *See* Mendoza et al.

As noted above, cases before sector regulators in regulated industries, such as the airline, telecommunications and, electricity industries in the Philippines, among others, involving competition issues shall be under the original and primary jurisdiction of the PCC. It also acquires jurisdiction if the issue involves both competition and non-competition issues, where the PCC is required to consult and afford the sector regulator concerned a reasonable opportunity to submit its own opinion and recommendation on the matter before the PCC issues a decision. The jurisdiction of the PCC over cases before sector regulators involving competition and non-competition issues may give rise to conflict between the PCC and sector regulators.

First, the phrase the PCC "*shall still have jurisdiction if the issue involves both competition and non-competition issues*," in Section 32 of Rep. Act 10667, referring to the jurisdiction of the PCC over regulated industries, may result to over-reach on the part of the PCC. If the PCC also has jurisdiction even over non-competition issues that could be embedded in the competition issue, it runs the risk of infringing on operational and regulatory matters that may well be within the jurisdiction of the sector regulators.

Second, on matters involving both competition and non-competition issues, the PCC have the authority to render a decision. The sector regulators may only be consulted and afforded a reasonable opportunity to submit their own opinion and recommendation. Nothing in the law indicates that the PCC is duty-bound to recognize the sector regulators' expertise on industry-specific matters. It seems that the intent of the PCA is to give competition primacy over industry-specific concerns, such as for example in the pursuit of an established industrial policy. This may give rise not only to jurisdictional conflict, but policy conflict as well.

It is thus important that the PCC and sector regulators issue joint regulations to govern the resolution of competition and non-competition issues and include a mechanism for resolving issues such as conflict between competition policy and other governmental policy involving the industry or conflict between the mandate of the sector regulators over operational or regulatory industry concerns and those of the PCC on competition matters.

The above issues and challenges, if not properly addressed, can either render the PCC ineffective in removing both regulatory and behavioral barriers to entry in the market, or worsen the same.

*2.2.12.2. Ease of Doing Business.* Despite the many permits, licenses, and even taxes imposed on enterprises in the Philippines, Republic Act No. 11032 may alleviate delays in establishing a business, at least at the frontlines.

Republic Act No. 11032 was passed to primarily amend and enhance the effectiveness of the Anti-Red Tape Law. It mandates the posting of a Citizens' Charter at agencies and offices which should state the requirements, procedures, the person responsible, and the maximum time necessary to complete an application. It also mandates that the procedure for complaints be included in the Citizens Charter.[148]

The law also adopts a no contact policy where, except in the preliminary assessment or evaluation of an application or request, a government personnel in such office or agency cannot have contact with the applicant. The law also directs the migration of manual applications to

[148] Section 6, R.A. 11032.

online systems once the DICT has established a registration system acceptable to the public.[149] In fact, the law also provides that all government agencies concerned shall, when applicable, develop electronic versions of licenses, clearances, permits, certifications or authorizations with the same level of authority as that of the signed hard copy.[150]

The law significantly lays responsibility upon the head of agency for his office's efficiency. Section 8 of the law makes the head of the agency accountable in rendering fast, efficient, convenient and reliable service. All transactions and processes are deemed to have been made with the permission or clearance from the highest authority having jurisdiction over the government office or agency concerned. [151]

One highlight of the law is the prescribed processing time of applications. Applications or requests submitted must be acted upon by the assigned officer or employee within the prescribed processing time stated in the Citizen's Charter which shall not be longer than three (3) working days in the case of simple transactions and seven (7) working days in the case of complex transactions from the date the request and/or complete application or request was received. [152]

Simple transactions refer to applications or requests submitted by applicants or requesting parties of a government office or agency which only require ministerial actions on the part of the public officer or employee, or that which present only inconsequential issues for the resolution by an officer or employee of said government office. [153] Meanwhile, Complex transactions refer to applications or requests submitted by applicants or requesting parties of a government office which necessitate evaluation in the resolution of complicated issues by an officer or employee of said government office, such transactions to be determined by the office concerned.[154]

Applications or requests involving activities which pose danger to public health, public safety, public morals, public policy, and highly technical applications, the prescribed processing time shall in no case be longer than twenty (20) working days. [155] This may be extended only once and for the same period.

If the application requires approval by a Sanggunian, it shall be acted upon not later than 45 days from receipt of the application and such period may be extended for 20 days.[156]

No application or request shall be returned to the applicant or requesting party without appropriate action. In case an application or request is disapproved, the officer or employee who rendered the decision shall send a formal notice to the applicant or requesting party within the prescribed processing time, stating therein the reason for the disapproval.[157]

The law also limits the signatories for any document. It limits number of signatories in any document to a maximum of three which shall represent officers directly supervising the office or agency concerned. In case the authorized signatory is on official business or official leave,

[149] Section 7, R.A. 11032.
[150] Section 9(e), R.A. 11032.
[151] Section 8, R.A. 11032.
[152] Section 9 (b) (1), R.A. 11032.
[153] Section 4(m), R.A. 11032.
[154] Section 4(d), R.A. 11032.
[155] Section 9 (b) (1), R.A. 11032.
[156] *Id.*
[157] Section 9 (b)(2), R.A. 11032.

an alternate shall be designated as signatory. Electronic signatures or pre-signed license, clearance, permit, certification or authorization with adequate security and control mechanism may be used.[158]

If a government office or agency fails to approve or disapprove an original application or request for issuance of license, clearance, permit, certification or authorization within the prescribed processing time, said application or request shall be deemed approved. Of course, this is on the premise that all required documents have been submitted and all required fees and charges have been paid by the applicant.[159] Likewise, if a government office or agency fails to act on an application or request for renewal of a license, clearance, permit, certification or authorization subject for renewal within the prescribed processing time, said license, clearance, permit, certification or authorization shall automatically be extended.[160]

The law also covers renewal of permits at the LGU level. It prescribes A single or unified business application form in processing new applications for business permits and business renewals which consolidates all the applicant's information in various local government departments, such as local taxes and clearances, building clearance, sanitary permit, zoning clearance, and other specific LGU requirements, including the fire clearance from the Bureau of Fire Protection (BFP).[161] All these permits are to be issued together with the business permit.[162]

The law also advances the establishment of a Philippine Data Bank. Documents already submitted by an applicant or requesting party to an agency which has access to the PBD shall no longer be required to resubmit them. At the local government level, the city or municipal business process and licensing office shall not require the same documents already provided by an applicant or requesting party to the local government departments in connection with other business-related licenses, clearances, permits, certifications or authorizations such as, but not limited to, tax clearance, occupancy permit and barangay clearance. [163]

The law imposes administrative and criminal liability on government personnel who fail to observe the mandates of the law. Thus, any person who performs or cause the performance of the following acts shall be liable:

a. Refusal to accept application or request with complete requirements being submitted by an applicant or requesting party without due cause;
b. Imposition of additional requirements other than those listed in the Citizen's Charter;
c. Imposition of additional costs not reflected in the Citizen's Charter;
d. Failure to give the applicant or requesting party a written notice on the disapproval of an application or request;
e. Failure to render government services within the prescribed processing time on any application or request without due cause;
f. Failure to attend to applicants or requesting parties who are within the premises of the office or agency concerned prior to the end of official working hours and during lunch break;
g. Failure or refusal to issue official receipts; and

[158] Section 9 (d), R.A. 11032.
[159] Section 10, R.A. 11032.
[160] *Id.*
[161] Section 11, R.A. 11032.
[162] *Id.*
[163] *Id.*

h. Fixing and/or collusion with fixers in consideration of economic and/or other gain or advantage. [164]

## 3. Review of regulations affecting trade and investment in the financial services sector

### *3.1. Definition and scope*

Article I:2 of the General Agreement on Trade in Services (GATS) defines trade in services as the supply of a service:

a. From the territory of one Member into the territory of any other Member (Mode 1 — Cross border trade);
b. In the territory of one Member to the service consumer of any other Member (Mode 2 — Consumption abroad);
c. By a service supplier of one Member, through commercial presence, in the territory of any other Member (Mode 3 — Commercial presence); and
d. By a service supplier of one Member, through the presence of natural persons of a Member in the territory of any other Member (Mode 4 — Presence of natural persons).

Under the GATS Annex on Financial Services, "A financial service is any service of a financial nature offered by a financial service supplier of a Member." It covers two broad categories of financial services: (i) insurance and insurance-related services; and (ii) banking and other financial services (excluding insurance).

Insurance and insurance-related services include the following activities:

a. Direct insurance (including co-insurance), broken down into life and non-life;
b. Reinsurance and retrocession;
c. Insurance intermediation, such as brokerage and agency; and
d. Services auxiliary to insurance, such as consultancy, actuarial, risk assessment and claim settlement services.

Activities covered under banking and other financial services include:

a. Acceptance of deposits and other repayable funds from the public;
b. Lending of all types, including consumer credit, mortgage credit, factoring and financing of commercial transaction;
c. Financial leasing;
d. All payment and money transmission services, including credit, charge and debit cards, travelers cheese and bankers drafts;
e. Guarantees and commitments;
f. Trading for own account or for account of customers, whether on an exchange, in an over-the-counter market or otherwise, the following: (a) money market instruments (including checks, bills, certificates of deposits) ; (b) foreign exchange; (c) derivative products including, but not limited to, futures and options; (d) exchange rate and interest rate instruments, including products such as swaps, forward rate agreements; (e) transferable securities; and (f) other negotiable instruments and financial assets, including bullion.

[164] Section 13, R.A. 11032.

g. Participation in issues of all kinds of securities, including underwriting and placement as agent (whether publicly or privately) and provision of services related to such issues;
h. Money broking;
i. Asset management, such as cash or portfolio management, all forms of collective investment management, pension fund management, custodial, depository and trust services;
j. Settlement and clearing services for financial assets, including securities, derivative products, and other negotiable instruments;
k. Provision and transfer of financial information, and financial data processing and related software by suppliers of other financial services;
l. Advisory, intermediation and other auxiliary financial services on all the activities listed in (v) through (xv), including credit reference and analysis, investment and portfolio research and advice, advice on acquisitions and on corporate restructuring and strategy.

Cross-border trade in financial services has been defined as "the provision of financial services by a financial firm located in one country to a customer residing in another country without the establishment of a commercial presence, such as a branch or subsidiary, in the country of the customer (the "host country")" (OECD 2000: 23). In this definition, the country in which the financial firm is "located" could be either the country in which it is headquartered or a third country in which it has a branch or subsidiary. Furthermore, there is no assignment of geographic location to the transaction in this definition, that is, it does not determine whether the transaction "takes place" in the country of the service provider or the country of the customer. Because financial services are intangible, assigning a geographic location to their provision across borders is difficult and complex. Thus, the distinction between Modes 1 (cross border trade) and 2 (consumption abroad) is not always clear. The rise of e-commerce will further raise the issue of geographic location (OECD 2000).

The scope of the financial services sector addressed in this study includes the major groups in the Philippine financial system that provide financial services: banks and nonbank financial intermediaries (NBFIs), with particular focus on private insurance which forms part of NBFIs. The treatment of issues is largely based on thematic lines because many of the key forces and developments are not entity or market specific.

## *3.2. Economic significance*

### 3.2.1. Financial services sector

The financial system is a network of financial institutions and markets dealing in a variety of financial instruments that are employed in money transmission, and the lending and borrowing of funds. Its structure consists of the current stock of varied financial assets and the pattern of financial institutions in existence. It is unique in the way its markets, prices, institutions, and policies impinge upon the rest of the economy. Money is the only good that trades against all others, and interest rates have pervasive relevance to economic decisions (Shaw 1973).

The two traditional functions of an effective financial system are to provide an adequate supply of acceptable money, and to transfer resources efficiently between lenders and borrowers. In other words, it generates and pumps the money and finance (or credit) necessary for the production and distribution of goods and services. But the financial system is more than a generator of money and credit. It is, by the very nature of its function, a powerful influence on how the wealth of an economy is created and allocated, what goods and services are produced and by whom, and who gains from the opportunity of trading in and distributing these goods and services (Drake 1980).

The ways in which financial transactions occur has changed significantly over time, but the underlying objectives have not. A modern financial sector provides at least four core functions (RBA 2014):

a. Value exchange: a way of making payments. A safe and efficient payment system is essential to support the day-to-day business of an economy. An efficient payment system is one that is timely, accessible, easy to integrate with other processes, easy to use, safe and reliable, and affordable and transparent;
b. Intermediation: a way of transferring resources between savers and borrowers. Intermediation has gone beyond the traditional banking service of taking deposits and making loans. For instance, investment banks intermediate between investors and bond issuers, and brokers perform a similar function in connecting the buyers and sellers of equities. Intermediation now also involves other functions such as pooling resources, asset transformation, risk assessment and information processing, monitoring borrowers, and accurate accounting;
c. Risk transfer: a means for pricing and allocating certain risks. That is, the role of the financial sector is not to remove risk entirely, which is not possible, but to facilitate the transfer of risks to those best able to manage them;
d. Liquidity: a means of converting assets into cash without undue loss of value. A financial system that works well will allow individuals, businesses, and governments to convert their assets into cash at short notice, without undue loss of value.

These functions are important in the functioning of the economy, but they are not generally ends in themselves. **The financial sector is an intermediate sector**, which is why it is important that financial services are provided in the most efficient and sound way. All economic transactions require efficient and reliable access to financial services (McGuire 2002). Ultimately, the main goal of a well-functioning modern financial sector is to promote efficiency in other economic sectors.

The crucial role that an efficient financial system plays in the process of economic development cannot be disputed. That there is a positive relationship between financial development and economic growth has been recognized in the literature from the time of Adam Smith. As a result, financial sector development, or the expansion and elaboration over time of the financial structure, has become a major policy issue and objective in itself. Also, its precise role and how to maximize it in the development process has become the subject of numerous theoretical and empirical studies[165].

The various ways that a financial sector can be said to develop include (DFID 2004):

a. The efficiency and competitiveness of the sector may improve;
b. The range of financial services that are available may increase;
c. The diversity of institutions which operate in the financial sector may increase;
d. The amount of money that is intermediated through the financial sector may increase;
e. The extent to which capital is allocated by private sector financial institutions, to private sector enterprises, responding to market signals (rather than government directed lending by state owned banks), may increase;
f. The regulation and stability of the financial sector may improve; and

[165] For example, Honohan (2004a, 2004b), DFID (2004), Levine (2004), and Andrianova and Demetriades (2008) conducted in-depth surveys of this extensive literature.

g. Particularly important from a poverty reduction perspective, more of the population may gain access to financial services.

Thus, financial sector development comprises both financial widening (i.e., offering a wider range of financial goods and services with different maturities, risks and returns from a variety of financial intermediaries) and financial deepening (i.e., the accumulation of financial assets at a faster pace than the accumulation of non-financial wealth).

In developing economies, financial sector development and deepening is assigned an additional role of helping to promote poverty alleviation. In particular, financial sector development is posited to have both direct (to the extent that financial sector development widens access to financial services for the poor and small businesses) and indirect (through its positive impact on growth) impacts on poverty (Greenwood and Javanovic 1990). Zhuang et al. (2009) undertook an extensive review of the theoretical and empirical literature on the role of financial sector development, and came to the conclusion there are both strong arguments as well as empirical support that it plays a critical role in facilitating economic growth and poverty alleviation. Thus, financial inclusion – defined as "the effective access to and use of available, affordable, convenient, quality and sustainable financial services" (UNCTAD 2015) – was designated as a key enabler of the Post-2015 Development Agenda.

In turn, financial innovation, backed by advancements in digital technology, has been deemed as a major driver of financial inclusion. Distribution is the underlying problem of financial inclusion, which can be caused by poor formal financial infrastructure (e.g., low penetration of bank branches, and even ATMs). Digital innovation overcomes time-space constraints. Thus, it offers a promising digital pathway to financial inclusion by addressing the distribution problem (Nan 2018). Innovations to promote financial inclusion have occurred within mainstream financial industry, as well as other sectors not traditionally identified as part of the financial system. In particular, innovations within the financial sector, innovations within the telecommunications sector, and innovations at the intersection of these two sectors have led to a growing number of mobile financial services geared toward enhancing financial inclusion of the unbanked and underbanked in emerging markets (Yawe and Prabhu 2015).

### 3.2.2. Regulatory assessment

Given that the financial sector is a critical link in the functioning of an economy, it is among the most heavily regulated sectors because of its systemic importance. Financial regulation plays a critical role in ensuring that financial markets work well. It preserves the integrity of the financial system through the removal of serious distortions to competition, protection of the essential needs of ordinary people in cases where there is asymmetric information, and prevention of costly market failures. Key goals of financial regulation include: (i) investor protection; (ii) consumer protection; (iii) financial stability; (iv) market efficiency; (v) competition; (vi) prevention of financial crime; and (vii) fairness. Oftentimes, the goals of financial regulation have to be traded off against each other. Thus, governments and regulators must have clearly defined objectives and priorities among these goals in order to achieve the desired balance (Brunnermeier et al. 2009).

Lifting barriers in the financial sector is seen to spur economic growth more than in any other service sector (McGuire 2002). While the simple removal of state imposed regulations would improve competition in most markets, some form of regulation is necessary in financial markets to protect the reputation and soundness of the financial system, as well as the competitive process. And a successful financial system must be simultaneously sound and competitive. On the one hand, a competitive but unsound financial system is unsustainable because its lack of soundness will ultimately cause the system to break down. On the other hand, a sound but uncompetitive financial system will increase inefficiency in both the financial system and the entire economy. Both cases will have deleterious effects on the economy's growth potential and society's welfare. The major issue confronting financial regulation then is how to balance the need for both soundness and competitiveness (Grimes 1999).

A critical component of any negotiation on financial services trade and investment is the relationship between domestic regulation and opening of financial markets. Financial liberalization issues in the context of trade negotiations are becoming more important. But liberalization of trade and investment in financial services must be seen as a subset of an economy's broader financial liberalization agenda. The former is aimed at increasing financial market access and removing discriminatory and other access-impeding barriers to foreign competition. On the other hand, the overall objective of financial liberalization is to remove distortions in domestic financial systems, which impede its competitiveness and efficiency. That being said, there is synergy between the two in that international trade agreements can provide the impetus to drive necessary domestic policy reforms. The challenge is how to strategize, negotiate and implement international trade agreements in financial services such that liberalization of financial services through trade agreements brings about financial deepening, modernization and stability (Haddad and Stephanou 2010).

A useful preparatory step for negotiations is to undertake a trade-related regulatory audit, which entails mapping explicitly restrictive governmental measures that affect trade and investment in financial services. Such an audit would: (i) provide precise information on the regulatory status quo, thus helping to clarify the sectoral intricacies and technical details needed by negotiators to effectively participate in the process, (ii) provide a one-stop inventory of restrictive measures maintained at home and in the markets of key trading partners to service providers; and (iii) help in the development of a roadmap of measures to target and rank order in future negotiations. Domestic purposes may be served as well. In particular, it may generate positive policy spillovers with respect to domestic regulatory conduct and design, and enhance dialogues and consultations within government and between government and the private sector and other key stakeholders (Sauvé 2010).

Ultimately, the goal of a regulatory review would be to identify the regulatory burdens that are of most concern to businesses. The Malaysia Productivity Corporation (MPC) developed a methodology to identify and reduce unnecessary regulatory burdens on businesses, which consolidates the approaches of developed economies (including the US and Australia) and multilateral organizations (particularly the OECD) but taking into account the conditions prevailing in developing economies (MPC 2014). In particular, MPC's methodology reviews both the regulations as well as their implementation.

Reducing unnecessary regulatory burdens (RURB) maximizes efficiency and effectiveness of regulations. RURB addresses unnecessary costs arising from poor or excessive regulation as well as from poor implementation of regulation. RURB supports national regulatory reform initiatives to improve overall regulatory regime such that policies and regulations fit together; i.e., no redundancies; no conflicting policies; better still, policies and regulations complement one another in support of greater efficiency, enhanced competitiveness and increased trade.

In general, unnecessary regulatory burdens include:

a. Excessive coverage by a regulation - that is, the regulation affects more economic activity than was intended or required to achieve its objective (includes "regulatory creep");
b. Subject-specific regulation covers much the same issues as other generic regulation;
c. Prescriptive regulation that unduly limits flexibility, such as preventing businesses from using the best technology, making product changes to better meet consumer demand, or meeting the underlying objectives of regulation in different ways;
d. Overly complex regulation;
e. Unwieldy license application and approval processes, or excessive time delays in obtaining responses and decisions from regulators;
f. Requests to provide more information than needed, or requests to provide the same information more than once;
g. Rules or enforcement approaches that inadvertently result in businesses operating in less efficient ways;
h. Unnecessarily invasive regulator behavior;
i. An overlap or conflict in the activities of different regulators; and
j. Inconsistent application or interpretation of regulation by regulators.

Regulations are generally meant to "…address risks to society, the economy or the environment which are not adequately addressed by individuals and unfettered markets" (MPC 2014: 18). The challenge is to ensure that the regulations are commensurate to the risks involved, and are no more burdensome to business, individuals, and/or communities than they should be to adequately address those risks.

### *3.3. Regulatory institutions*

The Philippines still essentially follows an institutional approach in regulating and supervising the three major institutional groups in the financial services sector – the Bangko Sentral ng Pilipinas (BSP) for the banking sector; Securities and Exchange Commission (SEC) for the securities market; and the Insurance Commission (IC) for the private insurance sector. The Philippine Deposit Insurance Corporation (PDIC), which insures the deposits of all banks, also monitors the activities of banks, although it primarily relies on information gathered by the BSP. The SEC also registers banks and insurance companies' articles of incorporation, but only if they are accompanied by a certificate of authority to operate issued by the Monetary Board or a recommendation from the IC, respectively. Organizationally, the SEC, IC and PDIC are attached agencies of the Department of Finance (DOF), which convenes an Inter-Agency Committee on Financial Services. BSP and IC's predecessors both came into existence as independent bodies in 1949. PDIC is the youngest organization, which was established in the early 1960s, while SEC is the oldest, having been established in 1936.

#### 3.3.1. Bangko Sentral ng Pilipinas

The New Central Bank Act (RA 7635), which called for the creation of a new, independent Central Monetary Authority called the Bangko Sentral ng Pilipinas (BSP), was signed into law in June 1993. The powers and function of the BSP, such as the conduct of monetary policy and supervision of the financial system, are exercised by its Monetary Board. The Governor is the chief executive officer of the BSP, and chairs the Monetary Board.

In particular, the Act redefined the scope of the BSP's supervisory and regulatory powers to be over banks, quasi-banks and institutions performing similar functions[166]. The Act also provided for the transfer of regulatory powers over finance companies without quasi-banking functions and other institutions performing similar functions from the BSP to the SEC, within five years from the effectivity of the Act[167]. On the other hand, the Act also gave the BSP authority to supervise and examine, not just banks and quasi-banks, but also their subsidiaries and affiliates engaged in allied activities[168]. This marked the move toward a conglomerated approach to the supervision of banks, as financial liberalization and deregulation of lines-of-business and ownership restrictions beginning in the 1980s promoted the formation of financial conglomerates. But some of these subsidiaries and affiliates of banks (including investment houses, securities dealers and brokers, finance companies and insurance companies) are primarily regulated by SEC and IC under relevant laws. The General Banking Law of 2000 (RA 8791) is the primary law that generally governs the regulation, organization, and operation of banks, quasi-banks, and other quasi-entities, taking into account the provisions of other banking laws, including the Thrift Bank Act, Rural Bank Act, and Cooperative Code.

Before a bank is incorporated, the Monetary Board must first issue a Certificate of Authority allowing the group of persons to organize a bank and register the corporation with SEC.[169]

The Monetary Board may also, to protect the funds of depositors and creditors and in exceptional cases, regulate the payment by the bank to its directors and officers of compensation, allowance, fees, bonuses, stock options, profit sharing and fringe benefits. [170] To maintain the quality of bank management and afford better protection to depositors and the public in general, the Monetary Board shall prescribe, pass upon and review the qualifications and disqualifications of individuals elected or appointed bank directors or officers and disqualify those found unfit.[171] It may also remove and suspend directors and officers for unfitness.

The Monetary Board also prescribes the minimum ratio which the net worth of a bank must bear to its total risk assets which may include contingent accounts.[172] In case a bank does not comply with the prescribed minimum ratio, the Monetary Board may limit or prohibit the distribution of net profits by such bank and may require that part or all of the net profits be used to increase the capital accounts of the bank until the minimum requirement has been met. The Monetary Board may, furthermore, restrict or prohibit the acquisition of major assets and the making of new investments by the bank.[173]

While the General Banking Act provides that the BSP has supervision over banks, banking supervision includes certain regulatory powers. For one, any person or entity seeking to engage in banking operations or quasi-banking functions must first secure an authority to do so from the BSP.[174]

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[166] Section 3, New Central Bank Act.
[167] Section 130, New Central Bank Act
[168] Section 25, New Central Bank Act.
[169] Section 14, General Banking Law.
[170] Section 18, General Banking Law.
[171] Section 16, General Banking Law.
[172] Section 34, General Banking Law.
[173] Section 34, General Banking Law.
[174] Section 6, General Banking Law.

The BSP's regulatory authority includes the authority to enforce prompt corrective action.[175] Its corrective action may be based on rules of conduct and standards it may issue.[176] It is also authorized to conduct regular investigations and audits of banks to determine whether they comply with safe and sound banking practices and accordingly address deficiencies or irregularities it may discover.[177] It also inquiries into the solvency and liquidity of institutions.[178] Upon the instance of the Monetary Board, the BSP also conducts an examination of banking institutions to ensure compliance with laws and regulations.

Moreover, the BSP ensures compliance by banks with Republic Act No. 6977, as amended, which mandates lending institutions to allocate 8% of its loan portfolio for micro and small enterprises loans.[179] Likewise, the BSP assists in implementing Republic Act No. 10000,[180] which mandates all banks to set aside 25% of its loanable funds to agriculture and fisheries credit and 10% of which should be set aside for beneficiaries of agrarian reform.[181] RA 10000 also prescribes possible modes of compliance. That is, it does not stipulate pure direct bank lending to the intended beneficiaries, but allows indirect compliance. Among several possible modes include holding bonds issued by government universal banks; opening special deposit accounts with accredited rural financial institutions; rediscounting with universal and commercial banks eligible paper covering agriculture, fisheries and agrarian reform credits, including loans covered by guarantees of the Quedan and Rural Credit Guarantee Corporation (QUEDANCOR) and the Philippine Crop Insurance Corporation (PCIC); and investing directly in preferred shares of stock in rural financial institutions.[182]

In May 2018, the BSP announced its implementation of a phased reorganization to enhance its capacity to fulfill its mandate. The reorganized BSP will have four (4) major sectors: (i) Monetary and Economics Sector in charge of monetary policy formulation, implementation, and assessment; (ii) Financial Supervision Sector, which will regulate banks and other BSP-supervised financial institutions, as well as provide oversight on matters relating to financial technology, payment systems, and consumer protection; (iii) Currency Management Sector, mainly responsible for the forecasting, production, distribution and retirement of Philippine currency; and (iv) Corporate Services Sector responsible for the effective management of corporate strategy, communications, and risks, as well as the BSP's human, financial, technological and physical resources to support the BSP's core functions (BSP 2018a).

In particular, the BSP undertakes regulation of banks and other BSP-supervised financial institutions, as well as the oversight and supervision of financial technology and payment systems through the Financial Supervision Sector (FSS), formerly known as the Supervision and Examination Sector. FSS is headed by a Deputy Governor. There are five sub-sectors under the FSS, each headed by an Assistant Governor/Managing Director. The Departments or Offices under each subsector are headed by a Director (Figure 2).

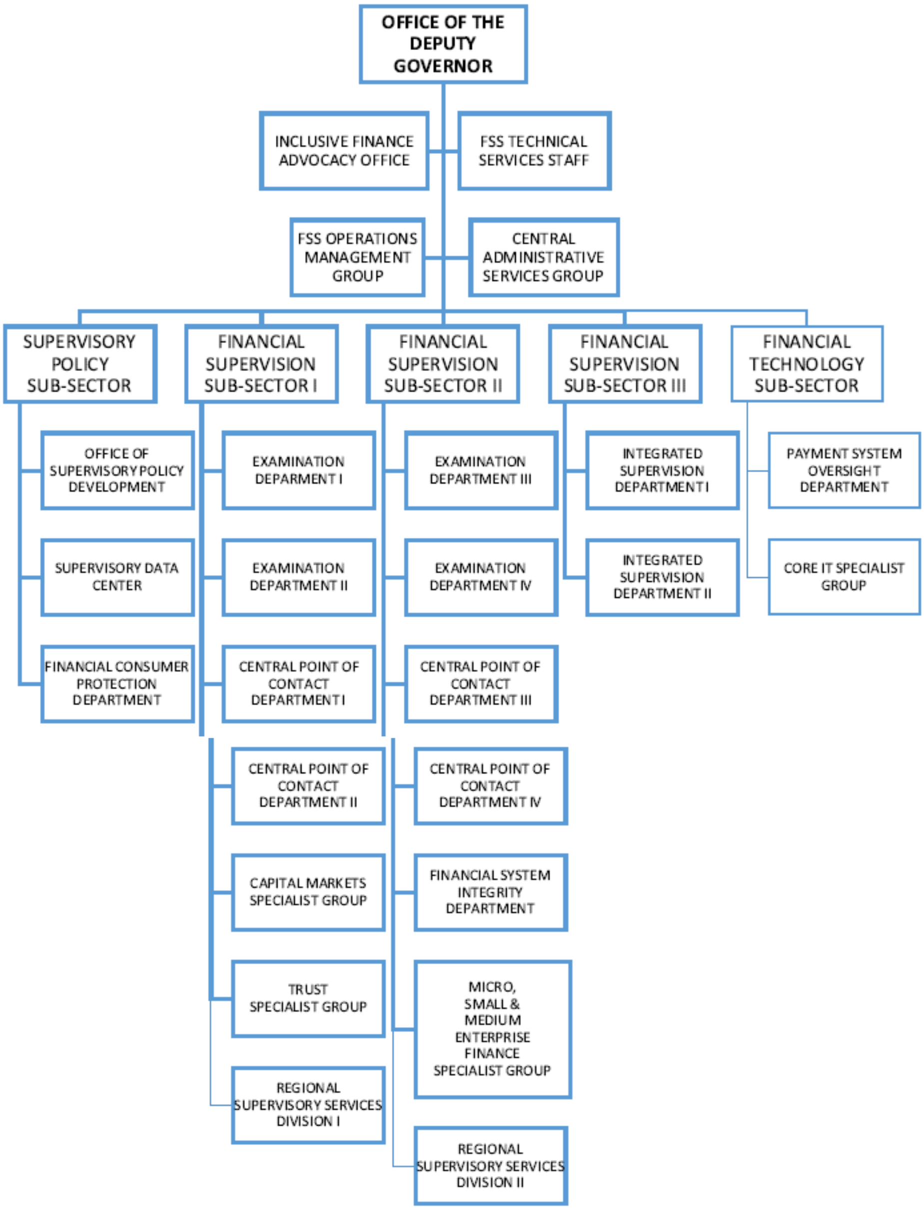
In particular, two Financial Supervision Sub-Sectors are in charge of on-site examination of: (i) universal banks and their subsidiaries/affiliates; (ii) commercial banks and their subsidiaries/affiliates; (iii) foreign banks and their subsidiaries/affiliates; and (iv) thrift, cooperative, and rural banks. The third Financial Supervision Sub-Sector undertakes integrated

[175] Section 4.6, General Banking Law.
[176] Section 4.1, General Banking Law.
[177] Section 4.4, General Banking Law.
[178] Section 4.5, General Banking Law.
[179] Section 15, R.A. 6977, as amended.
[180] Section 10, R.A. 10000.
[181] Section 6, R.A. 10000.
[182] Section 7, R.A. 10000

supervision, including monitoring and supervising non-bank financial institutions such as investment houses with quasi-banking and/or trust license, and non-stock savings and loans associations.

Prior to the BSP's recent reorganization, there was a division called Core Information Technology Supervisory Group under a Financial Supervision Sub-Sector to track the latest developments in electronic banking. Now there is a higher level Financial Technology Sub-Sector composed of the: (i) Payment System Oversight Department, which undertakes formal oversight of the national payment system (NPS); and (ii) Core Information Technology Specialist Group, which conducts information technology supervision and examination of banks and non-bank financial institutions, including payment systems, and ensures a safe and sound cyber-security environment for the Philippine financial services industry through cyber-security surveillance and oversight. The goal is to establish a regulatory environment that fosters innovation but at the same time ensures that risks are effectively managed.

**Figure 2. Organizational structure of the Financial Supervision Sector, Bangko Sentral ng Pilipinas**




Source: BSP (2018), p. 14.

There is also an office under Financial Supervision Sub-Sector II called the Micro, Small, and Medium Enterprise Finance Specialist Group, which examines banks that have adopted a business model dedicated to or highly exposed to micro, small, and medium enterprises. Finally, there is an Inclusive Finance Advocacy Office attached to the Office of the Deputy Governor, which focuses on advocacy work with financial institutions to promote sustainable methods in the delivery of microfinance and small and medium enterprise banking services.

Table 8 shows the number of banks and their subsidiary or affiliate NBFIs under the supervision/regulation of the BSP in 2017.

**Table 8. BSP supervised/regulated financial institutions, December 2017**

| | Total | Head Office | Other Offices |
|---|---|---|---|
| **BSP Supervised/Regulated Financial Institutions** | **28,807** | **6,084** | **22,723** |
| **I. Philippine Banking System** | **11,793** | **587** | **11,206** |
| a. Universal and Commercial Banks | 6,483 | 43 | 6,440 |
| Universal Banks | 5,935 | 21 | 5,914 |
| Commercial Banks | 548 | 22 | 526 |
| b. Thrift Banks [1/] | 2,417 | 55 | 2,362 |
| c. Rural and Cooperative Banks | 2,893 | 489 | 2,404 |
| Rural Banks [1/] | 2,742 | 464 | 2,278 |
| Cooperative Banks | 151 | 25 | 126 |
| **II. Non-Bank Financial Institutions with Quasi Banking Function** | **120** | **9** | **111** |
| Investment Houses | 4 | 3 | 1 |
| Financing Companies | 115 | 5 | 110 |
| Other Non-Bank with Quasi-Banking Function | 1 | 1 | 0 |
| **III. Non-Bank Financial Institutions without Quasi Banking Function** | **16,891** | **5,485** | **11,406** |
| Investment Houses with Trust Function | 12 | 3 | 9 |
| Non-Stock Savings and Loan Associations | 197 | 65 | 132 |
| Pawnshops | 16,582 | 5,346 | 11,236 |
| Others [2/] | 100 | 71 | 29 |
| **IV. Offshore Banking Units** | **3** | **3** | **0** |

Notes: [1] Includes Microfinance-Oriented Banks.
[2] Includes Investment House (w/o QB function) (12 Head Offices), Financing Co. (w/o QB function) (18 HOs), Investment Co. (w/o QB function) (1 HO), Securities Dealer/Broker (13 HOs), Lending Investor (1 HO), Venture Capital Corp (None), Credit Card Co. (4 HOs), Govt NBFI (2 HOs), Electronic Money Issuer (EMI) - Others (5 HOs), AAB Forex Corporations, Remittance Agent (1 HO), Credit Granting Entities (CGEs) (9 HOs) and Trust Corporations
Source: BSP Banking Statistic – Physical Network: Number of Offices-Philippine Banking System (http://www.bsp.gov.ph/banking/pbs_archives/2017/1.1.htm; Accessed 5 November 2018).

The BSP is a member of the Bank for International Settlements (BIS), which is an international organization owned by 60 central banks that serves them and other financial authorities worldwide to foster greater collective understanding of the world economy and international cooperation in the pursuit of global monetary and financial stability.

### 3.3.2. Securities and Exchange Commission

The SEC regulates and supervises the securities market, and also acts as the registrar for the Philippine corporate sector.

As the primary regulation authority of corporations, the SEC has authority to approve, reject, suspend, revoke or require amendments to registration statements, and registration and licensing applications.[183] As a regulatory agency, the SEC also regulates, investigates and supervises the activities of persons to ensure compliance with laws and legal requirements. It supervises, monitors, suspends or takes over the activities of exchanges, clearing agencies and other SROs. The SEC also has the power to impose sanctions for the violation of laws and rules, regulations and orders, and issued pursuant thereto.[184] It may also issue cease and desist orders to prevent fraud or injury to the investing public.[185] It can also suspend, or revoke, after proper notice and hearing the franchise or certificate of registration of corporations, partnership or associations, upon any of the grounds provided by law.[186]

[183] Section 5 (c), Securities Regulation Code.
[184] Section 5, Securities Regulation Code.
[185] Section 5 (i), Securities Regulation Code.
[186] Section 5 (m), Securities Regulation Code.

The SEC can also enlist the aid and support and deputize any enforcement agency of the Government, civil or military as well as any private institution, corporation, firm, association or person in the implementation of its powers and function.[187]

Securities sold or offered for sale or distribution within the Philippines must possess a registration statement duly filed with and approved by the SEC.[188] The requirement for registration also applies to asset backed securities,[189] which also must be covered by a permit to sell issued by the SEC in order to be sold in the market.[190]

The SEC also issues registrations for exchanges or over the counter markets.[191] In line with such authority, the SEC also has the authority to determine the number, size and location of stock exchanges, other trading markets and commodity exchanges and other similar organizations in light of national or regional requirements for such activities with the view to promote, enhance, protect, conserve or rationalize investment.[192] It also has the power of granting an exemption to an exchange from the restriction of performing another business than that of an exchange.[193] In addition, the SEC may require and enforce uniformity of trading regulations in or between or among exchanges or other trading markets.[194]

The SEC can promulgate rules and regulations for the prompt and accurate clearance and settlement of securities transactions.[195] To protect investors and the general public, the SEC has the power to summarily suspend trading of any listed security on any exchange or other trading market for a period not less than thirty (30) days but not exceeding ninety (90) days and conduct a hearing thereafter for the lifting of such suspension.[196]

The SEC regulates investment companies. It has the authority to examine its books.[197] The SEC also has the authority, after due notice and hearing to suspend or revoke the license of an Investment Company.[198] The SEC issues licenses to Certified Investment Solicitors and administers their examinations.

The Securities Regulation Code (SRC) (RA 8799) was enacted in July 2000 to address areas of institutional weaknesses in the securities market, which included the role of the SEC and its mandate, lack of confidence in the integrity of the market, and the adequacy of investor protection.

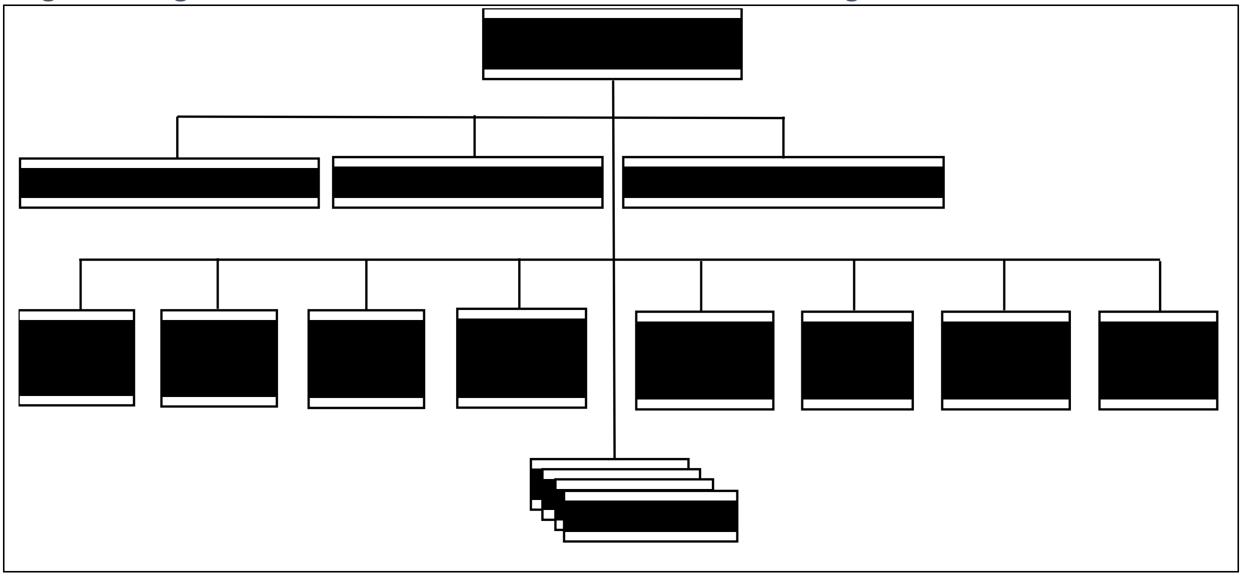
In particular, the SRC updated and increased the penalties on securities fraud, particularly insider trading. It also enforced a “full disclosure” approach for public offerings to ensure that investors have enough information to make informed investment decisions. It also focused on strengthening the role of the SEC as regulator/overseer by transferring its quasi-judicial functions, such as settlement of intra-corporate disputes and suspension of debt payments, to the regular courts. Thus, the SEC no longer has absolute control over corporations, which have

[187] Section 5(h), Securities Regulation Code.
[188] Section 8.1, Securities Regulation Code.
[189] Section 7, Republic Act No. 9267.
[190] Section 8, Republic Act No. 9267.
[191] Section 33, Securities Regulation Code.
[192] Section 36.3, Securities Regulation Code.
[193] Section 33.2 (b), Securities Regulation Code.
[194] Section 36.2, Securities Regulation Code.
[195] Section 36.4, Securities Regulation Code.
[196] Section 36, Securities Regulation Code.
[197] Rule, 11.4, 2018 Implementing Rules of the Investment Company Act.
[198] Rule 13.1.1, 2018 Implementing Rules of the Investment Company Act.

no secondary license from SEC, but only receives their financial statements and general information sheets.

To undertake its strengthened role in capital market development and regulation, a key element of the SRC reforms was the mandated reorganization and streamlining of the SEC to execute its core functions of capital market development and regulation; company registration and monitoring; enforcement; and support services. The reorganization, which was completed by December 2000, reduced the number of regular departments from 10 to eight (8), and abolished all ad hoc departments; and reduced the number of divisions from 36 to 26; and the number of extension offices from 11 to seven (7). The number of staff was thus reduced as a result of the streamlining. Two special offices were created in the Head Office to enable the SEC to perform expanded and specialized functions requiring expertise in law and in accounting principles and practices: the Office of the General Counsel and the Office of the General Accountant, respectively (Figure 3). The SEC also updated its Information Strategic Systems Plan (ISSP) to provide the framework for utilizing information technology to modernize its delivery of public services related to capital market development (SEC 2003).

**Figure 3. Organizational structure of the Securities and Exchange Commission**



Source: SEC website (http://www.sec.gov.ph/about/organizational-setup/) accessed on 15 October 2018.

In addition, the Credit Information System Act (CISA) of 2008 (RA 9510) mandated the SEC as the lead government agency to implement and enforce CISA. The Chairman of the SEC is designated as Chairman of chair the Board of Directors of the Credit Information Corporation, whose primary purpose is to receive and consolidate basic credit data; act as a central registry/central repository of credit information; and provide access to reliable, standardized information on credit history and financial condition of borrowers. More recently, the Microfinance Nongovernment Organizations (NGOs) Act of 2015 (RA 10693) mandated the SEC to establish an accrediting body called the Microfinance NGO Regulatory Council to be chaired by the Chairman of the SEC or a designated representative, and supported by a secretariat to be lodged at the SEC. Its functions include instituting and operationalizing a system of accreditation for microfinance NGOs, and monitoring their performance.

In particular, the SEC's Markets and Securities Regulation Department (MSRD) has wide-ranging functions as it primarily undertakes supervision and monitoring of the securities markets, market institutions, intermediaries and professionals, as well as self-regulatory organizations (SROs). It has three divisions:

a. Securities Registration: Registers securities or grants exemption from registration; and supervises, monitors, and audits issuers of securities;
b. Markets and Intermediaries: Monitors, supervises, and audits securities markets such as exchanges, alternative trading systems, over-the-counter markets, other trading markets, self-regulatory organizations (SROs), clearing agencies, depositories, custodians, transfer agents, central trade reporting systems and other securities related organizations and participants, as well as securities brokers, dealers, associated persons and salespersons of brokers dealers, investment houses, investment company advisers, mutual fund distributors, compliance officers and certified investment solicitors of investment company advisers/ mutual fund distributors, securities lending agencies, registrars of qualified buyers and other securities intermediaries, for their compliance with legal and regulatory requirements; and
c. Investment Products and Services: Registers securities markets and market institutions such as exchanges, alternative trading systems, over-the-counter markets and other trading markets, self-regulatory organizations (SROs), clearing agencies, securities lending agencies, depositories, custodians, central trade reporting system, registrars of qualified buyers and other securities-related organizations.

The MSRD also establishes linkages with national and international organizations [e.g. ASEAN and Asia-Pacific Economic Cooperation (APEC)], and regulatory agencies with regard to the securities markets, including cross-border products, services, and arrangements.

The Corporate Governance and Finance Department (CGFD) registers, or grants exemption from registration, securities of mutual fund companies, exchange traded funds (ETFs), and issuers of proprietary and non-proprietary membership certificates and timeshares. It also licenses investment companies, and monitors companies such as public companies, financing companies, lending companies, microfinance NGOs, and foundations for their compliance with existing laws and regulations. The CGFD also promotes good corporate practices and principles required of registered companies. In this regard, it monitors covered companies' compliance with the Revised Code of Corporate Governance (RCCG) and other governance issuances of the SEC. It also accredits CG training providers. The SEC also performs its functions required under the CISA and the Microfinance NGO Act through the CGFD.

Table 9 presents the different markets, institutions, and intermediaries supervised by the SEC's Markets and Securities Regulation Department (MSRD) and Corporate Governance and Finance Department (CGFD) in 2016.

Finally, the SEC is a member of the International Organization of Securities Commissions (IOSCO), which is the international body of the world's securities regulators that develops, implements, and promotes internationally recognized standards for securities regulation.

**Table 9. Number and type of entities regulated by MSRD and CGFD, 2016**

| Entities regulated by MSRD | | 2016 |
|---|---|---|
| 1 | Securities Brokers and Dealers (Head Office) | 148 |
| 2 | Securities Brokers and Dealers (Branch Office) | 27 |
| 3 | Dealer in Government Securities | 47 |
| 4 | Stock Transfer Agents | 22 |
| 5 | Underwriter of Securities | 12 |
| 6 | Investment Houses (Head Office) | 28 |
| 7 | Investment Houses (Branch Office) | 7 |
| 8 | Investment Company Advisers | 11 |
| 9 | Mutual Fund Distributors | 10 |
| 11 | Philippine Dealing and Exchange (PDEx) Listed Issuers | 40 |
| 12 | Accredited Surety Companies | 7 |
| 13 | Exchanges | 2 |
| 14 | Clearing House | 1 |
| 15 | Securities Depositories | 2 |
| 16 | Exchange Traded Funds (ETF) | 1 |
| 17 | Self Regulatory Organizations (SROs) | 3 |
| 18 | Registrars of Qualified Buyers | 20 |
| 19 | Operator of Alternative Trading System | 1 |
| | Total | 389 |

| Entities regulated by CGFD | | 2016 |
|---|---|---|
| 1 | Registered Issuers (Unlisted Securities) | 11 |
| 2 | Mutual Funds or Investment Companies | 61 |
| 3 | Issuers of Proprietary and Non-Proprietary Securities | 94 |
| 4 | ETF | 1 |
| 6 | Financing Companies | 642 |
| 7 | Lending Companies | 1,885 |
| 9 | Microfinance NGOs | 127 |
| | Total | 2,821 |

Source: SEC Annual Report 2016.

### 3.3.3. Insurance Commission

Insurance firms, excluding government-owned insurance corporations that are governed by their respective charters, are regulated and supervised by the Insurance Commission (IC). The IC is a powerful government agency, with licensing, regulatory and adjudicatory functions.

The IC regulates the insurance business and an insurance company must first secure a Certificate of Authority from the IC to do business in the Philippines.[199] The IC is given the authority to prescribe the qualifications of directors, executive officers and other key officials of insurance companies. The IC also grants licenses to insurance agents, reinsurance brokers, and adjusters. Likewise, the IC regulates and grants licenses to online insurance aggregators.[200]

The IC shall at least once a year and whenever he considers the public interest so demands, cause an examination to be made into the affairs, financial condition and method of business of every insurance company authorized to transact business in the Philippines and of any other person, firm or corporation managing the affairs and/or property of such insurance company.[201] The IC has the power to direct shareholders of any insurance company to contribute cash for the insurance company to comply with solvency thresholds.[202] It may also stop an insurance company from doing business if it declared dividends without the requisite minimum paid-up capital and net worth requirements.[203]

The IC also has the power to identify securities where an insurance company may invest.[204]

The IC suspends or revokes licenses of insurance companies found to have committed unfair claims settlement practices.[205]

[199] Section 193, Insurance Code.
[200] Circular Letter 2018-51.
[201] Section 253, Insurance Code.
[202] Section 200, Insurance Code.
[203] Section 201, Insurance Code.
[204] Section 206, Insurance Code.
[205] Section 247, Insurance Code.

The IC also has the power to suspend or revoke certificates of authority, when after examination, he finds:

a. An insurance company is in an unsound condition;
b. An insurance company has failed to comply with the provisions of law or regulations obligatory upon it;
c. An insurance company's condition or method of business is such as to render its proceedings hazardous to the public or to its policyholders; and
d. An insurance company's net worth requirement, in the case of a domestic stock company, or its available cash assets, in the case of a domestic mutual company, or its security deposits, in the case of a foreign company, is impaired or deficient, or that the margin of solvency required of such company is deficient.[206]

After suspending or revoking a certificate of authority, the IC may appoint a conservator to take charge of the assets, liabilities, and the management of the insurance company, collect all moneys and debts due to said company and exercise all powers necessary to preserve the assets of said company, reorganize the management thereof, and restore its viability.[207]

The Insurance Code of 1978 used to be the overall regulatory framework of the insurance industry. Changes to the 1978 Code had been very few. It was only in August 2013 that an amended Insurance Code (RA 10607) was signed into law. A key amendment is the increase in paid-up capital for new domestic life and nonlife insurance companies, while capital requirements for existing life and non-life insurance companies are progressively increased every three years until 2022 to meet the new requirement. It also added provisions on new products like bancassurance (i.e., the partnership between a bank and an insurance firm that allows the sale of insurance products in the bank's branches) and micro-insurance activities.

In July 2009, the Pre-Need Code of the Philippines (RA 9829) was enacted, which transferred the regulation and supervision of the pre-need industry from SEC to the IC. Section 5 of the Implementing Rules and Regulations of RA 9829 provided for the reorganization of the Insurance Commission to enable it to effectively and efficiently perform its functions and exercise its powers over the pre-need industry. More recently, EO No. 192 (s.2015) transferred the regulation and supervision of health maintenance organizations (HMOs) from the Department of Health to the IC.

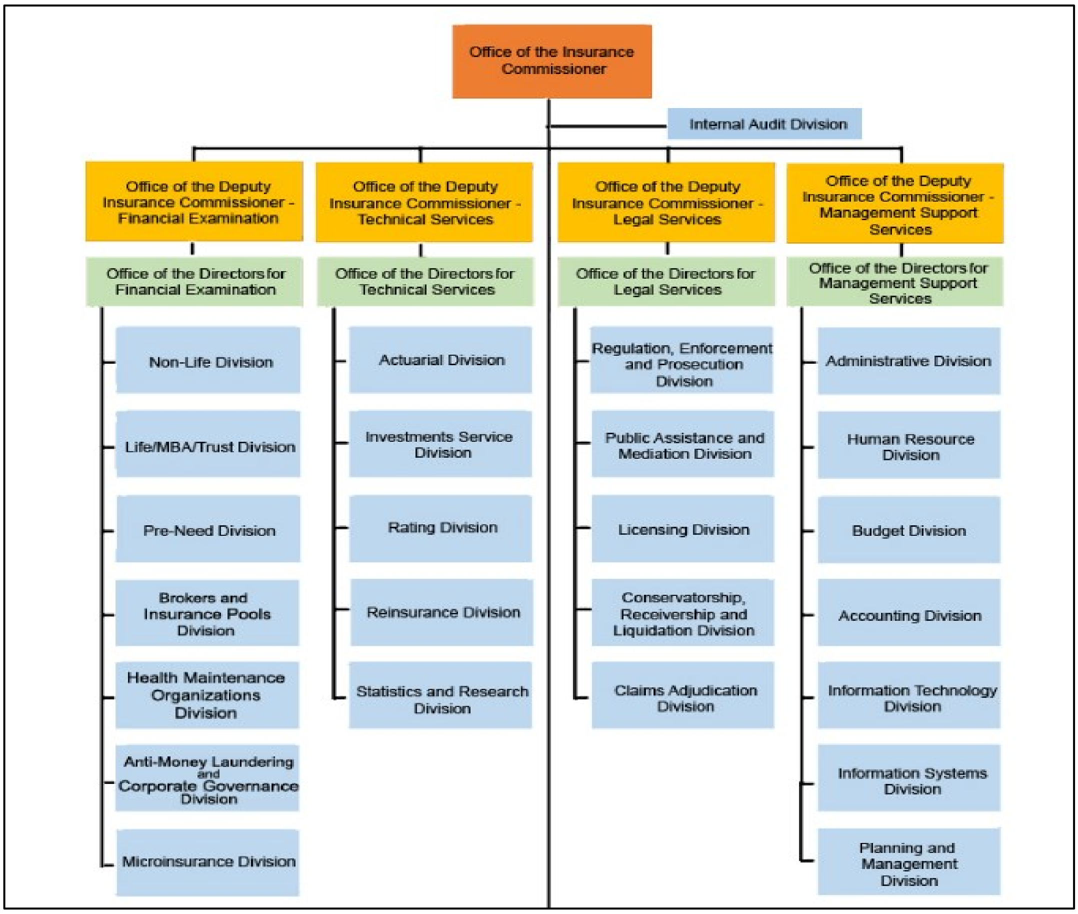
The IC likewise underwent a reorganization, which was approved in July 2012 and involved changes in its organizational structure, staffing pattern, and compensation plan. In particular, four deputy insurance commissioner positions were created for financial examination, technical services, legal services, and management support services, plus a brokers division, an information technology division, and a planning division. Financial examination was then structured by product per division so each division could focus on the specific industry assigned to them (Figure 4).

The new structure also reflected the laws and regulations that expanded the coverage of the IC's mandate. Thus, there are separates divisions in charge of life, nonlife, preneed, HMOs, and microinsurance. In the previous set-up, an insurance examiner could be assigned to several different product types in a given year. Similar to the BSP and SEC, the new division on information technology reflected the importance of utilizing IT for efficient and effective

[206] Section 254, Insurance Code.
[207] Section 255, Insurance Code.

delivery of services to the public. Unlike the SEC, reorganization of the IC entailed the hiring of additional staff again reflecting the IC's expanded functions.

**Figure 4. Organizational structure of the Insurance Commission**




Source: Insurance Commission website (https://www.insurance.gov.ph/about/organizational-structure/) accessed on 15 October 2018.

Table 10 shows the number of regulated entities under the Insurance Commission.

**Table 10. Regulated entities of the Insurance Commission, 2016**

| Licensed companies | Number |
|---|---|
| Direct insurers | 97 |
| Composite | 4 |
| Life | 27 |
| Nonlife | 66 |
| Professional reinsurer | 1 |
| Mutual Benefit Associations | 34 |
| Pre-need companies | 18 |
| HMOs[1] | 31 |

| Sales agencies | Number |
|---|---|
| Ordinary agents | 42,084 |
| General agents | 154 |
| Variable life agents | 38,174 |
| Brokers | 79 |
| Pre-need sales counselors | 23,664 |
| Technical services | |
| Nonlife company underwriters | 367 |
| Resident agents | 73 |
| Accredited actuaries | 51 |
| Public adjuster | 1 |
| Independent adjusters | 49 |
| Accredited external auditors | 44 |

Note: [1]Data is for 2018.
Source: 2016 Annual Report, Insurance Commission.

The IC is also a member of the International Association of Insurance Supervisors (IAIS), which is a voluntary membership organization of insurance supervisors and regulators and the international standard-setting body responsible for developing and assisting in the implementation of principles, standards and other supporting material for the supervision of the insurance sector.

### 3.3.4. Philippine Deposit Insurance Corporation

Under the Philippine Deposit Insurance Corporation (PDIC) Charter,[208] the state policy behind its creation, as a mandatory deposit insurance coverage system, is to generate, preserve, maintain faith and confidence in the country's banking system, and protect it from illegal schemes and machinations.[209] Thus, any bank engaged in the business of receiving deposits must be insured with the PDIC.[210]

The PDIC is granted the authority to conduct an insurance risk evaluation on bank identified by the BSP to be capital deficient. The PDIC, in such risk evaluation, determines (i) the fair market value of the assets and liabilities of the bank; or (ii) the risk classification of the bank; or (iii) the possible resolution modes to take.[211]

The PDIC also reports to the Monetary Board any illegal and unsafe or unsound practices in conduct of business of a bank for proper corrective action.[212] In the event the Monetary Board fails to take corrective action within 45 days, the PDIC itself may institute the necessary corrective action and even issue a cease and desist order. In the event that the acts subject of the corrective action are likely to cause insolvency or substantial dissipation of assets or earnings of the bank, or is likely to seriously weaken the condition of the bank or otherwise seriously prejudice the interests of its depositors and the PDIC, the PDIC may take corrective action sooner or within fifteen days. On top of the corrective action, the PDIC also has the power to impose fines. In addition, the PDIC may terminate the insured status of any bank that fails or refuses to comply, within thirty (30) days from notice, with any cease-and-desist order issued by it, or with any corrective action imposed by the Monetary Board pertaining to a deposit-related unsafe and/or unsound banking practice.

### 3.3.5. Cooperative Development Authority

The CDA grants registrations to Credit Cooperatives, Financial Service Cooperatives, and Financial Service Cooperative Federations and regulates their operations.[213] Membership in cooperatives are limited to Filipinos.[214] The CDA, before granting any registration to a cooperative, requires the submission of an economic survey indicating the cooperative's area of operation and size of membership.[215]

The CDA has the power to inspect the books of cooperatives.[216] The CDA also requires cooperatives to submit reports on their programs and socio-civic activities and the cooperative's failure to submit a report is a ground for the revocation of its registration.[217]

[208] Republic Act No. 3591, as amended by Republic Act 10846 (PDIC Charter).
[209] Section 2, PDIC Charter.
[210] Section 6, PDIC Charter.
[211] Section 6, PDIC Charter.
[212] Section 8, PDIC Charter.
[213] Article 124, Cooperative Code, as amended.
[214] Article 10, Cooperative Code, as Amended.
[215] Article, 11, Cooperative Code, as amended.
[216] Article 52, Cooperative Code, as amended.
[217] Article 53, Cooperative Code, as amended.

Under Memorandum Circular No. 2009-03, external auditors of cooperatives need to be accredited by the CDA. The accreditation period is three years.[218] The external auditor is only allowed to audit the cooperative for five succeeding years and may resume his audit functions for the cooperative after the lapse of two years.[219]

With regard to cooperative banks, the BSP has primary supervision over them.[220] For instance, while the articles of cooperative and bylaws of a cooperative bank, or any amendment, are registered with the CDA, the CDA only accepts then when they are accompanied by a certificate of authority issued by the BSP, under its official seal.[221] Similarly, financial service cooperatives are only granted registrations by the CDA after the BSP has issued a certificate of authority.[222] Nevertheless, the CDA is the primary regulatory authority over financial service cooperatives, but the BSP can still conduct risk-based supervision and examination of them.[223]

Existing cooperatives may organize themselves into a cooperative insurance society to insure life and property of cooperatives and their members.[224] This insurance entity must comply with insurance laws,[225] but regulation appears to be jointly exercised by the Insurance Commission and the CDA.[226]

#### 3.3.6. Inter-agency bodies

*3.3.6.1. Financial Sector Forum (FSF).* The FSF was formally established in July 2004 with the signing of a Master Memorandum of Agreement (MOA) by the heads of its four participating agencies - BSP, SEC, IC, and PDIC. The FSF is not a regulatory body, but a voluntary inter-agency body. The aim is to develop an institutionalized framework to promote a (weak) form of coordinated supervision and regulation of the financial system within each agency's mandate. Agency leaders at that time saw the need for a formal venue for the four financial regulators to engage in dialogue, and foster cooperation and coordination with respect to cross-cutting issues in the financial sector. "Understandings reached by the Forum are expected to be implemented by the member agencies in the interest of enhancing the overall supervision process" (BSP 2004); i.e., outcomes are nonbinding. Prior to the establishment of the FSF, the four financial regulators had entered into several bilateral MOAs to address the need for coordination in specific areas in order for them to effectively carry out their mandates.

The FSF convenes on a bi-monthly basis, and is chaired by the BSP Governor. The FSF initially formed three committees to serve as technical working groups in an advisory capacity on three broad key areas (BSP 2004):

a. Supervision methodology and regulatory policy coordination: focused on harmonization and coordination of supervisory and regulatory methods and policies to address regulatory gaps and regulatory arbitrage;
b. Reporting, information and exchange, and dissemination: focused on developing comprehensive rules on disclosure to enhance transparency of firms, harmonizing regulatory reporting requirements, and creating database linkages between the agencies to facilitate a speedier and more accurate transfer of information; and

[218] Section 4, CDA MC 2009-03.
[219] Section 5 (h), CDA MC 2009-03.
[220] Article 96, Cooperative Code, as amended.
[221] Article 97 (3), Cooperative Code, as amended.
[222] Article 119, Cooperative Code, as amended.
[223] Article 121, Cooperative Code, as amended.
[224] Article 105, Cooperative Code, as amended.
[225] Article 107, Cooperative Code, as amended.
[226] Article 108, Cooperative Code, as amended.

c. Consumer protection and education: to curb the proliferation of unlawful and unethical business practices as well as various financial scams.

In April 2006, the FSF members signed a MOA on information exchange, which specified the procedures for sharing relevant information among the four members. In October 2011, the FSF created a voluntary inter-agency council called the Financial Stability Coordination Council (FSCC) to address financial issues on a national level. In addition to the members of the FSF, the Department of Finance is also a member of FSCC. The key objective of the FSCC is to identify, manage and mitigate the build-up of systemic risks to safeguard the stability of the Philippine financial system. The FSCC releases an annual Financial Stability Report to monitor and analyze financial stability issues and concerns in order to promote coordinated action among financial regulators, the fiscal authority, the market, and the public. The FSCC is also chaired by the BSP Governor. And most recently, it was reported in July 2018 that the FSF is looking to establish a Fintech Committee.

*3.3.6.2. Anti-Money Laundering Council (AMLC).* The Anti-Money Laundering Council is the financial intelligence unit of the Philippines.[227] It is composed of the Governor of the Bangko Sentral ng Pilipinas as Chairman, the Commissioner of the Insurance Commission and the Chairman of the Securities and Exchange Commission, as members.[228] Its jurisdiction pertains to what the law defines are covered persons, which are essentially those under the regulatory jurisdiction of the BSP, SEC, and the IC.

The AMLC may inquire into or examine any particular deposit or investment with any banking institution or non-bank financial institution upon order of any competent court.[229] The AMLC may apply with the Court of Appeals to freeze of any monetary instrument or property alleged to be laundered, proceeds from, or whose instrumentalities are used or intended for use in any unlawful activity.[230] The freeze order should not exceed six months unless the case calls for the period to be extended. Moreover, only the Supreme Court could issue a temporary restraining order or a writ of injunction against any freeze order. [231]

The AMLC may also apply with civil courts, through the Solicitor General, for civil forfeiture of properties related to unlawful activities.[232] The AMLC may include in its petition the freezing of related and materially-linked accounts.[233] If the forfeiture order could not enforced, as in cases where property is in another jurisdiction or money is commingled with other accounts, the court may, instead of enforcing the order of forfeiture, order the convicted offender to pay an amount equal to the value of the monetary instrument or property.[234]

Money laundering is committed by any person who, knowing that any monetary instrument or property represents, involves, or relates to the proceeds of any unlawful activity and yet, he transacts said monetary instrument or property or converts, transfers, disposes of, moves, acquires, possesses or uses said monetary instrument or property. Money laundering is also committed when one conceals or disguises the true nature, source, location, disposition, movement or ownership of or rights with respect to the monetary instrument or property. Even if one does not directly commit money laundering, one may still be liable when he merely

[227] Rule 3 (B), 2016 Implementing Rules of the AMLC.
[228] Section 7, Republic Act No. 9160, as amended.
[229] Section 11, Republic Act No. 9160, as amended.
[230] Section 7 (6), Republic Act No. 9160, as amended.
[231] Section 10, Republic Act No. 9160, as amended.
[232] Section 12, Republic Act No. 9160, as amended.
[233] Rule 10 (1), 2016 Implementing Rules of the AMLC.
[234] Section 12 (c), Republic Act No. 9160, as amended.

attempts or conspires to commit any act of money laundering or aids, abets, assists in or counsels the commission of money laundering. One may also be held liable for money laundering if he performs or fails to perform any act as a result of which he facilitates the offense of money laundering. If any covered person described in the law who, knowing that a covered or suspicious transaction is required under the law to be reported to the Anti-Money Laundering Council, but fails to do so is likewise liable for money laundering. [235]

Covered persons under the law are required report to the AMLC all covered transactions and suspicious transactions except those subject to professional secrecy or legal professional privilege.[236] Covered persons are prohibited from establishing anonymous accounts or those with fictitious names.[237] Numbered accounts are also prohibited.[238]

The AMLC also mandates covered persons to have a system of verifying the true identity of their clients based on reliable, independent source, documents, data, or information. Covered persons are also required to maintain a system of verifying their legal existence and organizational structure, as well as the authority and identification of all persons purporting to act on their behalf. [239] As far as practicable, the AMLC also mandates that covered persons conduct face-to-face contact at the commencement of the relationship with their customers or clients.[240] In the submission of identification documents, for entities registered outside of the Philippines, the documents or information must be duly authenticated by a senior officer of the covered person assigned in the country of registration or in the absence of such officer, the documents should be authenticated by the Philippine Consulate, company register or notary public, where said entities are registered.[241]

In cases where an account is opened or a transaction is conducted by any person in behalf of another, covered persons are required to establish and record the true and full identity and existence of both the account holder or transactor and the beneficial owner or person on whose behalf the transaction is being conducted.[242] Covered persons must also develop clear, written and graduated customer acceptance policies and procedures, including a set of criteria for customers that are likely to pose low, normal, or high risk to their operations. Such criteria include the size of the transaction and whether the customer comes from a high risk jurisdiction. [243] Covered persons are mandated to examine the background and purpose of all complex, unusually large transactions, all unusual patterns of transactions, which have no apparent economic or lawful purpose, and other transactions that may be considered suspicious.[244]

The AMLC also prescribes rules for wire transfers. It mandates that transfer be made electronically than through manually initiated fund transfer instructions.[245] Beneficiary institution should not accept instructions to pay-out fund transfers to non-customer beneficiaries, unless it has conducted the necessary customer due diligence to establish the true and full identity and existence of the beneficiary.[246] Likewise, an originating institution shall not accept instructions to wire/fund transfer from a non-customer originator, unless it has

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[235] Section 4, Republic Act No. 9160, as amended.
[236] Section 9 (c), Republic Act No. 9160, as amended.
[237] Rule 9 (A) (4), 2016 Implementing Rules of the AMLC.
[238] Rule 9 (A) (4), 2016 Implementing Rules of the AMLC.
[239] Section 9, R.A. 9160; Rule 9 (A), 2016 Implementing Rules of the AMLC.
[240] Rule 9 (A) (1) (a), 2016 Implementing Rules of the AMLC.
[241] Rule 9 (A) (1) (b), 2016 Implementing Rules of the AMLC.
[242] Rule 9 (A) (1) (e), 2016 Implementing Rules of the AMLC.
[243] Rule 9 (A) (2), 2016 Implementing Rules of the AMLC.
[244] Rule 9 (A) (2) (b), 2016 Implementing Rules of the AMLC.
[245] Rule IX-A (4) (d), 2016 Implementing Rules of the AMLC.
[246] Rule IX-A (4) (a), 2016 Implementing Rules of the AMLC.

conducted the necessary customer due diligence to establish the true and full identity and existence of the originator.[247] If the originator is a high risk customer, the beneficiary institution shall conduct enhanced due diligence on the beneficiary and the originator.[248]

The AMLC may inquire into or examine any particular deposit or investment account, including related accounts, when there is probable cause that the deposits or investments involved, including related accounts, are in any way related to any of certain unlawful activities.[249] Such unlawful activities pertain to Kidnapping for Ransom, Violations of the Comprehensive Drugs Act, Hijacking, Arson, and Murder, and Terrorism or Terrorism Financing.[250]

The AMLC, is also authorized to investigate any property or funds that are in any way related to financing of terrorism or acts of terrorism and property or funds of any person or persons in relation to whom there is probable cause to believe that such person or persons are committing or attempting or conspiring to commit, or participating in or facilitating the financing of terrorism or acts of terrorism.[251] Financing of terrorism refers to any person who, directly or indirectly, willfully and without lawful excuse, possesses, provides, collects or uses property or funds or makes available property, funds or financial service or other related services, by any means, with the unlawful and willful intention that they should be used or with the knowledge that they are to be used, in full or in part:

a. To carry out or facilitate the commission of any terrorist act;
b. By a terrorist organization, association or group; or
c. By an individual terrorist.[252]

### 3.3.7. E-banking/E-money regulatory framework

Similar to other emerging markets where mobile network operators pioneered mobile money services for which they were not originally licensed, the BSP allowed Globe Cash (G-Cash) and Smart Money to pilot electronic money (e-money) products in the Philippines in 2004. This facilitated the development of a regulatory framework to govern the issuance of e-money and the operations of electronic money issuers (EMIs) in March 2009, when the BSP allowed the outsourcing of services by EMIs to electronic money network services providers (EMNSPs) to facilitate the use of e-money especially by the unserved/underserved segments of the population in rural areas (BSP 2010).

In 2015, the BSP launched the National Retail Payments System (NRPS) to promote the development of a "safe, efficient, affordable, interoperable, and reliable retail payments system in the country" (Espenilla 2018). The NRPS Framework was adopted in November 2017, which operationalizes and enforces the adoption of the NRPS by the BSP supervised financial institutions (BSFIs). Central to the operation of the NRPS are the multilateral automated clearing house (ACH) agreements, which define the participation, clearing and settlement rules of payment schemes. In particular, the batch interbank fund transfer service of the Philippine Clearinghouse Corporation (PCHC) was transitioned into the Philippine EFT System and Operations Network (PESO Net), and InstaPay was launched in April 2017 to allow 24/7 low-value electronic fund transfers. In January 2018, the BSP and the Philippine Payments

[247] Rule IX-A (4) (b), 2016 Implementing Rules of the AMLC.
[248] Rule IX-A (4) (c), 2016 Implementing Rules of the AMLC.
[249] Section 8, R.A. 9160, as amended.
[250] Rule 11 (B), 2016 Implementing Rules of the AMLC.
[251] Section 10, R.A. 10168.
[252] Section 4, R.A. 10168.

Management, Inc. (PPMI) entered into a memorandum of agreement, which designated PPMI as the payment system management body under the authority of the BSP as the primary overseer of the retail payment system (through the Payment System Oversight Department under its Financial Technology Sub-Sector) (BSP 2018b).

With respect to virtual currencies (VCs), the BSP established a formal regulatory framework in February 2017 for VC exchanges and similar entities that classifies them as remittance and transfer companies (RTCs) and requires them to register with the BSP. VC exchanges are also required to meet minimum capital requirements, internal controls, regulatory reporting, and compliance with anti-money laundering rules and regulations. The BSP also monitors the use of VC for trading and fund-raising through initial coin offerings (ICOs), and private digital currencies and Central Bank-Issued Digital Currencies (CBDCs).

Through the rapidly evolving fintech landscape, the BSP vowed to continue espousing a flexible "test and learn" or regulatory sandbox[253] approach to financial innovation. That is, to be aware of the risks, adopt mitigating actions as needed, but allowing room for market players to leverage on new technologies (Espenilla 2018).

## *3.4. Current performance of the financial services sector*

### 3.4.1. State of the industry

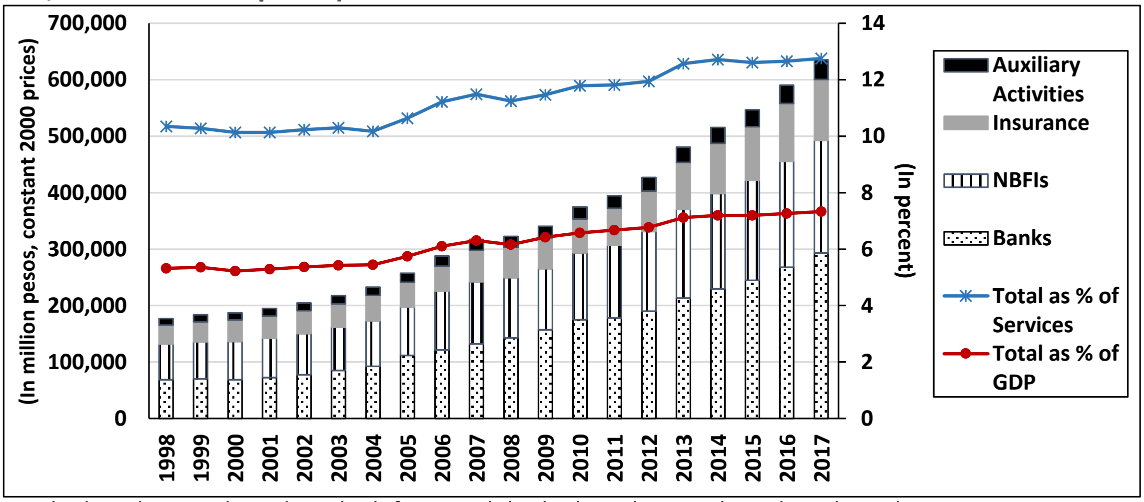
The Philippine financial system consists of banks and nonbank financial institutions (NBFIs). RA 8791 classifies banks into commercial banks, universal banks (expanded commercial banks), thrift banks (composed of savings and mortgage banks, stock savings and loan associations, and private development banks), rural banks, cooperative banks, and Islamic banks. NBFIs include, among others, insurance companies, investment houses, financing companies, securities dealers and brokers, fund managers, lending investors, pension funds, pawnshops, and nonstock savings and loan associations.

Figure 5 shows the gross value added (GVA) in financial intermediation by institutional grouping, and total GVA in financial intermediation as percent of total GVA in services and GDP. In particular, banks dominate the sector, which accounted for almost half of the sector's GVA in 2017. The ratio of financial services in total GVA in services and GDP increased by just around 2 percentage points over the period 1998-2017.

In terms of employment, the financial services sector accounted for just around 1.3 percent of total employment, and 2.2 percent of total services employment in 2017.

[253] Jenik and Lauer (2017) define regulatory sandbox as "a framework set up by a financial sector regulator to allow small scale, *live testing* of *innovations* by private firms in a *controlled environment* (operating under a special exemption, allowance, or other limited, time-bound exception) under the regulator's supervision" (p. 1).

**Figure 5. Gross value added in financial intermediation by institutional grouping (In million pesos, constant 2000 prices)**




Note: The bar chart is plotted on the left axis, while the line chart is plotted on the right axis.
Source: Philippine Statistics Authority - National Accounts (https://psa.gov.ph/nap-press-release/data-series; Accessed on 26 Nov 2018).

Table 11 shows the number of offices of financial institutions in 1990, 2001, 2010, and 2017. Overall, it indicates significant expansion in the number of branches/agencies over the last three decades, although the number of head offices of thrift and rural banks significantly declined while the number of head offices of universal and commercial was fairly steady. In contrast, NBFIs consisted primarily of pawnshops. This indicates that there has not been significant financial widening in terms of more varied types of financial intermediaries from 1990 to 2017.

**Table 11. Number of financial institutions, Selected years**

| | 1990 | 2001 | 2010 | 2017 |
|---|---|---|---|---|
| **T o t a l** | **7,488** | **17,432** | **24,870** | **28,904** |
| Head Offices | 4,142 | 6,323 | 7,386 | 6,180 |
| Branches/Agencies | 3,346 | 11,109 | 17,484 | 22,723 |
| Banks | **3,639** | **7,585** | **8,869** | **11,793** |
| Head Offices | 942 | 929 | 758 | 587 |
| Branches/Agencies | 2,697 | 6,656 | 8,111 | 11,206 |
| Universal and Commercial Banks | 1,941 | 4,320 | 4,679 | 6,483 |
| Head Offices | 35 | 44 | 38 | 43 |
| Branches/Agencies | 1,906 | 4,276 | 4,641 | 6,440 |
| Thrift Banks | 653 | 1,351 | 1,419 | 2,417 |
| Head Offices | 103 | 104 | 73 | 55 |
| Branches/Agencies | 550 | 1,247 | 1,346 | 2,362 |
| Rural Banks [1] | 1,045 | 1,914 | 2,771 | 2,893 |
| Head Offices | 804 | 781 | 647 | 489 |
| Branches/Agencies | 241 | 1,133 | 2,124 | 2,404 |
| Non-Banks [2] | **3,849** | **9,847** | **16,001** | **17,111** |
| Head Offices | 3,200 | 5,394 | 6,628 | 5,594 |
| Branches/Agencies | 649 | 4,453 | 9,373 | 11,517 |
| Pawnshops | | 9,397 | 15,596 | 16,582 |
| Head Offices | | 5,018 | 6,367 | 5,346 |
| Branches/Agencies | | 4,379 | 9,229 | 11,236 |

Notes: [1]Includes Cooperative Banks. [2] Includes Investment Houses, Finance Companies, Investment Companies, Securities Dealers/Brokers, Pawnshops, Lending Investors, Non-Stock Savings and Loan Associations, Electronic Money Issuer, Remittance Agent, Credit Granting Entities, Credit Card Companies (under BSP supervision); and Private and Government Insurance Companies (i.e., SSS and GSIS). Private Insurance Companies only cover the head offices and their foreign branches.
Source: BSP Statistics - Financial System Accounts/Number of Financial Institutions (http://www.bsp.gov.ph/statistics/efs_fsa1.asp; Accessed on 14 November 2018)

Table 12 shows the total assets of the Philippine financial system in 1990, 2001, 2010, and 2017. It shows the continuing dominance of banks in general, and universal banks in particular. On the other hand, the asset share of NBFIs is dominated by the two government social security systems, Government Service Insurance System (GSIS) and Social Security System (SSS), which together accounted for half of total NBFIs assets in 2017. The minor role of other NBFIs is worrying because they play an important role in the development of the capital market as buyers and sellers, and as producers and innovators of financial products (Abola 2016).

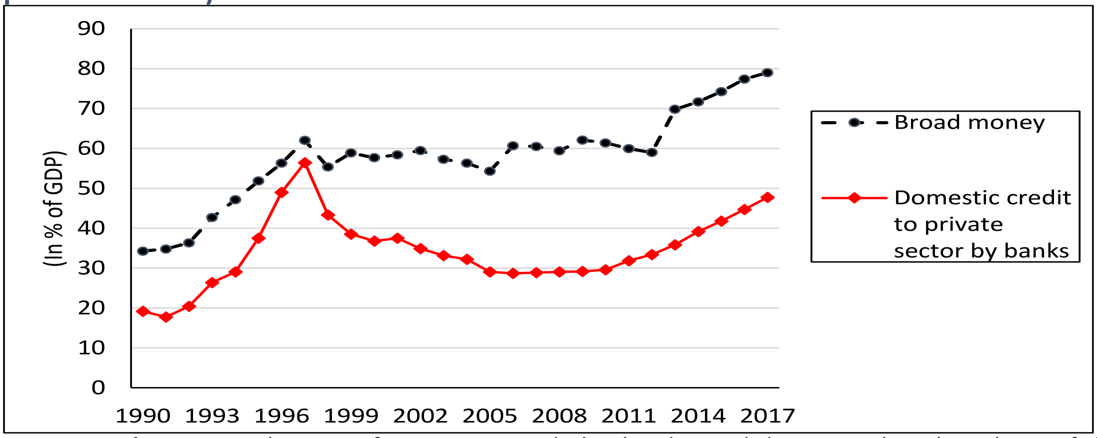
**Table 12. Total assets of financial institutions, Selected years**

| | 1990 | 2001 | 2010 | 2017 |
|---|---|---|---|---|
| Total assets (In billion pesos, current prices) | 782 | 4,160 | 9,038 | 18,943 |
| Total assets (In billion pesos, constant 2000 prices) | 1,768 | 3,941 | 5,723 | 10,385 |
| Total assets (In % of GDP)) | 65 | 107 | 100 | 120 |
| Total banks assets (In % of total assets) | 76 | 82 | 80 | 82 |
| Distribution by type of bank | | | | |
| Universal and Commercial Banks | 91 | 90 | 89 | 90 |
| Thrift Banks | 6 | 8 | 9 | 8 |
| Rural Banks | 2 | 2 | 2 | 2 |
| Non-banks[1] assets (In % of total assets) | 24 | 18 | 20 | 18 |

Note: [1]Includes Investment Houses, Finance Companies, Investment Companies, Securities Dealers/Brokers, Pawnshops, Lending Investors, Non-Stock Savings and Loan Associations, Electronic Money Issuer, Remittance Agent, Credit Granting Entities, Credit Card Companies (under BSP supervision), Government Insurance Companies (i.e., SSS and GSIS), and head offices and branches of Private Insurance Companies.
Source: BSP Statistics - Financial System Accounts/Total Resources of the Philippine Financial System (http://www.bsp.gov.ph/statistics/efs_fsa1.asp; Accessed on 14 November 2018).

Figure 6 shows the ratio to GDP of broad money and domestic credit to the private sector by banks from 1990 to 2017. The ratio of broad money to GDP is used as a proxy for financial deepening, and it indicates that the expansion of banks and banking services and products has led to some degree of financial deepening. On the other hand, the ratio of domestic credit to the private sector by banks has not kept pace and was just around half of the ratio of broad money to GDP.

**Figure 6. Broad money and domestic credit to private sector by banks, 1990-2017 (In percent of GDP)**




Note: **Broad money** is the sum of currency outside banks; demand deposits other than those of the central government; the time, savings, and foreign currency deposits of resident sectors other than the central government; bank and traveler's checks; and other securities such as certificates of deposit and commercial paper. **Domestic credit to private sector by banks** refers to financial resources provided to the private sector by other depository corporations (deposit taking corporations except central banks), such as through loans, purchases of nonequity securities, and trade credits and other accounts receivable, that establish a claim for repayment.
Source: World Bank World Development Indicators – Financial Sector (https://data.worldbank.org/indicator; Accessed on 23 November 2018)

Overall, the results indicate:

a. The Philippine financial system has been consistently growing over the last three decades. From 1990 to 2017, total financial assets grew at an average annual real rate of 7%, with total financial assets growing at a faster rate of 10% from 2011 to 2017. Banks, particularly universal and commercial, have been growing at a faster rate over the same time periods;
b. There has been no significant financing widening. The continued dominance of banks in the Philippine financial system, particularly universal and commercial banks, is stark; and
c. When measured relative to the domestic economy, the ratio of total financial assets to GDP has not significantly increased in the last 20 years, and financial deepening has been modest.

Thus, there has been no significant change in the structure of the Philippine financial sector. A bank-dominated financial system is not necessarily bad. The issue is whether such a structure is a market-outcome, or the result of government regulation and policy. The banking sector has historically been the focus of financial sector policy, development and reform. A theory on the relationship between financial development and economic development in a market-oriented economy posits that the banking system, which initially leads financial development, declines in importance as real growth and financial development continue. One observed characteristic of the process of economic development over time in a market-oriented economy is an expansion and elaboration of the financial structure (institutions, instruments and activities). On the other hand, economic development is retarded if financial intermediaries do not evolve. This is also borne out in the empirical literature (King and Levine 1996; Levine 2004). The dominant banking sector has proven to be resilient in the face of global financial crises, underpinned by a strong regulatory and supervisory framework.

*3.4.1.1. Access to financial services.* Table 13 shows the regional distribution of offices of financial institutions supervised by the BSP, which include banks, bank subsidiaries and affiliates, and other NBFIs under the BSP's purview. In particular, it shows a highly skewed distribution of head offices and branches/other offices of universal and commercial banks in favor of Metro Manila and to a lesser extent other major cities. This is also evident in the density and customer ratios by region. In particular, universal and commercial bank offices are located primarily in the big cities, while thrift and rural banks are better distributed in the other regions.

In December 2017, the BSP introduced a new category of banking office called "branch-lite unit" to facilitate access for the unbanked population nationwide. A branch-lite unit performs limited banking activities, and can be established anywhere in the country with simplified and more flexible provisions. There were 1,753 branch-lite units stationed all over the country at the end of June 2018 (BSP 2018c). The concept has since been redefined to include other classifications of banking offices such as extension offices, other banking offices, and microbanking offices to comprise the branch-lite network. In terms of NBFIs offices, overall they are better distributed compared to banking offices, especially pawnshops that operate even in unbanked areas.

### Table 13. Regional distribution of bank and nonbank offices[1], 2017

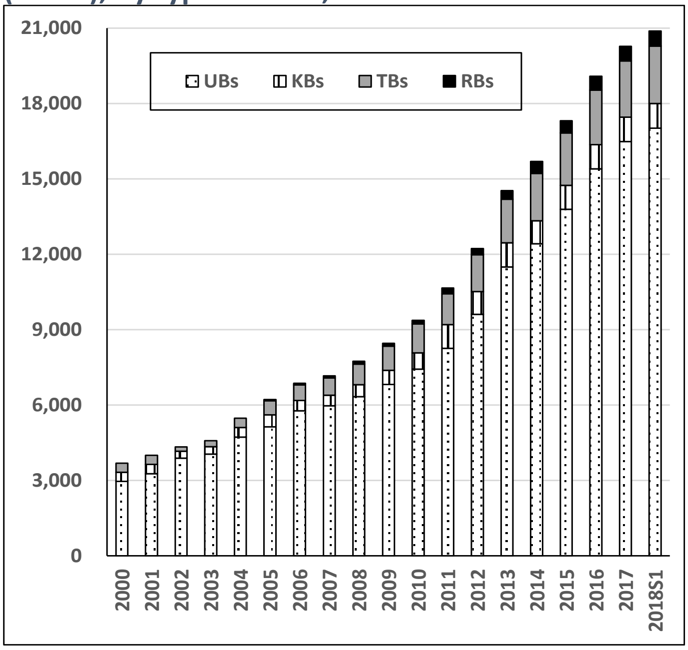
| | Banks | | | | | | NBFIs | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | **Total Banking Offices** | Universal and Commercial Banks | Thrift Banks | Rural Banks | Density Ratio [2] | Customer Ratio [3] | **Total NBFI Offices** | Financing Companies | NSSLAs | Pawnshops | Other NBFI Offices |
| **Nationwide** | **11,744** | **6,434** | **2,417** | **2,893** | | | **17,011** | **162** | **197** | **16,582** | **70** |
| Overseas | 49 | 49 | | | | | | | | | |
| | **Regional distribution (Percent of nationwide total)** | | | | | | **Regional distribution (Percent of nationwide total)** | | | | |
| NCR | **31** | 46 | 24 | 3 | 215 | 3,537 | **21** | 21 | 35 | 21 | 83 |
| Luzon | | | | | | | | | | | |
| Region I | **5** | 3 | 6 | 8 | 5 | 9,007 | **5** | 7 | 5 | 5 | 1 |
| Region II | **3** | 2 | 3 | 6 | 4 | 9,263 | **2** | 5 | 3 | 2 | 0 |
| Region III | **10** | 8 | 12 | 13 | 9 | 9,438 | **13** | 12 | 9 | 13 | 1 |
| Region IV-A | **15** | 11 | 21 | 18 | 12 | 8,436 | **14** | 11 | 9 | 14 | 1 |
| Region IV-B | **2** | 1 | 2 | 5 | 4 | 11,574 | **2** | 2 | 4 | 2 | 0 |
| Region V | **4** | 2 | 4 | 7 | 4 | 13,522 | **4** | 2 | 4 | 4 | 0 |
| CAR | **2** | 1 | 1 | 3 | 2 | 10,442 | | | | | |
| Visayas | | | | | | | | | | | |
| Region VI | **6** | 5 | 6 | 8 | 5 | 11,482 | **7** | 4 | 5 | 7 | 4 |
| Region VII | **7** | 6 | 7 | 7 | 6 | 9,747 | **9** | 9 | 6 | 9 | 1 |
| Region VIII | **2** | 2 | 2 | 3 | 2 | 20,751 | **3** | 5 | 3 | 3 | 0 |
| Mindanao | | | | | | | | | | | |
| Region IX | **2** | 2 | 2 | 3 | 3 | 17,325 | **3** | 2 | 5 | 3 | 0 |
| Region X | **3** | 3 | 4 | 5 | 4 | 12,265 | **4** | 6 | 5 | 4 | 3 |
| Region XI | **4** | 4 | 3 | 5 | 9 | 11,528 | **5** | 6 | 3 | 5 | 1 |
| Region XII | **2** | 2 | 2 | 3 | 5 | 19,124 | **4** | 2 | 3 | 4 | 0 |
| Region XIII | **2** | 1 | 2 | 4 | 3 | 13,168 | **2** | 2 | 2 | 2 | 0 |
| ARMM | **0.2** | 0.2 | 0.0 | 0.1 | 0 | 205,405 | **1** | | | 1 | |

[1] Only refers to head offices, branches, and other offices of financial institutions supervised by the BSP.
[2] Density ratio is the ratio of the total number of banking offices to the total number of cities/municipalities in the region.
[3] Customer Ratio or Population-to-Banking Offices Ratio is the ratio of the population to the total number of domestic banking offices in the region.
Note: NSSLAs refers to Non-Stock Savings and Loan Associations.
Source: Table 1 and 1a, BSP (2017)

*3.4.1.2. Electronic banking.* In addition to the increase in traditional bricks-and-mortar type of banking offices, electronic banking (e-banking) also facilitated access to financial services. E-banking services include a range of banking and other services or facilities that use electronic equipment, such as automated teller machines (ATMs), debit card services, online or internet banking, phone banking, SMS banking, fund transfer services, point of sales (POS) banking, and other e-commerce or valued added services. The BSP allowed banks to engage in e-banking beginning in 2000 to enable them to expand client reach and improve financial access (Espenilla 2018).

ATMs are the most common to date. Figure 7 shows the significant increase in total number of automated teller machines (ATMs) by type of bank from 2000 to June 2018, although the increase was largely accounted for by universal banks. Table 14 shows the regional distribution of ATMs in June 2018, which is again skewed in favor of Metro Manila and other major cities.

## Figure 7. Number of automated teller machines (ATMs), By type of bank, 2006-June 2018



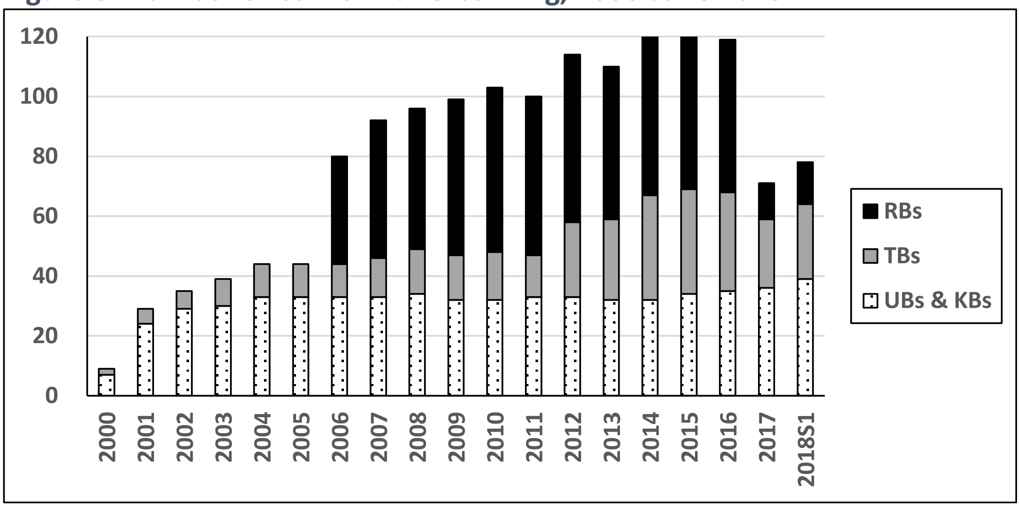

## Table 14. Regional distribution of ATMs, June 2018

| Region | ATMs (Onsite and offsite) Total number | Density Ratio |
|---|---|---|
| Nationwide | **20,881** | |
| NCR | 8,138 | 479 |
| Luzon | 7,352 | 10 |
| Region I | 705 | 6 |
| Region II | 429 | 5 |
| Region III | 1,960 | 15 |
| Region IV-A | 3,131 | 22 |
| Region IV-B | 289 | 4 |
| Region V | 554 | 5 |
| CAR | 284 | 4 |
| Visayas | 2,910 | 7 |
| Region VI | 991 | 7 |
| Region VII | 1,566 | 12 |
| Region VIII | 353 | 2 |
| Mindanao | 2,481 | 6 |
| Region IX | 325 | 5 |
| Region X | 579 | 6 |
| Region XI | 829 | 17 |
| Region XII | 419 | 8 |
| Region XIII | 289 | 4 |
| ARMM | 40 | 1 |

Note: Density ratio is the ratio of total number of ATMs to the number of cities/municipalities per region.
Source: BSP Statistics – Number of ATMs and banks with electronic banking (http://www.bsp.gov.ph/statistics/statnatmpbs.asp; Accessed on 14 November 2018).

Figure 8 shows the number of bank with e-banking as authorized by the BSP from 2000 to June 2018. Seven universal and commercial banks, and two thrift banks began to engage in e-banking in 2000, which steadily increased in number as well as type of services in the 2000s. E-banking then consisted primarily of telephone-based (mobile and non-mobile) and computer based (internet and proprietary systems) e-banking services. Banks also began to participate in the e-payment operation of the Bureau of Internal Revenue's Electronic Tax Filing and Payment System (ETFPS) in the early 2000s, which mandated large taxpayers to file and pay their taxes electronically.

## Figure 8. Number of banks with e-banking, 2006-June 2018




Source: BSP Statistics – Number of ATMs and banks with electronic banking (http://www.bsp.gov.ph/statistics/statnatmpbs.asp; Accessed on 14 November 2018).

Rural banks began putting up ATMs in 2005, and began offering e-banking largely in the form of e-wallets (mobile-based electronic money (e-money) services), particularly Globe Cash and Smart Money) in 2006. The bigger banks continued to offer expanded telephone-based and computer based banking services, plus hybrid mobile/internet banking via Bancnet-Megalink's Switch banking services, e-wallets, and cash/remittance cards. More recently, payments and settlement systems have become important services offered by banks.

Table 15 shows the breakdown of authorized e-banking operations of 78 banks in June 2018. It demonstrates significant evolution in the use of financial technology since the BSP allowed e-banking in 2000, and now cuts across payments, insurance, deposit-taking, lending, capital raising, investment management, and financial market infrastructure linkages. In particular, there are more universal and commercial banks offering a wide range of e-banking and e-money services. Thrift banks offer mobile, phone and internet banking, and EMIs. The impact of fintech in the areas of payments and settlement services, and funds transfer is also evident.

**Table 15. Number of banks authorized to engage in e-banking operations, June 2018**

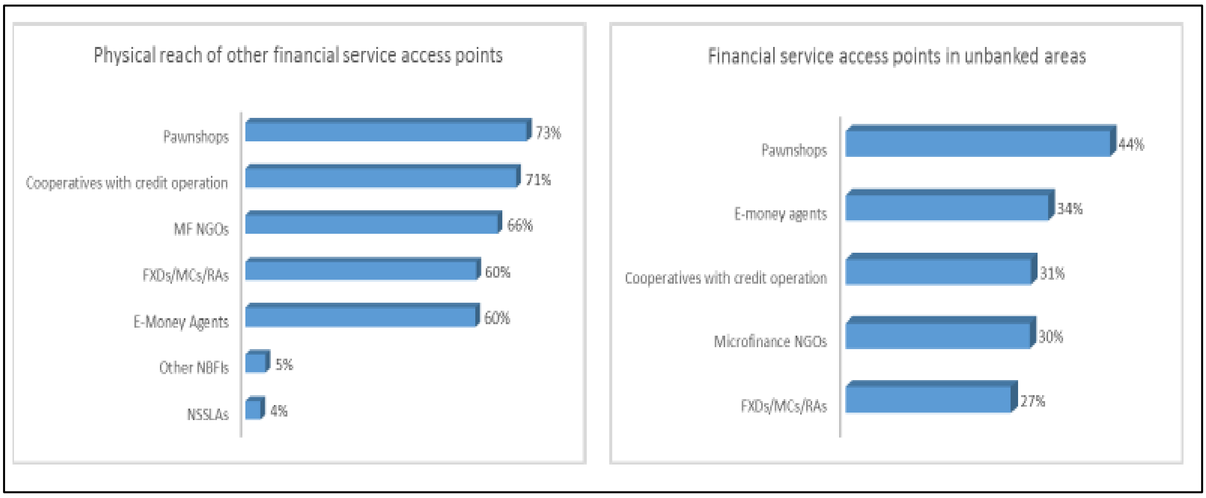
| | No. of Banks w/ E-Banking Facilities | No. of E-Banking and E-Money Applications | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Mobile Banking | Phone Banking | Internet Banking | | Mobile Financial Services Thru Mobile Apps | Bancnet POS Cash-Out Aggregator/ Acquirer | ETFPS (BIR) | Electronic Money Issuers |
| | | | | Proprietary | Thru BancNet | | | | |
| Universal and Commercial Banks | **39** | 15 | 14 | 34 | 6 | 20 | 10 | 18 | 19 |
| Thrift Banks | **25** | 7 | 4 | 10 | 7 | 6 | 6 | 2 | 8 |
| Rural Banks | **14** | 1 | | 1 | 2 | - | 8 | - | 3 |
| Total | **78** | **23** | **18** | **45** | **15** | **26** | **24** | **20** | **30** |

| | No. of E-Banking and E-Money Applications | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Lendr Program (of Voyager) | FinTech-WeChat Pay | Cardless Withdrawal | PesoNet | | Instapay | | Blockchain based financial services | FinTech-Alipay |
| | | | | Send | Receive | Send | Receive | | |
| Universal and Commercial Banks | 6 | 3 | 6 | 32 | 36 | 5 | 14 | 2 | 3 |
| Thrift Banks | 5 | 1 | 1 | 3 | 4 | 2 | 4 | - | 1 |
| Rural Banks | 2 | - | - | - | - | - | - | - | - |
| Total | **13** | **4** | **7** | **35** | **40** | **7** | **18** | **2** | **4** |

Source: Appendix 7, BSP 2018b.

The earlier discussion highlighted the skewed distribution of banking offices and ATMs in favor of Metro Manila and the other major cities. As expected, rural banks are the most accessible in the other regions, with their services supplemented by e-banking primarily in the form of e-money. The BSP monitors the state of financial inclusion in the country. It found that 582 out of 1,634 LGUs, or around 36 percent of the total, are still unbanked in June 2017 (BSP 2017b). Of the unbanked LGUs, 403 do have access to other financial access points. Pawnshops have traditionally been the most accessible. More recent years have seen the rise in importance of e-money agents, including pawnshops also registered as e-money agents (Figure 9).

**Figure 9. Other financial service access points, 2016**




Source: BSP (2016), page 5.

*3.4.1.3. Insurance sector.* The growth of the insurance sector is important in terms of increasing insurers' role in the economy both as providers and channels of risk pooling and transfer, and as institutional investors. Such developments promote economic activities. Thus, there is a growing body of theoretical and empirical literature examining the linkage between insurance market activities and economic growth. Dash et al (2017) provide a review of some key studies and identified two key channels: (i) through financial transfers and indemnification activities; and (ii) life insurance products encourage long-term savings, which can be reinvested in public and private sector projects.

Tables 16 and 17 present the number and assets of insurance companies by type of business for selected years. In terms of number, there are more nonlife insurance companies although its number has significantly dropped from 2000 to 2016. But in terms of assets, the sector is dominated by life insurance, which accounted for around 86% of total insurance assets but just around 32% of total number of insurance companies. This indicates the relative smallness of nonlife compared to life insurance companies on average. Also, the size of sector relative to the economy and the whole financial system increased modestly from four to nine percent of GDP, and from six to just seven percent of total financial assets in , respectively, in 1990-2016.

**Table 16. Market structure of insurance sector, Selected years**

| | 1990 | 2000 | 2010 | 2016 |
|---|---|---|---|---|
| **Total number of insurers** | **130** | **156** | **119** | **98** |
| Direct | 126 | 152 | 118 | 97 |
| Composite | 2 | 3 | 4 | 4 |
| Life | 23 | 39 | 30 | 27 |
| Nonlife | 101 | 110 | 84 | 66 |
| Professional Reinsurers (PRs) | 4 | 4 | 1 | 1 |
| Preneed companies | 54 [2] | 49 | 21 | 18 |
| Mutual Benefit Associations (MBAs) | | | 26 | 34 |

Source: Insurance Commission Key Data (https://www.insurance.gov.ph/statistics/key-data/; Accessed 15 November 2018)

**Table 17. Assets of insurance sector, Selected years**

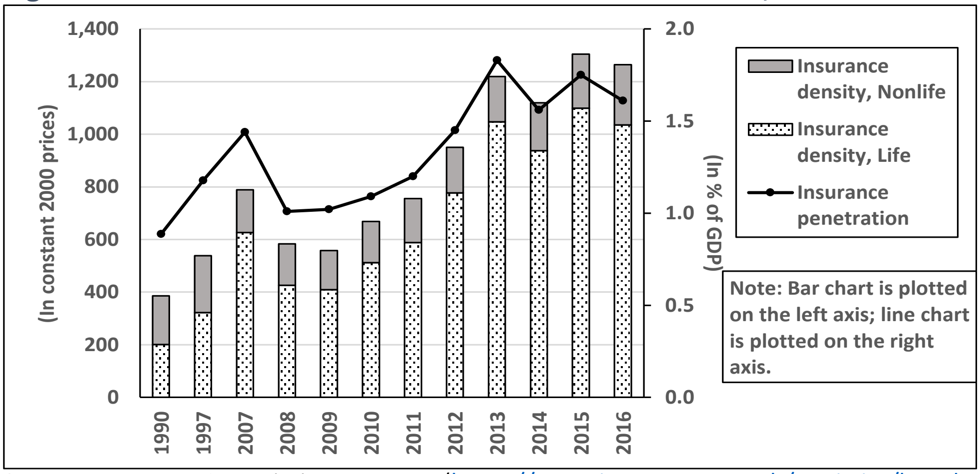
| | 1990 | 2000 | 2010 | 2016 |
|---|---|---|---|---|
| Total insurance | | | | |
| Current prices, billion pesos | 45.151 | 211.530 | 585.425 | 1,239.592 |
| Constant 2000 prices, billion pesos | 102.144 | 211.530 | 370.726 | 695.367 |
| % of GDP | 3.8 | 5.9 | 6.5 | 8.6 |
| % of Total financial assets | 5.8 | 5.2 | 6.5 | 7.2 |
| Distribution of assets (in percent) | | | | |
| Life | 57 | 69 | 81 | 86 |
| Nonlife & PRs | 43 | 31 | 19 | 14 |
| Preneed companies | | | | |
| Current prices, billion pesos | | | 80.235 | 114.937 |
| Constant 2000 prices, billion pesos | | | 50.809 | 64.475 |
| Mutual Benefit Associations (MBAs) | | | | |
| Current prices, billion pesos | | | 27.561 | 67.958 |
| Constant 2000 prices, billion pesos | | | 17.453 | 38.122 |

Source: Insurance Commission Key Data (https://www.insurance.gov.ph/statistics/key-data/; Accessed 15 November 2018). Author's own calculations.

In addition to private insurance companies, the IC also licenses preneed companies and mutual benefit associations (MBAs), which are all domestically owned. There was also a dramatic decline in the number of preneed companies from 49 in 2000 to 18 in 2016. On the other hand, the number of MBAs increased from 26 in 2010 to 34 in 2016. MBAs are social organizations that provide insurance to its members on an assessment basis. Of the 34 MBAs in 2016, 22 are microinsurance MBAs which have become dominant players in microinsurance.

Figure 10 presents some performance indicators for the insurance industry. In particular, there are two indicators typically used to show the state of the insurance industry within an economy: (i) insurance density is calculated as the ratio of insurance premium[254] to the total population of a given country, and indicates how much a country spends on insurance per capita in terms of premium; and (ii) insurance penetration is calculated as the ratio of insurance premium to GDP, and measures the contribution of insurance premium to the economy. Insurance density in 2016 was more than triple that in 1990, but insurance penetration is still quite low.

**Figure 10. Performance indicators of the insurance sector, Selected Years**




Source: Insurance Commission Key Data (https://www.insurance.gov.ph/statistics/key-data/; Accessed 15 November 2018).

[254] Insurance premium refers to the amount of money that an individual or business pays for an insurance policy. It becomes income for the insurance company once it is earned, and also represents a liability in that the insurer must provide coverage for claims being made against the policy.

In terms of types of insurance products, traditional life insurance products include ordinary, group, and industrial life insurance. Variable life insurance has been marketed as not just a life insurance product, but a saving/investment vehicle as well. Unlike an ordinary life insurance where the death benefit remains level from the date of purchase, a variable life insurance generally offers fixed premiums and the ability to invest the cash value in a choice of stock, bond, or money market-based investment options offered by the insurer. Thus, cash values and death benefits can rise or fall based on the performance of the investment choices. Table 18 shows a dramatic increase in the number and premium income of variable life insurance policies from 2010 to 2016, which was facilitated by bancassurance. Thus, the country's estimated life insurance coverage also significantly increased to 46% of the population in 2016.

**Table 18. Life insurance by type of product, Selected years**

| | 2007 | 2010 | 2016 |
|---|---|---|---|
| Estimated life insurance coverage (% of population) | 13.6 | 16.3 | 46.2 |
| No. of life policies in force | 3,405,970 | 3,385,934 | 4,798,038 |
| Traditional | 3,215,648 | 3,070,510 | 2,933,811 |
| Variable | 190,322 | 315,424 | 1,864,227 |
| Premium income (In million pesos) | | | |
| Current prices | 76,213.0 | 70,727.2 | 182,855.2 |
| Constant 2000 prices | 55,597.9 | 44,788.7 | 102,575.4 |
| Distribution by type of product | | | |
| Traditional | 54.9 | 62.5 | 27.9 |
| Variable | 45.1 | 37.5 | 72.1 |

Source: Insurance Commission Key Data (https://www.insurance.gov.ph/statistics/key-data/; Accessed 15 November 2018). Author's calculation.

Figure 11 shows the gross and net premiums written in nonlife insurance by line of business. Fire and motor car insurance roughly account for a third of total gross premiums written each, followed by casualty insurance with a share of around 20%.

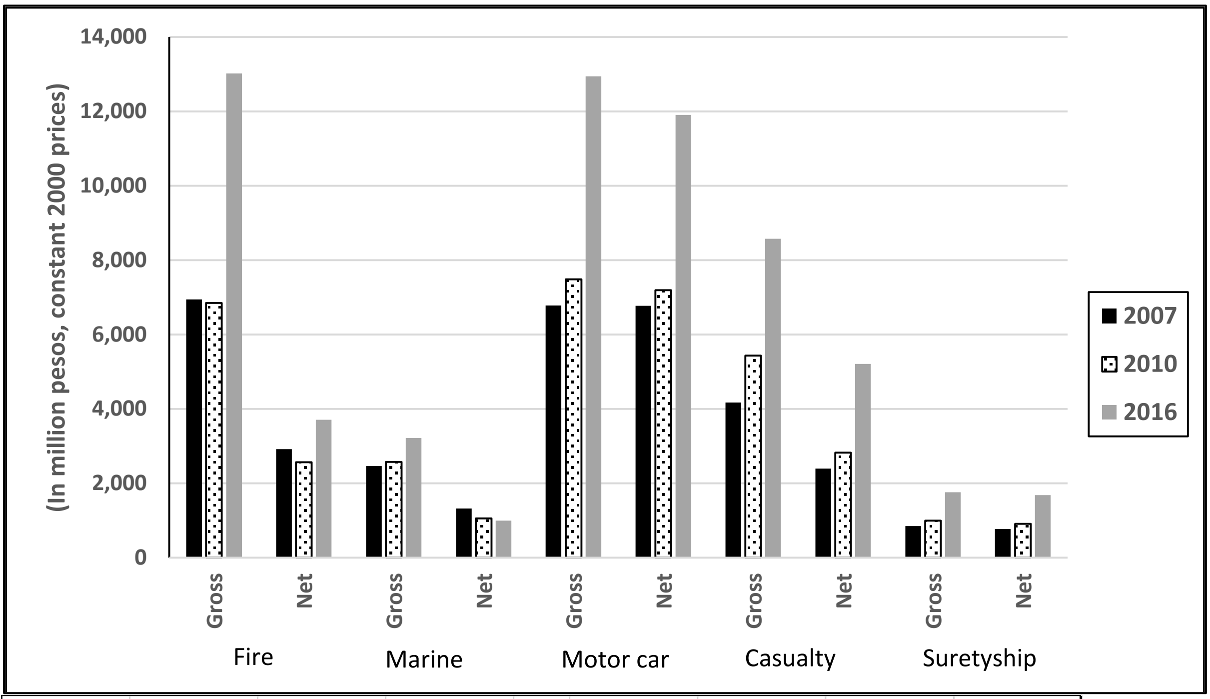
Net premiums written is the sum of gross premiums written less premiums ceded to reinsurance companies, plus any reinsurance assumed. Thus, net premiums written represents the amount of premiums the company keeps for assuming risk. What is noteworthy in Figure 10 is the fairly high rate of premiums being ceded to reinsurance companies by fire (72% in 2016), marine (69% in 2016), and casualty (39% in 2016) insurance companies. This high dependence on reinsurance can be a key source of inefficiency in nonlife insurance because it could be just adding an unnecessary layer to the underwriting chain.

In terms of investments, total investments of the insurance sector reached PHP1,111.6 billion or around 8% of GDP in 2016. Life insurance accounted for over 90% of total investments, with almost half going into investments under variable life insurance policies. Almost 34% of life insurance investments went into government bonds and securities, and 6% into stocks[255].

Overall, the insurance sector is still largely underdeveloped.

[255] The published data does not contain a breakdown of investments into variable life insurance products, which could include additional investments in government bonds and securities and stocks.

**Figure 11. Gross and net premiums written in nonlife insurance by line of business, Selected years (In million pesos, constant 2000 prices)**




| | 2007 | 2016 | | 2007 | 2016 |
|---|---|---|---|---|---|
| **Gross premiums (million pesos)** | | | **Net premiums (million pesos)** | | |
| Total (current prices) | 29,123 | 70,446 | Total (current prices) | 19,658 | 42,153 |
| Total (constant prices) | 21,245 | 39,518 | Total (constant prices) | 14,341 | 23,646 |

Source: Insurance Commission Key Data (https://www.insurance.gov.ph/statistics/key-data/; Accessed 15 November 2018). Author's calculation.

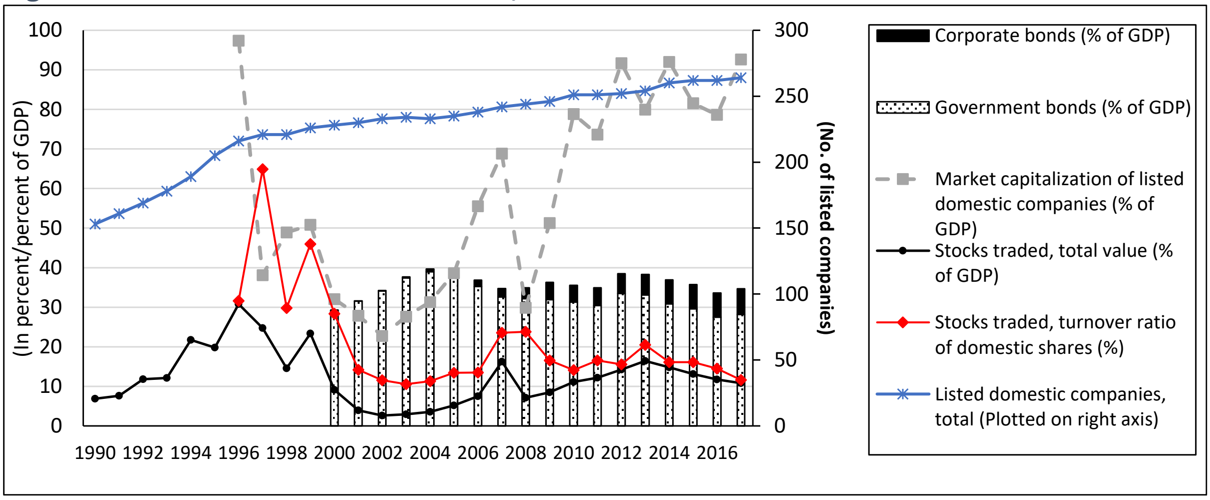
*3.4.1.4. Securities market.* Figure 12 presents some indicators of the size of the local bond market[256] and stock or equity market. In particular, the local bond market is dominated by government issuances. Corporate bonds were just 23% of government bonds in 2017, although there has been rapid growth in recent years. As a percent of GDP, government bonds amounted to 23%, while corporate bonds were just 6.5% in 2017.

There has been a steady increase in the number of listed domestic companies, and market capitalization increased especially in recent years. However, activity in the stock market is still quite low as shown by the low total value and turnover ratio of domestic shares[257], which were just around 11% of GDP and 11% respectively in 2017. The equity market still fairly thin, in that there are low numbers of buyers and sellers. With few transactions taking place in a thin market, this can lead to price volatility and less liquid assets.

[256] Government bonds include obligations of the central government, local governments, the central bank, and state-owned entities. Corporate bonds comprise both public and private companies, and include financial institutions. Bonds are defined as long-term bonds and notes, treasury bills, commercial paper, and other short-term notes.

[257] The value of shares traded is the total number of shares traded, both domestic and foreign, multiplied by their respective matching prices. Figures are single counted (only one side of the transaction is considered). Companies admitted to listing and admitted to trading are included in the data. Data are end of year values. Turnover ratio is the value of domestic shares traded divided by their market capitalization. The value is annualized by multiplying the monthly average by 12 (World Bank World Development Indicators).

**Figure 12. Securities market indicators, 1990-2017**




Note: Only the number of listed companies is plotted on the right axis, the rest are plotted on the left axis.
Sources: World Bank World Development Indicators – Financial Sector/Stock Market Indicators (https://data.worldbank.org/indicator; Accessed on 23 November 2018) and ADB Asian Bonds Online (https://asianbondsonline.adb.org/data-portal/; Accessed on 23 November 2018). Author's calculation.

High transaction costs are among the challenges facing the equity markets, particularly high broker's fees and taxes, according to Antonio and Abola (2005; in Abola 2016). With respect to the market for government securities, they noted that the secondary market is still fairly small and illiquid because: (i) financial institutions prefer to hold on to existing issues; (ii) inefficient trading system; (iii) lack of market makers; and (iv) heavy taxation of secondary market transactions. The corporate bond market faced the same challenges.

### 3.4.2. Trade in financial services

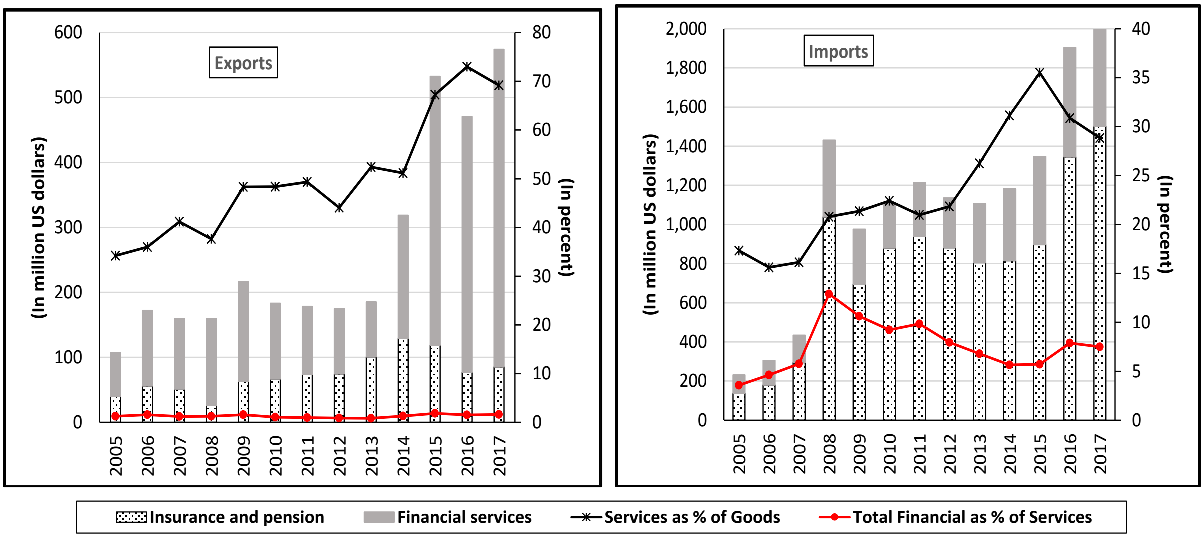
The services sector has been deemed as the most important sector for most developing economies. As developing economies remove barriers to investments in services trade, their service sectors develop, through foreign direct investments, and eventually they mature to becoming major exporters of services (McGuire 2002). Indeed, trade in services has become the most dynamic segment of world trade over the past 20 years, which has been growing more rapidly than trade in goods. In particular, developing countries and transition economies have become increasingly important players in this area, increasing their share in exports of world services from a quarter to one-third over the period 1995-2014 (WTO 2015).

This trend has also been evident in the Philippines. As shown in Figure 13, exports of services as a percent of goods exports rose from 34% in 2005 to 70% in 2017, while imports of services as a percent of goods imports rose from 17% to 29% over the same time period. Of these, exports of financial services only amounted to around 1.5% of total exports of services in 2017, while imports of financial services were more significant at 8% of total imports of services. The Philippines exported primarily financial services (most likely related to OFW remittances), and imported insurance and pension services (most likely the risk premium ceded offshore by nonlife insurance companies). In particular, these cover cross-border trade in financial services as classified in the IMF Balance of Payments definitions[258] being followed by the BSP. They

[258] Financial services (other than those related to insurance enterprises and pension funds) cover financial intermediation services and auxiliary services conducted between residents and nonresidents. Included are commissions and fees for letters of credit, lines of credit, financial leasing services, foreign exchange transactions, consumer and business credit services, brokerage services, underwriting services, arrangements for various forms of hedging instruments, etc. Auxiliary services include financial market operational and regulatory services, security custody services, etc.

do not cover financial services delivered via foreign branches, subsidiaries, or affiliates (i.e. essentially Mode 3 or commercial presence).

**Figure 13. Exports and imports of financial services, 2005-2017 (In million US dollars)**




Source: BSP Statistics - External Accounts (http://www.bsp.gov.ph/statistics/efs_bop2.asp; Accessed on 26 Nov 2018)
Note: The bar chart is plotted on the left axis, while the line chart is plotted on the right axis.

*3.4.2.1. Foreign banks.* Relevant to the GATS Mode of Supply 3 are statistics for the number of foreign banks. Table 19 presents the total number of offices of universal and commercial banks by type of ownership. In 2017, universal banks accounted for over 90 percent of total universal and commercial banking offices. In terms of ownership, private domestic banks dominate in terms of number of offices. There were 17 private domestic banks in 2017, down from 23 in 2001, but with more branches and other offices at 5,737 in 2017. There were 3 government owned universal banks in 2017, whose number of branches and other offices increased from 415 in 2001 to 589, although its share in number of offices decreased slightly.

**Table 19. Number of offices of universal and commercial banks, By type of ownership, Selected years**

| | 2001 | | | 2010 | | | 2017 | | |
|---|---|---|---|---|---|---|---|---|---|
| | Total | Head Office | Other Offices | Total | Head Office | Other Offices | Total | Head Office | Other Offices |
| Universal and Commercial Banks | 4,320 | 44 | 4,276 | 4,681 | 38 | 4,643 | 6,483 | 43 | 6,440 |
| Universal Banks | 3,587 | 18 | 3,569 | 4,121 | 19 | 4,102 | 5,935 | 21 | 5,914 |
| Private Domestic Banks | 3,157 | 12 | 3,145 | 3,674 | 11 | 3,663 | 5,331 | 12 | 5,319 |
| Government Banks | 418 | 3 | 415 | 430 | 3 | 427 | 592 | 3 | 589 |
| Branches of Foreign Banks | 12 | 3 | 9 | 17 | 5 | 12 | 12 | 6 | 6 |
| Commercial Banks | 733 | 26 | 707 | 560 | 19 | 541 | 548 | 22 | 526 |
| Private Domestic Banks | 538 | 11 | 527 | 472 | 8 | 464 | 423 | 5 | 418 |
| Subsidiaries of Foreign Banks | 179 | 5 | 174 | 74 | 2 | 72 | 105 | 2 | 103 |
| Branches of Foreign Banks | 16 | 10 | 6 | 14 | 9 | 5 | 20 | 15 | 5 |

Insurance and pension services cover the provision of insurance to nonresidents by resident insurance enterprises and vice versa. This item comprises services provided for freight insurance (on goods exported and imported), services provided for other types of direct insurance (including life and non-life), and services provided for reinsurance.

Source: BSP Statistics - Financial System Accounts/Number of Financial Institutions (http://www.bsp.gov.ph/statistics/efs_fsa1.asp; Accessed on 14 November 2018)

On the other hand, there were 23 branches and subsidiaries of foreign banks in 2017, up from 18 in 2001. Despite their increase in number of head offices, their number of branches fell from 189 to 114 over the same period. It should be noted that there were also three foreign bank-controlled thrift banks with 31 branches in 2017. Finally, there were three offshore banking units (OBUs) in 2017, down from 13 in 2000. OBU refers to a branch, subsidiary, or affiliate of a foreign banking corporation duly authorized by the BSP to conduct banking transactions in foreign currencies.

In Table 20, the trend in the distribution of total assets of universal and commercial banks by type of ownership was similar to the number of offices, in terms of the dominance of private domestic banks. In terms of distribution by size, the biggest bank was a private domestic universal bank with an asset share of 18% in 2017. The next three biggest banks, of which two were private domestic universal banks and one was a government universal bank, were comparable in size and accounted for 36% of total assets. The assets of the fifth biggest bank was just half in size of the fourth biggest bank. The biggest foreign bank was ranked 13th, with an asset share of two percent. Thus, the gap between the bigger banks and the smaller banks is stark, even just among domestic banks but more so between domestic and foreign-owned banks. The sustained dominance of a few, large private domestic universal banks raises the issue of market power.

**Table 20. Total assets of universal and commercial banks, By type of ownership, Selected years**

| | 2001 | 2010 | 2017 |
|---|---|---|---|
| Total universal and commercial banks | | | |
| In billion pesos, current prices | 2,942.77 | 6,131.76 | 13,763.28 |
| In billion pesos, constant 2000 prices | 2,788.05 | 3,882.99 | 7,545.61 |
| | | | |
| Universal Banks (% of Total) | 79 | 86 | 92 |
| Commercial Banks (% of Total) | 21 | 14 | 8 |
| | | | |
| By Ownership (% of Total) | | | |
| Private Domestic Banks | 71 | 73 | 76 |
| Government Banks | 12 | 14 | 16 |
| Foreign Bank Branches | 14 | 12 | 7 |
| Foreign Bank Subsidiaries | 2 | 1 | 1 |

| Rank in 2017 | % Share in Assets |
|---|---|
| 1 | 18.4 |
| 2-4 | 36.0 |
| 5-10 | 27.6 |

Source: BSP Statistics - Financial System Accounts/Total Resources of the Philippine Financial System (http://www.bsp.gov.ph/statistics/efs_fsa1.asp; Accessed on 14 November 2018).

Finally, five private domestic universal banks and one government universal bank had 49 offices overseas in 2017 primarily to cater to overseas Filipino workers (OFWs): 13 regular branches, 16 representative offices, 14 remittance desk officers, and six other offices with limited function. But it should be noted that 30 of those offices belonged to just one private domestic universal banks, which used to be a government-owned bank and the largest before it was privatized in the mid-1990s. In terms of location, 19 were in Asia Pacific, four in Europe, five in North America, and 21 in the Middle East.

*3.4.2.2. Foreign insurers.* Table 21 presents the number of private insurance companies by type of insurer and ownership. The number of insurance companies significantly declined from 2000 to 2016, which was largely due to the decline in the number of domestic nonlife companies. In contrast to the banking sector, there is significant foreign participation in the insurance industry, especially in life insurance, although the number of foreign insurers also declined from 2000. Similar to the banking sector, private insurance is dominated by domestic insurance companies in terms of number.

### Table 21. Number of private insurance companies, By type of insurer and ownership, Selected Years

| | 1990 | 2000 | 2010 | 2016 |
|---|---|---|---|---|
| TOTAL | 130 | 156 | 119 | 98 |
| Domestic | 108 | 125 | 102 | 80 |
| Foreign | 20 | 29 | 17 | 18 |
| Direct | 126 | 152 | 118 | 97 |
| Composite | 2 | 3 | 4 | 4 |
| Domestic | | | 3 | 3 |
| Foreign/Dom incorporated | | | 1 | 1 |
| Life | 23 | 39 | 30 | 27 |
| Domestic | 19 | 23 | 22 | 18 |
| Foreign | 4 | 16 | 8 | 9 |
| Nonlife | 101 | 110 | 84 | 66 |
| Domestic | 86 | 99 | 76 | 58 |
| Foreign | 15 | 12 | 8 | 8 |
| Professional Reinsurers | 4 | 4 | 1 | 1 |
| Domestic | 3 | 3 | 1 | 1 |
| Foreign | 1 | 1 | | |

Source: Annual Reports of the Insurance Commission, Various years.

But in marked contrast to the banking sector, foreign-owned insurance companies accounted for half of total assets in 2000, which steadily increased to almost 60 percent in 2016. In particular, foreign insurers dominated the life insurance sector in terms of assets (Table 22).

### Table 22. Total assets of private insurance companies, By type of insurer and ownership, Selected Years

| | 1990 | 2000 | 2010 | 2016 |
|---|---|---|---|---|
| **All Insurance Firms (In billion pesos)** | **45.15** | **211.53** | **585.43** | **1,239.59** |
| Domestic (Percent share) | 85 | 49 | 48 | 41 |
| Foreign (Percent share) | 15 | 51 | 52 | 59 |
| Life (In billion pesos) | 25.5 | 146.7 | 476.5 | 1,066.4 |
| Domestic (Percent share) | 86 | 37 | 39 | 33 |
| Foreign (Percent share) | 14 | 63 | 61 | 67 |
| Non-Life + Professional Reinsurers (In billion pesos) | 19.6 | 64.8 | 109.0 | 173.2 |
| Domestic (Percent share) | 83 | 76 | 88 | 90 |
| Foreign (Percent share) | 17 | 24 | 12 | 10 |
| **Social security systems** | | | | |
| GSIS | | | 578.4 | 1,013.0 |
| Life | | | 558.4 | 978.1 |
| Nonlife | | | 20.0 | 35.0 |
| SSS | | | 297.6 | 476.4 |

Source: Annual Reports of the Insurance Commission, GSIS, and SSS, Various years.

Although the insurance industry is largely privately owned, it also includes government insurance corporations: the Government Service Insurance System (GSIS), Social Security System (SSS), the Philippine Crop Insurance Corporation (PCIC), and the Philippine Deposit

Insurance Corporation (PDIC). These government corporations are governed by their respective charters and do not fall under the authority of the IC. In particular, SSS and GSIS provide compulsory social security for employees in the private and public sectors, respectively, and are almost as big as the private insurance sector in terms of assets.

An important law that could have significant implications on the role of government in the sector is the Personal Equity and Retirement Account (PERA) Law, which was signed in 2008 but was only fully implemented and became operational in 2016. PERA is an alternative voluntary retirement savings plan. PERA administrators can be bank, insurance companies, or securities brokers, which are pre-qualified by their respective regulatory authorities (i.e., BSP, IC and SEC, respectively) and accredited by the Bureau of Internal Revenue (BIR). The BSP, SEC, or IC can also prequalify its other supervised entities to become PERA administrators if they are deemed eligible to act as such. To date, three universal banks are registered as PERA administrators, while the Land Bank of the Philippines is designated as PERA custodian. The BSP also plans to explore the use of digital solutions to accelerate the growth of the PERA market.

Similar to issue of credit to the agriculture sector by banks, a critical gap in the private nonlife insurance industry is crop/agriculture insurance. Historically, this role was assigned to the Philippine Crop Insurance Corporation (PCIC), which is a government owned and controlled corporation (GOCC) created in 1978. PCIC is an attached agency of the Department of Agriculture and the implementing agency of the government's agricultural insurance program. Its principal mandate is to provide insurance protection to farmers against losses arising from natural calamities, plant diseases and pest infestations of their palay and corn crops as well as other crops. PCIC also provides fisheries insurance, livestock insurance, non-crop agricultural asset insurance, and credit and life term insurance to agricultural producers, fisherfolk and other stakeholders. In addition, the Quedan and Rural Credit Guarantee Corporation (QUEDANCOR) administers various quedan credit and guarantee programs.

To complete the list of government financial institutions, the BSP also reported two government NBFIs in its list of supervised financial institutions - Small Business Guarantee and Finance Corporation (SBGFC) and the Trade and Investment Development Corporation (TIDCORP). SBGFC was merged with the Guarantee Fund for Small and Medium Enterprises (GFSME) in 2001, to form the Small Business Corporation (SBC) attached to the Department of Trade and Industry (DTI) and tasked with developing and implementing financing and capacity building support programs for MSME development. TIDCORP was also reorganized in 2002 to form the Philippine Export-Import Credit Agency (PhilEXIM). PhilEXIM was attached to the Department of Finance (DOF) to provide guarantees to facilitate foreign loans for the needs of export-oriented industries, public utilities, and those registered with the Board of Investments (BOI).

Most recently, the President issued Executive Order No. 58 in July 2018 to merge PhilEXIM with the Home Guarantee Fund (HGF), with PhilEXIM as the surviving entity to be renamed Philippine Guarantee Corporation (PGC). EO 58 also mandated the transfer to PhilEXIM of the guarantee functions, programs and funds of SBC, and the administration of the Agricultural Guarantee Fund Pool (AGFP) and the Industrial Guarantee and Loan Fund (IGLF). HGC was an attached agency of the Housing and Urban Development Coordinating Council (HUDCC), and provided guarantee for the payment of mortgages, loans, and other credit facilities and receivables arising from residential contracts. AGFP was designed to mitigate risks in agriculture lending, while the IGLF was a re-lending and guarantee fund for SMEs. This move was aimed to streamline the operations of state-owned corporations by reducing redundancies; standardizing policies, processes and procedures for similar initiatives; facilitating approvals; lowering costs; and improving monitoring of the programs.

### 3.4.3. Comparative performance

Overall, the review of developments in banking, insurance, and securities markets indicates that there is still significant room for the Philippine financial system to grow, diversify, and deepen. The still fairly underdeveloped state of the Philippine financial system becomes more evident when compared to other ASEAN Member States (Table 23). In particular, Malaysia and Thailand significantly outperformed the Philippines across the various performance indicators covering bank, insurance, stock market, and financial inclusion in 2016. Even Vietnam performed as well as or even better than the Philippines in several key indicators.

**Table 23. Selected indicators of financial sector performance for ASEAN Members, 2016**

| ASEAN Member State | Commercial bank branches (per 100,000 adults) | Automated teller machines (ATMs) (per 100,000 adults) | Account ownership at a financial institution or with a mobile money service provider (% of population ages 15+) | Depositors with commercial banks (per 1,000 adults) | Domestic credit provided by financial sector (% | Domestic credit to private sector by banks (% of GDP) | Broad money (% of GDP) |
|---|---|---|---|---|---|---|---|
| Brunei Darussalam | 19 | 75 | .. | 1,535 | 35 | 44 | 93 |
| Cambodia | 6 | 13 | 22 | 250 | 71 | 81 | 79 |
| Indonesia | 17 | 55 | 49 | 1,056 | 48 | 33 | 40 |
| Lao PDR | 3 | 24 | 29 | 510 | .. | .. | .. |
| Malaysia | 11 | 48 | 85 | 823 | 145 | 124 | 130 |
| Myanmar | 3 | 3 | 26 | 252 | 39 | 22 | 50 |
| Philippines | 9 | 27 | 34 | 487 | 63 | 45 | 77 |
| Singapore | 9 | 58 | 98 | 2,277 | 130 | 127 | 131 |
| Thailand | 12 | 113 | 82 | 1,214 | 167 | 114 | 126 |
| Vietnam | 4 | 25 | 31 | 963 | 140 | 124 | 151 |

| ASEAN Member State | Life insurance | | Nonlife insurance | | Listed domestic companies, total | Market capitalization of listed domestic companies (% of GDP) | Stocks traded, total value (% of GDP) |
|---|---|---|---|---|---|---|---|
| | Insurance density (Premiums per capital in USD) | Insurance premiun (Premiums as % of GDP) | Insurance density (Premiums per capital in USD) | Insurance premiun (Premiums as % of GDP) | | | |
| Brunei Darussalam | .. | .. | .. | .. | .. | .. | .. |
| Cambodia | .. | .. | .. | .. | .. | .. | .. |
| Indonesia | 73 | 18 | 1.90 | 0.46 | 537 | 46 | 10 |
| Lao PDR | .. | .. | .. | .. | .. | .. | .. |
| Malaysia | 339 | 147 | 3.32 | 1.44 | 890 | 121 | 33 |
| Myanmar | .. | .. | .. | .. | .. | .. | .. |
| Philippines | 37 | 16 | 1.24 | 0.55 | 262 | 79 | 12 |
| Singapore | 3,835 | 915 | 6.64 | 1.58 | 479 | 207 | 61 |
| Thailand | 237 | 112 | 3.59 | 1.69 | 656 | 105 | 79 |
| Vietnam | 30 | 19 | 1.29 | 0.81 | 320 | 32 | 11 |

Source: World Bank World Development Indicators – Financial Sector (https://data.worldbank.org/indicator; Accessed on 23 November 2018).

Table 24 presents the World Bank's latest Ease of Doing Business overall ranks and scores for the 10 ASEAN Member States, as well as the ranks and scores for Getting Credit. The overall Ease of Doing Business score and Getting Credit score indicate an economy's position relative to the best regulatory practice. Higher scores show absolute better ease of doing business/getting credit (the best score is set at 100), while lower scores show absolute poorer

ease of doing business/getting credit (the worst performance is set at 0). The Getting Credit[259] component consists of two sets of indicators that measure: (i) the legal rights of borrowers and lenders with respect to secured transactions; and (ii) the reporting of credit information.
The strength of legal rights index measures the degree to which collateral and bankruptcy laws protect the rights of borrowers and lenders and thus facilitate lending. It consists of 10 aspects related to legal rights in collateral law and 2 aspects in bankruptcy law. A score of 1 is assigned for each of the following features of the laws:

a. The economy has an integrated or unified legal framework for secured transactions that extends to the creation, publicity and enforcement of four functional equivalents to security interests in movable assets: fiduciary transfers of title; financial leases; assignments or transfers of receivables; and sales with retention of title.
b. The law allows a business to grant a nonpossessory security right in a single category of movable assets (such as accounts receivable, tangible movable assets and inventory), without requiring a specific description of the collateral.
c. The law allows a business to grant a nonpossessory security right in substantially all its movable assets, without requiring a specific description of the collateral.
d. A security right can be given over future and after-acquired assets, and extends automatically to the products, proceeds and replacements of the original assets.
e. All types of debts and obligations can be secured between the parties, and a general description of such debts and obligations is permitted in the collateral agreement and in registration documents.
f. A collateral registry or registration institution for security interests granted over movable property by incorporated and nonincorporated entities is in operation, unified geographically and with an electronic database indexed by debtors' names.
g. The collateral registry is a notice-based registry—a registry that files only a notice of the existence of a security interest (not the underlying documents) and does not perform a legal review of the transaction. The registry also publicizes functional equivalents to security interests.
h. The collateral registry has modern features such as those that allow secured creditors (or their representatives) to register, search, amend or cancel security interests online.
i. Secured creditors are paid first (for example, before tax claims and employee claims) when a debtor defaults outside an insolvency procedure.
j. Secured creditors are paid first (for example, before tax claims and employee claims) when a business is liquidated.
k. Secured creditors are subject to an automatic stay on enforcement procedures when a debtor enters a court-supervised reorganization procedure, but the law protects secured creditors' rights by providing clear grounds for relief from the automatic stay (for example, if the movable property is not used for the reorganization or sale of the business as a going concern, or if there is a risk to its existence) and setting a time limit for it.
l. The law allows parties to agree in the collateral agreement that the lender may enforce its security right out of court; the law allows the assets to be sold through public or private auctions and permits the secured creditor to take the asset in satisfaction of the debt.

The index ranges from 0 to 12, with higher scores indicating that collateral and bankruptcy laws are better designed to expand access to credit.

The depth of credit information index measures rules and practices affecting the coverage, scope and accessibility of credit information available through either a credit bureau or a credit

[259] The discussion of the methodology is extracted from: http://www.doingbusiness.org/en/methodology/getting-credit; accessed on 18 December 2018.

registry. A score of 1 is assigned for each of the following eight features of the credit bureau or credit registry (or both):

a. Data on firms and individuals are distributed.
b. Both positive credit information (for example, original loan amounts, outstanding loan amounts and a pattern of on-time repayments) and negative information (for example, late payments and the number and amount of defaults) are distributed.
c. Data from retailers or utility companies are distributed in addition to data from financial institutions.
d. At least two years of historical data are distributed. Credit bureaus and registries that erase data on defaults as soon as they are repaid or distribute negative information more than 10 years after defaults are repaid receive a score of 0 for this component.
e. Data on loan amounts below 1% of income per capita are distributed.
f. By law, borrowers have the right to access their data in the largest credit bureau or registry in the economy. Credit bureaus and registries that charge more than 1% of income per capita for borrowers to inspect their data receive a score of 0 for this component.
g. Banks and other financial institutions have online access to the credit information (for example, through a web interface, a system-to-system connection or both).
h. Bureau or registry credit scores are offered as a value-added service to help banks and other financial institutions assess the creditworthiness of borrowers.

The index ranges from 0 to 8, with higher values indicating the availability of more credit information, from either a credit bureau or a credit registry, to facilitate lending decisions. If the credit bureau or registry is not operational or covers less than 5% of the adult population, the score on the depth of credit information index is 0.

The Philippines' overall Ease of Doing Business Score is only slightly better than the scores of the least developed ASEAN Member States. The Philippines fared worst when it came to the Getting Credit component.

**Table 24. Ease of Doing Business and Getting Credit in ASEAN, 2019**

| ASEAN Member State | Ease of Doing Business | | Getting Credit | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Global Rank | Global Score | Rank | Score | Strength of legal rights index (0-12) | Depth of credit information index (0-8) | Credit registry coverage (% of adults) | Credit bureau coverage (% of adults) | Getting credit total score |
| Brunei Darussalam | 55 | 72.03 | 1 | 100.00 | 12 | 8 | 75.2 | 0 | 20 |
| Cambodia | 138 | 54.8 | 22 | 80.00 | 10 | 6 | 0 | 50.4 | 16 |
| Indonesia | 73 | 67.96 | 44 | 70.00 | 6 | 8 | 58.2 | 38.1 | 14 |
| Lao PDR | 154 | 51.26 | 73 | 60.00 | 6 | 6 | 14.5 | 0 | 12 |
| Malaysia | 15 | 80.6 | 32 | 75.00 | 7 | 8 | 63.3 | 86.6 | 15 |
| Myanmar | 171 | 44.72 | 178 | 10.00 | 2 | 0 | 0 | 0 | 2 |
| Philippines | 124 | 57.68 | 184 | 5.00 | 1 | 0 | 0 | 2.7 | 1 |
| Singapore | 2 | 85.24 | 32 | 75.00 | 8 | 7 | 0 | 60.9 | 15 |
| Thailand | 27 | 78.45 | 44 | 70.00 | 7 | 7 | 0 | 60.2 | 14 |
| Vietnam | 69 | 68.36 | 32 | 75.00 | 8 | 7 | 54.8 | 29.5 | 15 |

Source: World Bank Ease of Doing Business Historical Data Sets and Trends Data (http://www.doingbusiness.org/en/custom-query; Accessed on 18 December 2018).

#### 3.4.4. Preliminary issues arising from the review of the state of the Philippine financial sector

a. Financial sector development and financial inclusion need to go beyond the banking sector

Efforts to develop and deepen the Philippine financial system have typically focused on traditional financial institutions and services, principally banks and banking services. Even recent initiatives to promote digital finance have primarily involved banks. But persistent credit needs remain, particularly facilitating SMEs and the agriculture sector's access to credit. In the insurance sector, there is heavy reliance on reinsurance by nonlife insurance companies. Insurance companies are also heavily invested in government securities. And the capital market primarily caters to large corporations.

Recently, the government has been highlighting the importance of promoting innovation in industry[260], including among SMEs. But all innovative ideas need funding in order to develop and commercialize them. It is more difficult to find funding for innovation activities for several reasons, including: (i) innovation produces an intangible asset that traditional sources such as banks do not typically accept as collateral; and (ii) the technological and market uncertainty of innovation activities makes the returns to investment highly uncertain, which could complicate the standard risk adjustment methods used by traditional providers of funds. Thus, policymakers need to understand the different sources of funding businesses may use to fund their innovation activities, as well as the interventions they can develop to provide finance for innovative businesses (Bravo-Biosca, Cusolito and Hill 2012; OECD 2015).

A good example is the US economy, which is driven by invention and innovation. In turn, the US venture capital industry has been deemed as a key driver of economic growth. In particular, the link between the rise of the Silicon Valley and presence of venture capitalists has been well studied and documented. For instance, Ferrary and Granovetter (2009) noted that what is noteworthy about Silicon Valley was its complete and robust complex system of innovation supported by social networks of interdependent economic agents, in which the venture capital firms had a key role.

In 2001, there were only 4 venture capital corporations that were subsidiaries or affiliates of universal banks. None were reported in 2017[261].

In ASEAN, it is also argued that access to alternative sources of finance for MSMEs needs to be enhanced, while access to traditional funding remains prohibitive or limited. Alternative financing provided by nontraditional financial institutions include various forms of equity finance such as angel investors, venture capital, social impact investment, and equity crowd funding (ASEAN Secretariat 2017a, 2017b).

The role of financial technology in promoting other, non-bank based financial services also needs to be supported and promoted.

b. Role of government as direct provider of financial services

The question related particularly to government NBFIs' role as direct provider of financial services is, why are they still necessary many years, even decades, after they were initially established because the private financial sector at the time was unable or unwilling to meet the credit and other financial services needs of specific sectors in the economy? Why are such gaps

[260] The Department of Trade and Industry's Inclusive Innovation Industrial Strategy (i3S), to promote innovative and globally competitive manufacturing, agriculture, and services while strengthening their linkages into domestic and global value chains with innovation at the core of the country's strategic policies and programs (DTI 2017).

[261] Venture capital firms do not appear in the SEC's list of supervised entities.

persistent? In particular, why did the private financial sector seemingly fail to address the gaps over the years? Simply put, the role of government in the financial sector needs to be reevaluated to determine the underlying cause of the gaps in financial services and identify appropriate recommendations.

c. Role of foreign competition

Despite the increasing number of foreign banks and strong presence of foreign insurance companies, they do not seem to be making a significant mark in terms of promoting the competitiveness and development of these sectors. Why is this so? Are there regulatory and other impediments that could be hindering them from fully contesting the market and playing a more important role in promoting financial sector development and deepening, and ultimately the growth of the economy?

More generally, are there regulatory and other impediments that could be hindering the development of various financial sectors and services in the Philippines?

### 3.4.5. OECD FDI Regulatory Restrictiveness Index[262]

The Organisation for Economic Co-operation and Development's (OECD) FDI Regulatory Restrictiveness Index (FDI Index) currently covers 22 sectors and four types of measures or restrictions in those sectors: (i) foreign equity restrictions; (ii) screening and prior approval requirements; (iii) rules for key personnel; and (iv) other restrictions on the operation of foreign enterprises (such as limits on purchase of land, repatriation of profits and capital, and establishment of branches; access to local finance, and reciprocity). Each measure or restriction is given a score based on an assessment of its importance. The highest score for any measure in any sector is 1 (the measure fully restricts foreign investment in the sector) and the lowest is 0 (there are no regulatory impediments to FDI in the sector). The score for each sector is obtained by adding the scores for all four types of measures, with the constraint that their sum is also capped at a value of 1. The scores for the 22 sectors are then averaged to obtain a country score, the FDI Index for the country. The Philippine FDI Index, and the FDI Index for services, and financial services and its components (banking, insurance, and other finance) from 1997 to 2017 are presented in Figure 14.

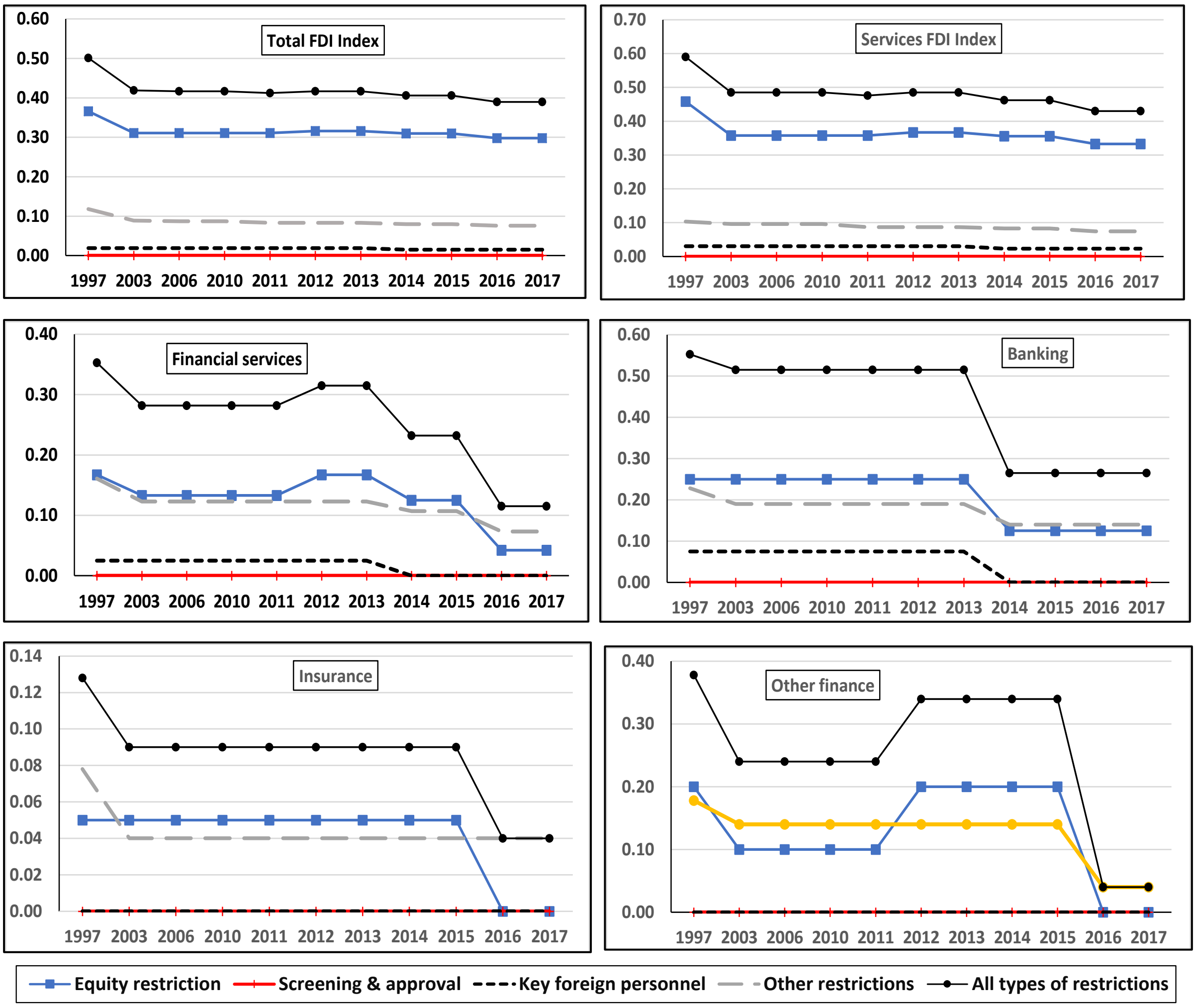
Early in the report, it was noted that foreign direct investment (FDI) restrictions in the Philippines are high by both regional and global standards, based on the most recent FDI Index calculations of the OECD. Broken down by sector, the results indicated that FDI in the services sector is even more restricted compared to overall FDI restrictiveness. In particular, the measure that is most restrictive overall and in services related to equity restrictions. The trend in services overall was not true for the financial services sector in recent years, which has become fairly open compared to other services sectors. In financial services, equity restrictions and other restrictions were also the most restrictive measures, although they have eased in recent years. Among the components of financial services, banking is the most restrictive overall with respect to FDI, while insurance and other financial services are fairly open to FDI.

Figure 15 presents the FDI Index for financial services for selected ASEAN Member States from 1997-2017. The most dramatic improvement in terms of openness to FDI in financial services was Vietnam. Equity restrictions remain in banking, while insurance and other finance

[262] The discussion of the FDI Regulatory Restrictiveness Index is extracted from Kalinova et al (2010).

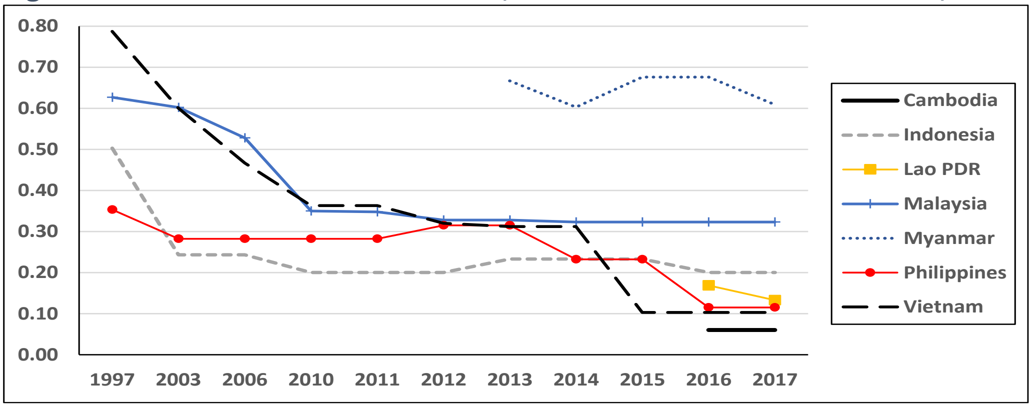
are fully open to foreign equity. Malaysia's level of overall restrictiveness has remained unchanged in the last 5 years. In particular, insurance has the most restrictive measures, followed by banking and other finance, particularly with respect to equity and screening and approval. Indonesia's level of overall restrictiveness was also largely unchanged in the last 10 years. Measures are most restrictive in other finance, followed by banking and insurance, particularly equity restrictions (other finance and insurance), key foreign personnel across all types of financial services, and other restrictions in other finance.

**Figure 14. Philippine FDI Index – Country, services and financial services, 1997-2017**




Source: OECD FDI Regulatory Restrictiveness Index Database (https://stats.oecd.org/Index.aspx?datasetcode=FDIINDEX#; Accessed on 18 December 2018).

**Figure 15. Financial services FDI Index, Selected ASEAN Member States, 1997-2017**




Source: OECD FDI Regulatory Restrictiveness Index Database (https://stats.oecd.org/Index.aspx?datasetcode=FDIINDEX#; Accessed on 18 December 2018).

What is interesting is that Malaysia has more restrictive measures across all four types in the three financial services subsectors, except other restrictions in banking and insurance. Yet the comparative analysis presented in the previous section showed that Malaysia's financial sector outperformed the Philippines' across all subsectors. It should also be noted that Malaysia ranked significantly higher than the Philippines in terms of overall Ease of Doing Business and Getting Credit. This indicates that whatever restrictions there are to FDI in financial services, they are not compounded by domestic regulatory and other impediments.

Empirical studies have been undertaken for several groups of countries, which indicate that better governance, institutions and credit culture lead to lower financial intermediation costs and financial deepening (e.g., Demirgüç-Kunt and Huizinga 1999; Demirgüç-Kunt et al. 2004; Poghosyan 2013; in Jarmuzek and Lybek 2018). Proxies for governance used typically incorporated property rights, rule of law, legal system, regulatory quality, effectiveness of the executive branch, and efficiency of the judiciary.

The FDI index is useful in: (i) determining the relative FDI restrictiveness of each country; (ii) tracking changes in restrictiveness over time; (iii) gauging a country's capacity to attract FDI given its level of restrictiveness; and (iv) matching the effects FDI liberalization with FDI inflows. It was also noted that the FDI Index scores overt regulatory restrictions on FDI, but does not take into account other aspects of the regulatory framework that may also impinge on the overall FDI environment, such as the nature of corporate governance, the extent of state ownership, and other institutional or informal restrictions. That is, the methodology captures regulatory restrictiveness, but it does not attempt to assess the overall restrictiveness of the regulatory regime as it is actually implemented (Kalinova et al 2010). The latter could be posing more serious restrictions in the Philippines, with adverse effects on the development of the financial sector. A wider review of regulations in financial services is presented in the following section.

### *3.5. Key regulations in the financial services sector*

The financial sector is among the most heavily regulated sectors in any economy because of its systemic importance. Thus, a key element in any negotiation on trade in financial services is the relationship between domestic regulation and opening of financial markets. In particular, financial market opening to promote greater contestability typically includes a shift in the *nature* of financial market regulation, which may necessitate new regulations, rather than a simple reduction in its *incidence*. The nature, pace, and sequencing of regulatory reform and liberalization efforts in the financial sector need to be carefully considered to ensure that they promote economic growth and development. Liberalization pursued in a progressive, orderly, and transparent manner would allow both incumbents and regulators to prepare for greater competition and its possible downsides. Establishing clear broad policy objectives in its pursuit of financial services agreements would also help the government to determine the extent to which it is willing to use such agreements to anchor current or future policy reforms (Sauvé 2010).

Undertaking a trade-related regulatory audit[263], which maps the universe of explicitly restrictive governmental measures affecting trade and investment in financial services, is a useful preparatory step for negotiations because: (i) exact information on the regulatory status quo clarifies the sectoral intricacies and technical details needed by individuals involved to effectively participate in services negotiations, (ii) it provides services suppliers with a one-stop inventory of restrictive measures maintained at home and in the markets of key trading partners; and (iii) it helps to develop a roadmap of measures to target and rank order in future negotiations. Such gains in terms of improved transparency also foster an overall culture of pro-competitive regulatory reform.

Conducting a regulatory audit in the context of negotiations on services trade and investment liberalization is useful not just for negotiation purposes but for domestic purposes as well. Positive policy spillovers may be generated in terms of domestic regulatory conduct and design, and consultations within and outside government in the services field would be enhanced. In the area of financial services, a regulatory audit on restrictive measures may also be useful in identifying economy-wide incidence of other types of discriminatory measures or measures that inhibit market access, such as provisions relating to capital transactions (for example, capital controls) that may be negotiated in other chapters of a trade agreement.

Key objectives of a trade-related regulatory audit include:

a. Ensure that key regulatory objectives, including prudential or social policy objective, are met in the most efficient manner;
b. Identify antiquated, ineffective or inefficient regulations, benchmark domestic regulations to determine the extent to which they approach established international standards, and move them towards international best regulatory practices;
c. Encourage, where feasible, the adoption of (pro-competitive) regulation that is market-access friendly;
d. Promote a unified approach to domestic regulation to build trust within the government through closer dialogue among trade negotiators, line ministries, and sectoral regulators;
e. Better inform the consultative process with key stakeholders in government (including regional and local governments), as well as with consumers and businesses; and
f. Anticipate and prepare for the negotiating (market-opening) requests of key trading partners.

It should be noted such an audit may not fully identify all nondiscriminatory measures, such as prudential measures that may be unduly burdensome or are possibly disguised restrictions to trade. Identifying such measures is inherently more difficult and requires considerably more dialogue and technical competence among trade negotiators, line ministries, and sectoral regulators.

[263] The discussion draws on Sauvé (2010).

An overview of the various financial entities and their corresponding regulators is presented in Table 25. The following sections discuss the financial entities in turn.

**Table 25. Summary of financial entities and their personalities and the corresponding regulators**

| Function | Personality | Governing Law | Regulator |
|---|---|---|---|
| Banks | Stock Corporation | The General Banking Act (R.A. 8791) | BSP and Monetary Board |
| Rural Bank | Stock Corporation | The Rural Bank Act (R.A. No. 7353) | BSP and Monetary Board |
| Thrift Bank | Stock Corporation | Thrift Bank Act (R.A. 7906) | BSP and Monetary Board |
| Brokers and Dealers | Natural Person, Partnership, or Stock Corporation | Securities Regulation Code | SEC |
| Credit Cooperative | Cooperative | The Cooperative Code of 2008 (R.A. 9520) | CDA |
| Cooperative Bank | Cooperative | The Cooperative Code of 2008 (R.A. 9520) | BSP |
| Exchanges | Stock Corporation | Securities Regulation Code | SEC |
| Financial Services Cooperative | Cooperative | The Cooperative Code of 2008 (R.A. 9520) | CDA and BSP |
| Insurance Company | Partnership, Cooperative, Association, Corporation | The Insurance Code (R.A. 10607) | Insurance Commission, DOF Secretary may increase required capitalization |
| Insurance Cooperative | Cooperative | The Cooperative Code of 2008 (R.A. 9520) | CDA and Insurance Commission |
| Investment Company | Stock Corporation | Investment Company Act (Republic Act No. 2629) and 2017 Implementing Rules | SEC |
| Lending Company | Stock Corporation | Lending Company Regulation Act of 2007 (R.A. 9474) | SEC (unless subsidiary or affiliate of bank, then BSP) |
| Microfinance NGO | Non-stock, non-profit Corporation | Microfinance NGO Act (R.A. 10693) | SEC and Microfinance NGO Regulation Council, also BSP and IC. |
| Mutual Fund Company | Stock Corporation | Investment Company Act | SEC |
| Non-stock savings and loan association | Association registered with the SEC | Revised Non-Stock Savings and Loan Association Act of 1997 (R.A. 8367) | BSP and Monetary Board |
| Pre-need Company | Stock Corporation | Pre-Need Act (R.A. 9829) | Insurance Commission |
| Quasi-banks | Stock Corporation | The General Banking Act (R.A. 8791) | BSP |
| Real Estate Investment Trust | Publicly Listed Corporation | The Real Estate Investment Trust Act of 2009 (R.A. 9856) | SEC |
| Trust Entity | Stock Corporation | The General Banking Act (R.A. 8791) | Monetary Board |

### 3.5.1. Financial entities

#### *3.5.1.1. Banks.*

*3.5.1.1.1. Lifting of moratorium on bank entry.* In a Monetary Board Resolution dated 21 January 2016, the lifting of the moratorium on the grant of new bank licenses or the establishment of new domestic banks started. In BSP Circular No. 902, series of 2016, the lifting of the moratorium was described to be in two phases. Under phase 1 of the liberalization, the grant of new universal or commercial banking licenses will be only allowed in connection with the upgrading of an existing domestic thrift bank. Under phase 2, the moratorium on the establishment of new domestic banks was fully lifted and locational restrictions were fully liberalized starting 01 January 2018.[264] Thus, there are no more restrictions on the establishment of new banks.

*3.5.1.1.2. Organization of banks.* Multiple authorities are needed to put up a bank. Even prior to incorporation, the group of persons intending to put up a bank must secure a Certificate of Authority to organize from the Monetary Board.[265] After incorporation, the Monetary Board evaluates the corporation on whether it sourced its capital from at least 20 persons and that it satisfies the capital requirement for the type of bank the corporation intends to operate.[266] The BSP then issues the final authority to operate a bank or quasi-banking institution.[267]

A bank is not permitted to directly engage in insurance business as the insurer.[268] However, the rules have been relaxed to allow bancassurance activities.

*3.5.1.1.3. Universal banks.* A universal bank has authority to exercise commercial banking activities such as accepting drafts and issuing letters of credit; discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; accepting or creating demand deposits; receiving other types of deposits and deposit substitutes; buying and selling foreign exchange and gold or silver bullion; acquiring marketable bonds and other debt securities; and extending credit.[269] A universal bank also has the powers of an investment house. In addition, it has the power to invest in non-allied enterprises.[270] It also has the authority to engage in quasi-banking activities.[271]

*3.5.1.1.4. Commercial banks.* A commercial bank has authority to exercise commercial banking activities such as accepting drafts and issuing letters of credit; discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; accepting or creating demand deposits; receiving other types of deposits and deposit substitutes; buying and selling foreign exchange and gold or silver bullion; acquiring marketable bonds and other debt securities; and extending credit.[272]

*3.5.1.1.5. Thrift banks.* Thrift banks may be savings and mortgage banks, private development banks, or stock savings and loans associations organized under existing laws, or any banking corporation that may be organized for the following purposes:

264 BSP Circular No. 902, s. 2016.
265 Section 14, General Banking Act.
266 Section 8, General Banking Act.
267 Section 6, General Banking Act.
268 Section 54, General Banking Act.
269 Section 29, General Banking Act.
270 Section 23, General Banking Act.
271 Section 6, General Banking Act.
272 Section 29, General Banking Act.

a. Accumulating the savings of depositors and investing them, together with capital loans secured by bonds, mortgages in real estate and insured improvements thereon, chattel mortgage, bonds and other forms of security or in loans for personal or household finance, whether secured or unsecured, or in financing for homebuilding and home development; in readily marketable and debt securities; in commercial papers and accounts receivables, drafts, bills of exchange, acceptances or notes arising out of commercial transactions; and in such other investments and loans which the Monetary Board may determine as necessary in the furtherance of national economic objectives;
b. Providing short-term working capital, medium- and long-term financing, to businesses engaged in agriculture, services, industry and housing; and
c. Providing diversified financial and allied services for its chosen market and constituencies especially for small and medium enterprises and individuals.[273]

Thrift banks may perform commercial banking services only with prior approval by the Monetary Board.

R.A. 10641 eliminated the previous limitation on foreign equity in thrift banks. However, R.A. 10641 does not refer to foreign management of banks. Under the thrift bank law, at least a majority of the members of the board of directors of any thrift bank must be citizens of the Philippines.[274]

*3.5.1.1.6. Rural banks.* The rural banking system was designed to make needed credit available and readily accessible in the rural areas on reasonable terms.[275] Loans or advances extended by rural banks are directed towards meeting the normal credit needs of farmers, fishermen or farm families owning or cultivating land dedicated to agricultural production as well as the normal credit needs of cooperatives and merchants.[276] In granting loans, the rural bank is required to give preference to farmers and merchants whose cash requirements are small.[277] To encourage the establishment of rural banks and to meet these stated policies, all rural banks shall be exempt from the payment of all taxes, fees and charges of whatever nature and description, except the corporate income tax and local taxes, fees and charges, for a period of five years from the date it commences operations.[278]

Previously, the capital stock of any rural bank must be fully owned and held directly or indirectly by citizens of the Philippines or corporations, associations or cooperatives qualified under Philippine laws to own and hold such capital stock.[279] With the enactment of Republic Act No. 10641, a rural bank may be fully owned by foreigners.

It appears that RA 10641 removed specific restrictions to holding capital in a rural bank. Under the Rural Bank Act, any Filipino individual or a domestic non-bank corporation may each own only up to sixty percent (60%) of the voting stock of a rural bank.[280] A corporate stockholder of a Rural Bank is deemed Filipino-owned if it is organized under the laws of the Philippines and at least sixty percent (60%) of its capital is owned by Filipino citizens.[281] These restrictions are no longer relevant in light of R.A. 10641.

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[273] Section 3 (a), R.A. 7906
[274] Section 7, R.A. 7906.
[275] Section 2, R.A. 7353.
[276] Sectin 6, R.A. 7353.
[277] *Id.*
[278] Section 14, R.A.7353.
[279] Section 4, R.A. 7353.
[280] Section X126.1 (c), MORB.
[281] Section X126.1 (h) (2), MORB.

Such provision should be interpreted to apply to any person since banking regulations should apply equally to foreign and domestic persons[282] plus a foreigner cannot have better rights than a Filipino. In addition, the limitation is specific to a rural bank and the restriction aims to limit the concentration of ownership in one person irrespective of nationality.

The law also mandates that all members of the Board of Directors of the rural bank shall be citizens of the Philippines at the time of their assumption to office.[283] RA 10641 dealt with capital ownership and did not lift restrictions on foreign management. Nevertheless, R.A. 10574 allows foreign participation in the board of directors in proportion to the foreign equity in the bank.

*3.5.1.1.7. Islamic Bank.* Al Amanah Islamic Investment Bank of the Philippines was created by virtue of Presidential Decree No. 264, but it is currently defined by its charter under Republic Act No. 6848. It is a subsidiary of the Development Bank of the Philippines, which holds 99.9% of its shares. It is the only Islamic Bank in the Philippines.

*3.5.1.1.8. Cooperative banks.* A cooperative bank is one organized for the primary purpose of providing a wide range of financial services to cooperatives and their members.[284] Hence, it does not cater to the general public based on this provision of law. While any cooperative bank may perform any or all of the banking services offered by other types of banks subject to the prior approval of the BSP,[285] its primary purpose limits it to mainly target cooperatives and members.

While R.A. 10641 lifted restrictions on foreign ownership of banks, it is not so clear if it affects cooperative banks since cooperatives in the Philippines are organized only by Filipino citizens.

The Cooperative Development Act provides geographical limitations for cooperative banks. Only one cooperative bank may be established in each province. However, an additional cooperative bank may be allowed in the same province to cater to the needs of the locality depending on the economic conditions of the province as may be determined by the BSP. In such case, the additional cooperative bank must be located in the City or municipality other that the city or municipality where the first cooperative bank is located in the province.[286]

The equity investment of any cooperative in any Coop Bank shall not exceed forty percent (40%) of the subscribed capital stock of such Coop Bank.[287]

Any officer or employee of CDA or any elective public official, except a barangay official are prohibited from being appointed or elected to the board of directors of a Cooperative Bank.[288]

*3.5.1.1.9. Foreign Banks.* While the entry of foreign banks was further liberalized by the enactment of Republic Act No. 10641, regulations remain to prevent the wholesale entry of foreign banks. In fact, it should be clarified that RA 10641 only allowed full entry, but not necessarily full ownership in every case. Foreign banks must first be qualified in order to vie

[282] See Section 5, R.A. 10641.
[283] Section 5, R.A. 7353.
[284] Article 23 (1), Republic Act No. 9520 (The Cooperative Code).
[285] Article, 100, Republic Act No. 9520.
[286] Article 97, Republic Act No. 9520.
[287] Section X126.1 (g), MORB.
[288] Section X143.2 (d), MORB.

for entry into the Philippine market. The primary qualifications of the foreign bank are that it is widely and publicly owned in its home country, unless it is a state-owned bank, and that it is established, reputable, and financially sound.[289]

The BSP also considers reciprocity in that Philippine banks should have the opportunity to establish operations in the foreign bank applicant's home country.[290] In addition, countries of origin of applicant foreign banks with substantial financial assistance to, and loans and investments, past and present, in the Philippines; and those with which the Philippines has significant volume of trade especially to those with which the country has substantial net exports, are given greater consideration by the BSP.[291] Likewise, the BSP also takes into account the capability of the foreign bank to promote trade and to bring foreign investments into the Philippines and the existence of long standing financial and commercial relationship with, and assistance extended to, the Philippines.[292] The BSP also ensures that there is representation from different parts of the world or international financial centers in qualifying foreign banks.[293]

The BSP also prescribes that the foreign bank has demonstrated capacity, global reputation for financial innovations and stability in a competitive environment. [294] The foreign bank should also be willing to share its banking technology.[295]

These qualified foreign banks may operate in the Philippines through any one of the following modes of entry:

Mode 1: By acquiring, purchasing or owning up to 100% of the voting stock of an existing domestic bank;
Mode 2: By investing in up to 100% of the voting stock of a new banking subsidiary incorporated in the Philippines; or
Mode 3: By establishing branches with full banking authority.

Foreign banks are allowed to offer their services in the Philippines. However, such services are only allowed to be offered if the foreign bank has local branches and subsidiaries.[296] The BSP requires the local branch or subsidiary to notify it that the parent bank or a branch abroad offers products in the Philippines through their website or local desks.[297]

*3.5.1.1.10. Common regulations on foreign equity in banks.* The Monetary Board has an extensive role in the regulation of the banking industry. One aspect, which the Monetary Board regulates, is the ownership and transfer of shares. Hence, certain transactions on bank shares require prior Monetary Board approval. Hence, transactions which result in ownership or control of more than twenty percent (20%) of voting shares of stock of a bank by any person whether natural or juridical or which will enable such person to elect, or be elected as a director of such bank needs prior Monetary Board approval. Likewise, a transaction on bank shares which effect a change in the majority ownership or control of the voting shares of stock of the

[289] Section X105.2, MORB.
[290] Section 3, R.A. 7721, as amended; Section X105.3 (e), MORB.
[291] Section 3, R.A. 7721, as amended; Section X105.3 (b), MORB.
[292] Section 3, R.A. 7721, as amended; Section X105.3 (c), MORB.
[293] Section 3, R.A. 7721, as amended; Section X105.3 (a), MORB.
[294] Section 3, R.A. 7721, as amended; Section X105.3 (d), MORB.
[295] Section 3, R.A. 7721, as amended; Section X105.3 (f), MORB.
[296] Section 1948, MORB.
[297] *Id.*

bank from one group of persons to another group, provided the change complies with capital requirements, requires prior Monetary Board approval.[298]

The percentage of foreign-owned voting stocks in a bank is determined by the citizenship of all its stockholders.[299] Meanwhile, the citizenship of the corporation, which is a stockholder of a bank, shall follow the citizenship of the controlling stockholders of the corporation, irrespective of the place of incorporation. [300] The term "controlling stockholders" refers to stockholders holding more than 50% of the voting stock of the corporate stockholders of the bank.[301] While the banking sector has been liberalized, the Monetary Board still ensures that the Philippine banking system, as a whole, is controlled by Filipinos by maintaining 60% of the resources or assets of the entire banking system is held by domestic banks, which are majority-owned by Filipinos[302].

Foreign banks are allowed to offer their services in the Philippines. However, such services are only allowed to be offered if the foreign bank has local branches and subsidiaries.[303] The BSP requires the local branch or subsidiary to notify it that the parent bank or a branch abroad offers products in the Philippines through their website or local desks.[304]

*3.5.1.2. Exchange.* An exchange is an organized market place or facility that brings together buyers and sellers and executes trade of securities and/or commodities.[305] Exchanges are required to be registered with the SEC[306]. Only stock corporations may be registered as exchanges.[307] In addition, the purpose of such stock corporation cannot be any other than engaging in the business of an exchange unless otherwise exempted by the SEC.[308]

The law restricts ownership in the exchange by one person, who may not beneficially own or control, directly or indirectly, more than five percent (5%) of the voting rights of the exchange. An industry or business group may also not beneficially own or control, directly or indirectly, more than twenty percent (20%) of the voting rights of the exchange. In any event, the SEC may set aside this prohibition where it finds that such ownership or control will not negatively impact on the exchange's ability to effectively operate in the public interest.[309]

*3.5.1.3. Investment company.* An "investment company" means any issuer which is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities;[310] It may be classified as an Equity Fund, Bond Fund, Balanced Fund, Feeder Fund, Fund-of-Funds, Index Fund, Money Market Fund, Multi-Asset/Asset Allocation Fund.[311] The kinds of funds are not limited to these and such other funds must be approved by the Securities and Exchange Commission.

[298] Section X126.2, par. b, MORB.
[299] Section X126.1 (h) (1), MORB.
[300] Section X126.1 (h) (2), MORB.
[301] Section X126.1 (h) (2), MORB.
[302] Section 3, RA 10641
[303] Section 1948, MORB.
[304] *Id.*
[305] Section 3.7, Securities Regulation Code.
[306] Section 33, Securities Regulation Code.
[307] Section 33.2 (a), Securities Regulation Code.
[308] Section 33.2 (b), Securities Regulation Code.
[309] Section 33.2 (c), Securities Regulation Code.
[310] Section 4(a), R.A. 2629.
[311] Rule 3.3, 2018 Implementing Rules of the Investment Company Act.

An Investment Company must be organized as a stock corporation with the primary purpose of engaging in the business of investing, reinvesting or trading in securities or other investment assets allowed by the Investment Company Act or the SEC. It is required to have a paid-up capital of Php50 Million unless it is part of a group of investment companies managed by the same Fund Manager with a track record of at least five years. In the latter case, the paid-up capital must at least be Php1 Million. [312]

The SEC has the power to limit the registration of investment companies to such number as the investment opportunities in the country would permit, and to allow the registration of new investment companies only when the conditions warrant it.[313]

No person shall serve as a director of a registered investment company unless he is a Filipino citizen.[314] This restriction was not lifted by Republic Act No. 10881.

The shares issued or sold by an Investment Company must be registered with the SEC. Operations by the Investment Company also involve other parties like the Fund Manager, the Fund Advisor, the Fund Distributor, the Transfer Agent, and the Custodian and Compliance Officer.[315]

An Investment Company is required to appoint a Fund Manager. The Fund Manager is required to secure an Investment Company Adviser License from the SEC.[316] A Fund Manager must also be a corporation with a paid-up capital of at least Php50 Million with an unimpaired net worth of at least Php50 Million apart from the revaluation surplus, unrealized gain in value of non-current investments, deferred income tax, and other capital adjustment which may be mandated by the SEC.[317]

The Fund Manager is prohibited from holding more than 50% of the membership of the board of the Investment Company and such prohibition extends to the Fund Manager's directors, CEO and key officers or managers.[318]

The SEC specifically enumerates the assets in which the Fund Manager may invest. A Fund Manager, based on the Investment Company's objective, policy, and focus, may only invest in transferrable securities, money market instruments, deposits, financial derivatives, tradable securities, units or participation in other CIS, and securities issued by or guaranteed by the Philippine government or the BSP.[319] Fund Managers are not permitted to invest in constant net asset value money market funds.[320] In addition, at least 10% of the Investment Company's assets must be invested in liquid or semi-liquid assets.[321]

Offering or selling investment schemes in other economies are subject to mutual or multilateral cross-border trading of funds agreements entered by the Philippines.[322]

[312] Rule 3.4, 2018 Implementing Rules of the Investment Company Act.
[313] Section 7(e), R.A. 2629.
[314] Section 15, R.A. 2629.
[315] Rule 5, 2018, Implementing Rules of the Investment Company Act.
[316] Rule 5.1.1, 2018 Implementing Rules of the Investment Company Act.
[317] Rule 5.1.1, 2018 Implementing Rules of the Investment Company Act.
[318] Rule 5.1.5, 2018 Implementing Rules of the Investment Company Act.
[319] Rule 6.1, 2018 Implementing Rules of the Investment Company Act.
[320] Rule 6.9, 2018 Implementing Rules of the Investment Company Act.
[321] Rule 6.10, 2018 Implementing Rules of the Investment Company Act.
[322] Rule 16.2, 2018 Implementing Rules of the Investment Company Act.

*3.5.1.4. Financing company.* Financing companies are corporations, except banks, investments houses, savings and loan associations, insurance companies, cooperatives, and other financial institutions organized or operating under other special laws, which are primarily organized for the purpose of extending credit facilities to consumers and to industrial, commercial, or agricultural enterprises, by direct lending or by discounting or factoring commercial papers or accounts receivable, or by buying and selling contracts, leases, chattel mortgages, or other evidences of indebtedness, or by financial leasing of movable as well as immovable property.[323]

Financing companies previously had foreign equity restrictions, which have since been lifted by Republic Act No. 10881. However, while previously foreigners may own equity in financing companies of up to 40%, the limits on shareholdings was further subject to reciprocity requirements. It appears though, with the amendment by R.A. No. 10881, that even the reciprocity requirement was removed.

The SEC and the BSP has regulatory authority over financing companies. The BSP regulates financing companies insofar as they conduct quasi-banking functions.[324] The BSP may also allow financing companies to engage in money market and trust operations.[325] The BSP may also allow financing companies to issue bonds and capital instruments.[326]

Financing companies enjoy a parity provision. When providing medium and long-term credit to small and medium enterprises, financing companies enjoy rights, powers, benefits and privileges granted by the law or regulation to other non-bank financial institutions when they provide similar credit to such enterprises.[327]

*3.5.1.5. Lending Company.* A lending company is a corporation engaged in granting loans from its own capital funds or from funds sourced from not more than 19 persons. It does not refer to banking institutions, investment houses, savings and loan associations, financing companies, pawnshops, insurance companies, cooperatives and other credit institutions already regulated by law. The term lending company is synonymous with lending investors.[328]

A lending company must be a corporation[329] and must secure a Certificate of Authority from the SEC to do business as such. In addition, the lending company must secure a separate Certificate of Authority if it intends to open a branch, an extension office, or unit or satellite office.[330]

Republic Act No. 10881 lifted the restriction on foreign ownership of a lending company.[331] While a lending company may now be 100% foreign owned, certain conditions must be met in foreclosure proceedings, as there continues to be a restriction on foreign ownership of land in the Philippines. The Lending Company Act, as amended, mandates that lending companies which foreign ownership exceeds 40% have five years from securing possession of the foreclosed property to transfer the property to a Filipino natural person or entity.[332]

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323 Section 3, R.A. 8556.
324 Section 4, R.A. 8556.
325 Section 10, R.A. 8556.
326 *Id.*
327 Section 11, R.A. 8556.
328 Section 3, R.A. 9474.
329 Section 4, R.A. 9474.
330 Rule 3, Implementing Rules and Regulations of Lending Company Regulation Act of 2007.
331 Section 5, R.A. 10881.
332 Section 5, R.A. 10881; Section 6, R.A. 9474, as amended.

Noticeably, the amendment of the old provision also removed the condition that ownership of any stock of a lending company must be subject to reciprocity. It appears now that a lending company may be fully foreign owned without the state of such foreign owner according the same right of ownership to Filipinos.

The SEC has regulatory authority over lending companies, which includes the power to suspend or revoke the license of the lending company.[333] Nevertheless, lending companies which are subsidiaries and affiliates of banks and quasi-banks are subject to BSP supervision and examination.[334] However, the Monetary Board can order the examination of a lending company if there are grounds existing to show that the lending company is being used as a conduit by BSP regulated institutions to circumvent BSP rules and regulations.[335]

Lending companies are mandated to use 51% of its funds for direct lending.[336] The total investment of a lending company in real estate and in shares of stock in a real estate development corporation and other real estate-based projects shall not at any time exceed 25% of its net worth.[337]

*3.5.1.6. Microfinance NGOs.* Recognizing the importance of microfinance in alleviating poverty, the Philippine legislature passed a law dealing with microfinance NGOs. Because of the altruistic ideals behind microfinance NGOs, government provides them with the incentive of a preferential tax rate.[338] While such juridical persons do not set profitability goals, their operations nevertheless require massive investments and likewise generate jobs. Hence, the incentives given to them and their existence need to be covered by a special regulation.

Microfinance NGOs are nonstock and nonprofit organizations duly registered with the SEC. Their primary purpose is implementing a microenterprise development strategy and providing microfinance programs, products, and services, such as microcredit and microsavings, for their poor and low-income clients.[339]

At a minimum, the law mandates microfinance NGOs to provide microcredit and financial literacy programs and microcredit and capital build-up (CBU) or microsavings to its clients.[340] Microsavings refer to the program of a Microfinance NGO to collect relatively small amounts of money from their clients for purposes of maintaining a compensating balance.[341]

In this regard, microfinance loans are small loans granted to the basic sectors, as defined in the Social Reform and Poverty Alleviation Act,[342] and those loans defined by the government as to their amount, scope, and coverage that are granted to the poor and low-income individuals for their microenterprises and small businesses. Microfinance loans are granted on the basis of the borrower's cash flow and are typically unsecured.[343]

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333 Section 9, R.A. 9474.
334 Section 11, R.A. 9474.
335 *Id.*
336 Rule 3(f), Implementing Rules and Regulations of Lending Company Regulation Act of 2007.
337 Rule 3(g), Implementing Rules and Regulations of Lending Company Regulation Act of 2007.
338 Section 20, R.A. 10693.
339 Section 3 (h) and Section 4, R.A. No. 10693.
340 Section 7, R.A. No. 10693.
341 Section 3(i), R.A. 10693.
342 Republic Act No. 8425.
343 Section 3 (g), R.A. No. 10693.

In order to enjoy the benefits of the law, microfinance NGOs must be accredited by the Microfinance NGO Regulatory Council.[344] This Regulatory Council was formed by the SEC pursuant to R.A. No. 10693. The Council collects accreditation fees based on the total portfolio of the microfinance NGO.

Aside from issuing Certificates of Accreditation,[345] the Council is tasked to monitor compliance by microfinance NGOs with the set standards for their performance[346] and discipline microfinance NGOs by placing them on probation or by suspending or revoking their certificates of accreditation for violation of such standards and any other requirements by law or regulations.[347] The Council also receives mandatory reports from the microfinance NGOs.[348]

*3.5.1.7. Insurance Companies.* An insurance company may be a partnership, association, cooperative or corporation, which may be government-owned or -controlled, except mutual benefit associations.[349] An insurance company may not be partly owned by an adjusting company and conversely, an insurance company may not have equity in an adjustment company.[350] New domestic life or non-life insurance companies, in a stock corporation, must have a paid-up capital equal to at least Php1 Billion.[351] Before it does business in the Philippines, it must first secure a certificate of authority to do so from the Insurance Commissioner.[352]

It can be seen that the new Insurance Code continues to impose financial requirements for foreign insurance companies as a form of protection for consumers. For a foreign insurance company to engage in business in the Philippines, it should have unimpaired capital or assets and reserve of not less than One billion pesos (₱1,000,000,000.00).[353] It should also have deposited with the Commissioner, for the benefit and security of its policyholders and creditors, securities covering the required capital. At least 50% of such securities should be bonds or debt instruments issued by the Philippine government or any of instrumentalities and GOCCs.[354] Another condition for foreign insurance companies is that their total investment in any registered enterprise must not exceed 20% of its net worth nor 20% of the capital of the registered enterprise, unless previously authorized in writing by the Insurance Commissioner.[355]

As a pre-licensing requirement of a new branch office of a foreign insurance company, in addition to the required asset or net worth, the Insurance Commissioner may require the company to have an additional surplus fund in an amount to be determined by the Insurance Commission.[356] The foreign insurance company is also required to keep reserves equivalent to the policies written in the Philippines and to invest such reserves only in the Philippines.[357]

These prudential regulations applied exclusively to foreign insurance companies must be tested whether they truly protect the insured. The risk of a local insurance company folding up and

[344] Section 10, R.A. No. 10693.
[345] Section 11 (b), R.A. No. 10693.
[346] Section 11 (c), R.A. No. 10693.
[347] Section 11(d), R.A. No. 10693.
[348] Section 11 (e), R.A. No. 10693.
[349] Section 190, Insurance Code.
[350] Section 193, Insurance Code.
[351] Section 194, Insurance Code.
[352] Section 193, Insurance Code.
[353] Section 197, Insurance Code.
[354] Section 197, Insurance Code.
[355] *Id.*
[356] *Id.*
[357] Section 198, Insurance Code.

leaving the insured without resort must be measured. If the risk is equal for both foreign and local insurance companies, the question of the added requirements on foreign insurance companies must then be resolved in light of the new investments that may be attracted without such additional requirements.

As a condition to transact insurance business in the Philippines, a foreign insurance company must file with the Insurance Commissioner a written power of attorney designating some person who is a Philippine resident, as its general agent.[358] Any notice provided by law or by any insurance policy, proof of loss, summons and other legal processes may be served against such agent. The foreign insurance company should express its consent that service upon such general agent would be considered as if served upon the foreign company at its home office.[359] A further condition is that the authorized personnel of the foreign company must file a statement with the Insurance Commissioner stating that if it ceases to have any business or representative in the Philippines, it would consider service upon the Insurance Commissioner as service to the foreign company.[360]

Similar to most financial institutions, members of the board of directors and officers of an insurance company must pass the fit and proper test. Under the Insurance Code, such is couched as any person of good moral character, unquestioned integrity and recognized competence.[361] The Insurance Code also prohibits any person from concurrently being a director and officer of an insurance company and an adjustment company.[362]

*3.5.1.8. Microinsurance.* Microinsurance is a financial product or service that meets the risk protection needs of the poor.[363] It is also characterized by the amount of contributions, premiums, fees or charges, computed on a daily basis, which does not exceed seven and a half percent of the current daily minimum wage rate for nonagricultural workers in Metro Manila.[364] In addition, the maximum sum of guaranteed benefits is not more than 1,000 times the current daily minimum wage rate for nonagricultural workers in Metro Manila.[365] The IC identified various types of microinsurance, which includes micro agri-insurance, health microinsurance, and pre-need microinsurance.

Microinsurance agents or brokers are licensed by the IC.[366] However, unlike in regular insurance, agents and brokers in microinsurance need not pass the licensure examination for agents or brokers, but they only need to take a microinsurance training program and pass the qualifying exam.[367]

MicroAgri refers to microinsurance which may be used to insure all assets and economic activities related to the agriculture, forestry, fisheries, and agro-processing sectors in the Philippines.[368] It may be used to insure inputs, crops/products in their various stages of development, and all types of assets directly related to production, storage, marketing and processing such as rice mills, fish pens, poultry facilities, poultry, animals, machineries, fishing

[358] Section 196, Insurance Code.
[359] *Id.*
[360] *Id.*
[361] Section 193, paragraph 3, Insurance Code.
[362] Section 193, paragraph 4, Insurance Code.
[363] Section 187, Insurance Code.
[364] Section 187 (a), Insurance Code.
[365] Section 187 (b), Insurance Code.
[366] Insurance Memorandum Circular No. 1-2010.
[367] Section 6, Insurance Memorandum Circular No. 1-2010.
[368] Par. 19, Insurance Commission Memorandum Circular No. 2015-53.

boats, and all types of equipment.[369] It may also protect against perils that can affect all the stages in the agricultural value chain, ranging from the pre-production to the final stages of the goods such as marketing of the finished products.[370] Events that may be insured include occurrences of drought, frost, hailstorms, typhoons, floods, excess rain, extreme heat, tsunamis, storm surges, earthquakes, volcanic eruptions, landslides, pests and diseases, fires, lightning, tornadoes, sinkholes, and such other contingent events that may be identified by the Insurance Commission.[371] It may also cover business interruptions in the value chain.[372]

Health microinsurance or "MicroHealth" refers to an activity providing specific health insurance, health insurance-like, and other similar products and services that address the health needs of the general population, particularly the low-income and the informal sectors.[373] MicroHealth principally covers curative care benefits in in-patient and out-patient settings such as treatment of illnesses and injuries, pregnancy-related cases, and medical procedures for therapeutic and rehabilitation purposes.[374] Health maintenance products that principally cover preventive health care and maintenance services such as regular executive check-ups, counselling, optical and dental services shall not fall under the definition of MicroHealth.[375]

The government, in line with the Pre-Need Code of the Philippines, established the Micro Pre-need Framework to allow the low-income sector to gain access to pre-need products and services that will cater to their needs.[376] A Micro Pre-Need product provides for a dedicated savings mechanism precisely designed for education, life, or memorial services, and pension.[377]

Only pre-need companies duly licensed by the IC may provide Micro Pre-Need Plans.[378] Meanwhile, only providers, sales counselors, pre-need general agents and pre-need brokers licensed by the lC shall be allowed to sell Micro Pre-Need products.[379] To facilitate distribution of Micro Pre-Need products, a Micro Pre-Need sales counselor must be licensed to sell only Micro Pre-Need products.[380] Those engaged in microfinance or microinsurance activities may apply for a license as Micro Pre-Need sales counselors or brokers, but the license shall only cover the solicitation of Micro Pre-Need products.[381]

*3.5.1.9. Pre-Need Companies.* The Securities Regulation Code assigned the SEC the responsibility of regulating the sale of Pre-Need Plans. [382] However, Republic Act No. 9829 or the Pre-Need Code, legislated all supervisory and regulatory functions over the Pre-Need industry to be under the primary and exclusive authority of the Insurance Commission.[383]

Pre-need plans are contracts, agreements, deeds or plans for the benefit of the planholders which provide for the performance of future services, payment of monetary considerations or delivery of other benefits at the time of actual need or agreed maturity date, in exchange for cash or installment amounts with or without interest or insurance coverage and includes life,

369 Par. 20, Insurance Commission Memorandum Circular No. 2015-53.
370 Par. 21, Insurance Commission Memorandum Circular No. 2015-53.
371 Par. 24, Insurance Commission Memorandum Circular No. 2015-53.
372 Par. 25, Insurance Commission Memorandum Circular No. 2015-53.
373 Section 1, Circular Letter No. 2016-22.
374 Section 3, Circular Letter No. 2016-22.
375 Section 4, Circular Letter No. 2016-22.
376 Insurance Commission Circular Letter No. 2015-51.
377 Section 1.1.1, par. 4, Insurance Commission Circular Letter No. 2015-51.
378 Section 6, Insurance Commission Circular Letter No. 2015-51.
379 Section 8.1, Insurance Commission Circular Letter No. 2015-51.
380 Section 8.2, Insurance Commission Circular Letter No. 2015-51.
381 Section 8.4, Insurance Commission Circular Letter No. 2015-51.
382 Section 16, Securities Regulation Code.
383 Section 5, R.A. 9829 or the Pre-need Code of the Philippines.

pension, education, interment and other plans, instruments, contracts or deeds as may in the future be determined by the Insurance Commission.[384] Pre-need company refers to any corporation registered with the Insurance Commission and authorized and licensed to sell or offer to sell pre-need plans. The term "pre-need company" may also refer to schools, memorial chapels, banks, nonbank financial institutions and other entities which have also been authorized and licensed to sell or offer to sell pre-need plans insofar as their pre-need activities or businesses are concerned.[385]

Pre-need companies must be organized as corporations. The issuance of a primary registration as a corporation remains with the SEC, but is dependent on a favorable recommendation by the Insurance Commission.[386] Such corporation must have at least Php100 Million in paid-up capitalization.[387] Subsequent the incorporation of a pre-need company, it must secure a license to operate as such from the IC.[388] Such license is renewed annually.[389]

Similar to board of directors of banks, the board of directors of pre-need companies must also pass the fit and proper test.[390] The law also mandates that the board of directors of pre-need companies reserve at least two and in larger boards, at least 20%, of the seats for independent directors.[391]

Directors and officers, as well as their relatives within the fourth degree of consanguinity or affinity, are also prohibited from having, directly or indirectly, for himself or as the representative or agent of others, an investment in excess of Php5 Million in any business in which the pre-need company's trust fund has a financial interest.[392]

*3.5.1.10. Philippine Crop Insurance Corporation.* The Philippine Crop Insurance Corporation is mandated to insure subsistence farmers against losses arising from natural calamities, plant diseases, and pest infestations.[393] The underlying state policy includes the government's motive to develop and support an adequate agricultural insurance program as a mechanism for managing the risks inherent in agriculture and stabilizing the financial fluctuations suffered by agricultural producers.[394]

The PCIC's crop insurance covers the cost of production inputs, the value of the farmer's own labor and those of the members of his household and the value of the labor of hired workers.[395]

Government subsidizes a portion of the premium paid by subsistence farmers for insurance for unforeseen and unavoidable risks.[396] In addition, the PCIC administers the mandated percentage of calamity funds earmarked by the government for crop insurance.[397] Previously, the PCIC received 10% of the PCSO's lotto earnings, which is mandated to be earmarked for crop insurance, until PCSO paid up its shares in PCIC.[398] Moreover, there is a state reserve

384 Section 4(b), R.A. 9829.
385 Section 4(c), R.A. 9829.
386 Section 7, R.A. 9829.
387 Section 8, R.A. 9829.
388 Section 10, R.A. 9829.
389 I*d.*
390 Section 11, R.A. 9829.
391 Section 12, R.A. 9829.
392 Section 13, R.A. 9829.
393 Section 1, PCIC Charter, as amended (PD 1467, as amended by R.A. 8175).
394 Section2, PCIC Charter, as amended.
395 Section 1, PCIC Charter, as amended.
396 Section 5, PCIC Charter, as amended.
397 Section 6.4, PCIC Charter, as amended.
398 Section 6.5, PCIC Charter, as amended.

fund for catastrophic losses which should answer for the proportion of all losses in excess of the risk premiums under the PCIC's Crop Insurance Program for small farmers.[399] Thus, the PCIC is buoyed up by funds from government. In addition, it is exempt from all national, provincial, municipal and city taxes.[400]

Participation in the palay crop insurance is compulsory on all farmers obtaining production loans for palay under the PCIC's supervised credit program. It is optional on self-financed farmers provided they agree to be under the supervision of agricultural production technicians.[401] While the initial coverage of the insurance provided by the PCIC is palay, it has expanded to other crops.

The PCIC is attached to the Department of Agriculture for budgetary purposes, but is governed by its own Board of Directors.[402] The Board of Directors is composed of the President of the Land Band of the Philippines (LBP), the President of the PCIC, the Executive Director of the Agricultural Credit Policy Council (ACPC), a representative for the private insurance industry to be nominated by the Secretary of Finance and three (3) representatives from the subsistence farmers' sector, preferably representing agrarian reform beneficiaries/cooperatives/ associations coming from Luzon, Visayas, and Mindanao, who shall be selected and nominated by the different farmers organizations and/or cooperatives.[403]

Among the powers of the PCIC is that it can determine its operating policies and to issue such rules and regulations as may be necessary to implement the crop insurance scheme.[404] It thus appears to be independent and not subject to the regulatory authority of the Insurance Commission.

In the authors' interview with representatives from the IC, this peculiar position of the PCIC makes it difficult for private insurance companies to gain entry into the crop insurance market. Private insurance companies intending to offer crop insurance find it difficult to compete with the PCIC because of the inherent benefits and guarantees provided by its charter.

Table 26 summarizes the restrictions on ownership and management of financial entities.

**Table 26. Summary of restrictions on ownership and management of financial entities**

| Entity | Ownership Restrictions | Nationality of Management/Board of Directors | Governing Law |
|---|---|---|---|
| Banks | Foreigners may own up to 100% of voting stock | Foreign nationals may become members of the board of directors to the extent of the foreign participation in the equity of the bank | General Banking Act of 2000 (R.A. 8791) as amended by R.A. 10641 |
| Thrift Banks | Foreigners may own up to 100% of voting stock | Majority of BOD must be Filipinos | Thrift Bank Act (R.A. 7906) as amended by R.A. 10641 |

399 Section 9, PCIC Charter, as amended.
400 Section 16, PCIC Charter.
401 Section 4, P.D. 1467.
402 Section 1, P.D.1467, as amended.
403 Section 9.1, P.D. 1467, as amended.
404 Section 3.1, P.D. 1467.

| Entity | Ownership Restrictions | Nationality of Management/Board of Directors | Governing Law |
|---|---|---|---|
| Brokers and Dealers | No restriction | No restriction | Securities Regulation Code |
| Credit Cooperative | Limited to Filipinos and members of the cooperative | Limited to Filipinos and members of the cooperative | The Cooperative Code of 2008 |
| Cooperative Bank | Limited to Filipinos and members of the cooperative | Limited to Filipinos and members of the cooperative | The Cooperative Code of 2008 |
| Financial Services Cooperative | Limited to Filipinos and members of the cooperative | Limited to Filipinos and members of the cooperative | The Cooperative Code of 2008 |
| Insurance Cooperative | Limited to Filipinos and members of the cooperative | Limited to Filipinos and members of the cooperative | The Cooperative Code of 2008 |
| Investment Company | No restriction under the law | All members of BOD must be Filipino | Investment Company Act (R.A. 2629) |
| Lending Company | Restriction amended | No restriction | Lending Company Regulation Act of 2007 (R.A. 9474), as amended by RA 10881 |
| Microfinance NGO | Majority of members must be Filipino | No restriction | Microfinance NGO Act (R.A. 10693) |
| Non-stock savings and loan association | No restriction to membership | Limited to members of the Association | Revised Non-Stock Savings and Loan Association Act of 1997 (R.A. 8367) |
| Pre-need Company | No restriction | No restriction (subject to fit and proper rule) | Pre-Need Code (R.A. 9829) |
| Rural Bank | May be owned up to 100% by foreigners | Foreigners may be elected to BOD to the extent of their participation in the equity of the rural bank | Rural Bank Act (R.A. 7353), as amended by R.A. 10574 |

### 3.5.2. Financial services trade professionals

Various concentrations of work are available in the financial industry. For the public's interest, more highly specialized jobs are restricted to those who have obtained a degree of expertise in the area. In most cases, restrictions come in the form of professional regulation where only those who have passed licensure examinations are allowed to exercise the profession. Hereafter are some professions in the financial industry:

*3.5.2.1. Under the Professional Regulation Commission: Accountancy.* All applicants for registration for the practice of accountancy shall be required to undergo a licensure examination to be administered by the Philippine Board of Accountancy.[405] An essential qualification is that that one aiming to practice accountancy in the Philippines must be a Filipino citizen.[406]

[405] Section 13, R.A. 9298.
[406] Section 14, R.A. 9298.

The practice of Public Accountancy includes holding out oneself as skilled in the knowledge, science and practice of accounting. A public accountant refers to one who is qualified to render professional services as a certified public accountant (CPA), which services include the audit or verification of financial transactions and accounting records; or the preparation, signing, or certification for clients of audit reports, balance sheets, and other financial, accounting and related schedules, exhibits, statement of reports. CPAs also render professional assistance in matters relating to accounting procedures and the recording and presentation of financial facts or data. It also includes practice in commerce and industry where one is involved in decision making requiring professional knowledge in the science of accounting. Meanwhile, the practice of accounting extends to practice in the academe, where one is involved in the teaching of accounting, auditing, management advisory services, finance, business law, taxation and other technically related subject.[407]

The practice of accountancy also includes some government work especially one who holds, or is appointed to, a position in an accounting professional group in government or in an government-owned or controlled corporation, including those performing proprietary functions, where decision making requires professional knowledge in the science of accounting, or where a civil service eligibility as a certified public accountant is a prerequisite.[408]

Foreigners may be allowed to practice accountancy in the Philippines in accordance with the provisions of existing laws and international treaty obligations, including mutual recognition agreements entered into by the Philippine government. In February 2009, the Philippines acceded to a mutual recognition agreement as regards the practice of accountancy in the country.

The foreigner intending to practice accountancy must prove, in the manner provided by the Rules of Court, the specific provision of law from his country of citizenship showing that citizens of the Philippines are admitted to the practice of accountancy without restriction.[409] The Board of Accountancy may issue a special or temporary permit approved by the Professional Regulatory Commission to a foreign certified public accountant called for consultation or for specific purpose who, in the judgment of the Board of Accountancy, is essential for the development of the country, provided, the practice shall be limited only for the particular work that he or she is being engaged. More importantly, the permit shall be issued only when there is no Filipino certified public accountant qualified for such consultation or specific purpose.[410] The Board of Accountancy may also issue such a permit to a foreign certified public accountant engaged as professor, lecturer or critic in fields essential to accountancy education in the Philippines and his or her engagement is confined only to teaching. The Board may also issue a special permit to a foreign certified public accountant who is an internationally recognized expert or one with specialization in any branch of accountancy and his or her service is essential for the advancement of accountancy in the Philippines.[411]

407 Section 4, R.A. 9298.
408 Section 4, R.A. 9298.
409 Section 34, R.A. 9298.
410 Section 35, R.A. 9298.
411 Section 35, R.A. 9298.

In the case of Independent Accountants or Auditors appointed to examine, audit, and certify financial statements of an Investment Company, a Fund Manager or Fund Distributor, they should be accredited by the SEC.[412]

*3.5.2.2. Under the Insurance Commission:*

*3.5.2.2.1. Insurance Agent.* In order to be able to solicit or procure insurance applications an insurance agent or an insurance broker, or receive compensation for services in obtaining insurance, one must first procure a license from the Insurance Commissioner, which must be renewed every three (3) years thereafter. Corollarily, the Insurance Code prohibits any insurance company doing business in the Philippines to pay any commission or other compensation to any person for services in obtaining insurance, who is not licenses to act as an insurance agent of the company or as an insurance broker.[413]

The Insurance Commissioner determines the competence of every applicant to be an insurance agent or broker based on a written examination he administers. Nevertheless, the Insurance Commissioner may delegate or authorize the administration of the examination to an independent organization.[414] In addition, one must be of good moral character and must not have been convicted of any crime involving moral turpitude.[415] He must satisfactorily show to the Commissioner that he has been trained in the kind of insurance contemplated and in the license applied for. Such examination may be waived if it is shown to the satisfaction of the Commissioner that the applicant has undergone extensive education or training in insurance.[416]

*3.5.2.2.2. Reinsurance Broker.* A reinsurance broker is neither a duly authorized agent, employee or officer of an insurer. A reinsurance broker is one who gets paid for being involved in the negotiation of reinsurance contracts, or placing risks of effecting reinsurance, for any insurance company authorized to do business in the Philippines. Reinsurance brokers do not take licensure examinations, but they are licensed by the Insurance Commission after paying the necessary fees and errors and omissions policies.[417]

*3.5.2.2.3. Adjusters.* An adjuster may be a natural person, partnership, association, or corporation. Such adjuster must be licensed by the Insurance Commissioner.[418] The nationality restriction on adjusters has since been eliminated by Republic Act 10881.

For every line of insurance claim adjustment, adjusters are licensed either as independent adjusters or as public adjusters. An adjuster cannot act on behalf of an insurer unless he is licensed as an independent adjuster and neither can an adjuster act on behalf of an insured unless he is licensed as a public adjuster. In addition, when a firm or person has been licensed as a public adjuster, he cannot not be granted another license as independent adjuster and vice versa.[419] Adjusters must pass a written examination administered by the Insurance Commission in order to obtain the license to practice as such.[420]

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[412] Rule 5.8.1, 2018 Implementing Rules of the Investment Company Act.
[413] Section 307, Insurance Code.
[414] Section 312, Insurance Code.
[415] Section 313, Insurance Code.
[416] *Id.*
[417] Section 320, Insurance Code.
[418] Section 332, Insurance Code.
[419] Section 334, Insurance Code.
[420] Section 336, Insurance Code.

#### *3.5.2.3. Under the SEC:*

*3.5.2.3.1. Broker, Dealer, Salesman.* The securities industry is a strictly regulated environment. Thus, in order to engage in the business of securities trading, the SEC requires those involved to be registered with it. This is the condition for anyone to engage in the business of buying or selling securities in the Philippines, either as a broker or dealer, or act as a salesman, or an associated person of any broker or dealer.[421] If the salesman of securities is employed by a broker or dealer already registered with the SEC, the broker or dealer shall likewise cause their salesman employees with the SEC.[422]

Registration, in this sense, is the same as licensing especially given the requirements prescribed by the SEC. Natural persons applying for registration are required to pass a written exam that test their proficiency and knowledge as a broker, dealer or salesman.[423] Brokers or dealers, in addition to passing the written exam, must comply with capital requirements and post a bond or security to ensure their compliance with applicable regulations.[424] Those from overseas must submit their consent to be served processes by the SEC.[425]

*3.5.2.3.2. Certified Investment Solicitor (CISol).* A certified investment solicitor is a person of legal age appointed by a fund or fund manager to solicit, sell or offer to sell share or units of an investment company to the public.[426] In order to be licensed or certified by the SEC, one must be of legal age and a resident of the Philippines.[427]

In order to be professionally qualified as a CISol, one must have passed the Investment Company Representative Certification Examination or any equivalent administered by the SEC. He should not have been censured, reprimanded or fined by a professional or regulatory body for negligence, incompetence, mismanagement or dereliction of duty.[428]

The practice of a CISol is attached to a mutual fund distributor (MFD). If the MFD's license is revoked or withdrawn, the CISol's license is automatically suspended until the CISol is registered with a licensed MFD.[429]

### 3.5.3. Payments and transfers

The payments and transfers of legal tender and other foreign currencies is heavily regulated by the Bangko Sentral ng Pilipinas (BSP) for certain public policy reasons. Among these are the policy of the State: (i) to ensure that the Philippines will not be used as a money laundering site for the proceeds of any unlawful activity;[430] (ii) to service its foreign/foreign currency loans in an orderly manner with due regard to the economy's overall debt servicing capacity;[431] and (iii) to encourage inward foreign investments.[432]

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[421] Section 28, Securities Regulation Code.
[422] Section 29, Securities Regulation Code.
[423] Section 28.4 (a), Securities Regulation Code.
[424] Section 28.4 (b), Securities Regulation Code.
[425] Section 28.4 (c), Securities Regulation Code.
[426] Rule 1 (4), 2018 Implementing Rules of the Investment Company Act.
[427] Rule 5.7.1, 2018 Implementing Rules of the Investment Company Act.
[428] Rule 5.7.1, 2018 Implementing Rules of the Investment Company Act.
[429] Rule 5.7.3, 2018 Implementing Rules of the Investment Company Act.
[430] As regulated under the Anti-Money Laundering Act (Rep. Act No. 9160), as amended, and related BSP regulations.
[431] BSP Manual of Regulations on Foreign Exchange Transactions, Part Three, Chapter I, Section 22.
[432] BSP Manual of Regulations on Foreign Exchange Transactions, Part Three, Chapter II, Section 32.

BSP's rules on payments and transfers affect service providers under the modes of supply of services.

Service trade transactions performed by non-residents to residents of the Philippines may be paid for either in pesos or in foreign currency. In relation to payments in pesos from Philippine residents for services rendered by such non-residents, the non-resident service provider may maintain peso deposit accounts in Philippine banks.[433] In addition to the proceeds of the payment for services rendered by the non-resident, such peso deposit account must be funded only by following:

a. Inward remittances of convertible foreign exchange;
b. Peso income of non-residents from, or peso sales proceeds of, properties in the Philippines allowed to be owned by non-residents under existing laws;
c. Onshore peso receipts of non-residents from residents for services rendered by the former to the latter, for which the resident would have been entitled to buy foreign exchange from Authorized Agent Banks (AABs)[434] and AAB-forex corporations[435] for remittance to the non-resident service provider;
d. Peso receipts of expatriates working in the Philippines with contracts of less than one (1) year representing salary/allowance/other benefits;
e. Onshore peso funds of: (i) foreign students enrolled for at least one semester in the Philippines; and (ii) non-resident Filipinos; and
f. Peso proceeds from the onshore sale by non-resident issuers of their PSE-listed equity securities.[436]

The non-resident peso deposit account holder may purchase foreign exchange from BSP authorized agent banks (AABs) of up to USD60,000.00 per day for the balance of such peso deposit account, without need of prior BSP approval.[437] Purchases of foreign exchange beyond this amount per day will already require BSP approval even if the balance of the peso deposit account exceeds USD60,000.00.

Non-resident tourists may also purchase foreign exchange from AABs or AAB-forex corporations, but only up to the extent of the amount of foreign exchange such tourists used to purchase Philippine pesos. Non-resident tourists may also re-convert unspent Philippine pesos at airports or other ports of exit up to a maximum of USD10,000.00 or its equivalent in other foreign currency, without showing proof of previous sale of foreign exchange for pesos.[438]

In addition, loans from offshore source, offshore banking units, and foreign currency loans obtained from locally operating banks must be submitted to the BSP for prior approval and/or registration if these will ultimately be serviced with foreign exchange purchased from the Philippine banking system, through AABs/AAB-forex corporations (including those covered by derivatives transactions), subject to certain exceptions.[439]

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433 BSP Manual of Regulations on Foreign Exchange Transactions, Part Two, Chapter I, Section 3(1)(c).

434 Authorized Agent Banks are defined under the BSP Forex Manual as "all categories of banks (except Offshore Banking Units (OBUs) duly licensed by the BSP. It is understood that each category of bank should function within the operational parameters defined by existing laws/regulations for the specific bank category to which they respectively belong."

435 AAB forex corps are defined under the BSP Forex Manual as an "AAB subsidiary/affiliate forex corporations whose business include buying and selling foreign exchange."

436 BSP Manual of Regulations on Foreign Exchange Transactions, Part Two, Chapter I, Section 3(1).

437 BSP Manual of Regulations on Foreign Exchange Transactions, Part Two, Chapter I, Section 3(2)(a).

438 BSP Manual of Regulations on Foreign Exchange Transactions, Part Two, Chapter I, Section 3(2)(c).

439 BSP Manual of Regulations on Foreign Exchange Transactions, Part Three, Chapter I, Section 22.

Foreign investments that need to purchase foreign exchange from the Philippine banking system, through AABs or AAB forex corporations to service the repatriation of capital and remittance of dividends, profits and earning from such investments must also be registered with the BSP.[440] However, if the corporation financed by foreign investments earns its own foreign currency from its operations, there generally is no need to purchase foreign currency from the Philippine banking system. In which case, there would be no need to register such foreign investment with the BSP.

Philippine pesos may be physically brought in and out of the Philippines, or by electronic transfer[441] in an amount not exceeding PhP50,000.00 without prior BSP approval. Any amount brought out of the country in excess of such limit must have prior written authorization from the BSP. Likewise, foreign currency, as well as other foreign currency-denominated bearer monetary instruments not exceeding USD10,000.00 does not require prior notice to and approval from the BSP. Transfers in excess of such amount must be declared in writing and the source, and purpose of the transport of such currency or monetary instrument must be fully disclosed to the BSP.[442]

### 3.5.4. Taxes affecting the financial services sector

Some changes in the tax code have been discussed above. However, based on key informant interviews conducted by the team, the change in rates or imposition of new taxes on financial transactions have increased friction costs. In terms of wholesale investments, these taxes become crucial in choosing jurisdictions to place money.

In the banking industry, Table 27 shows the significant increase in tax rates, where a number of taxes went up by 100%.

**Table 27. New tax rates on bank transactions**

| Transaction | Tax Base | Old rate | New rate |
|---|---|---|---|
| Interest income from Foreign Currency Deposit Unit | Amount of Interest Income | 7.50 % | 15%[443] |
| Bank checks, drafts, certificates of deposits not bearing interests, and other instruments | Fixed amount on each document | Php1.50 | Php3.00 |
| Debt instruments | For every Php200.00 and its exceeding fraction | Php1.00 | Php1.50 |
| Bills of exchange or drafts | For every Php200.00 and its exceeding fraction | Php0.30 | Php0.60 |
| Upon acceptance of bills of exchange | For every Php200.00 and its exceeding fraction | Php0.30 | Php0.60 |
| Foreign Bills of Exchange and Letters of Credit | For every Php200.00 and its exceeding fraction | Php0.30 | Php0.60 |

440 BSP Manual of Regulations on Foreign Exchange Transactions, Part Three, Chapter II, Section 32.
441 "Electronic transfer" is understood to mean under the BSP Forex Manual, as a system where the authority to debit or credit an account (bank, business or individual) is provided by wire, with or without a source document being mailed to evidence the authority.
442 BSP Manual of Regulations on Foreign Exchange Transactions, Part Two, Chapter I, Section 4(1) and (2).
443 Section 24 (B) (1) and Section 27 (D), Tax Code, as amended by R.A. 10963.

| Transaction | Tax Base | Old rate | New rate |
|---|---|---|---|
| Mortgages | When amount secured does not exceed Php5,000.00 | Php20.00 | Php40.00[444] |
| | On each Php5,000 and fraction exceeding every Php5,000.00 | Php10.00 | Php20.00[445] |

Source: Author's compilation.

Earlier, it was also mentioned that the preferential rate of 15% on income of foreign employees of Offshore Banking Units has been stricken out by R.A. 10963.

As to equities, stocks not traded in the stock exchange are now taxed 15%[446] on the capital gains from trading such stock when before it was only 5% if the gain were less than or equal to Php100,000.00 and 10% if the gain were over Php100,000.00. Meanwhile, for stocks traded in the stock exchange and not sold by a dealer, the applicable tax increased by 20% to 6/10 of 1%[447] from ½ of 1% of the gross selling price or value of the shares. These changes and that pertaining to DST are summarized below:

**Table 28. New tax rates on stock market transactions**

| Transaction | Tax Base | Old rate | New rate |
|---|---|---|---|
| Sale of stocks not traded in the stock exchange | Capital gains | 5% if the gain were less than or equal Php100,000.00 and 10% if the gain is over Php100,000.00 | 15% |
| Sale of stocks traded in the stock exchange and not sold by a dealer | gross selling price or value of the shares | ½ of 1% | 6/10 of 1% |
| Sale of shares without par value | DST on original issue of shares of stock | 25% | 50%[448] |

Source: Author's compilation.

On insurance transactions, the law prescribes various DST rates for life insurance policies. It also doubled the DST for certificates of damages.

**Table 29. New tax rates on insurance transactions**

| Transaction | Tax Base | Old rate | New rate |
|---|---|---|---|
| Life insurance | Old: premium charged<br>New: amount of insurance | Php0.50 for every Php4.00 or fraction | a. Less than Php100,000.00 – Exempt<br>b. Php100,000-Php300,000 – Php20.00<br>c. Php300,000-Php500,000 – Php50.00<br>d. Php500,000-Php750,000 – Php100.00<br>e. Php750,000-Php1,000,000- Php150.00 |

[444] Section 195 (a), Tax Code, as amended by R.A. 10963.
[445] Section 195 (b), Tax Code, as amended by R.A. 10963.
[446] Section 24 (C) and Section 27 (D) (2), Tax Code as amended by R.A. 10963.
[447] Section 127, Tax Code, as amended by R.A. 10963.
[448] Section 175, Tax Code, as amended by R.A. 10963.

| Transaction | Tax Base | Old rate | New rate |
|---|---|---|---|
| | | | f. Over Php1,000,000- Php200.00 |
| Pre-need Plan | On each specific amount or its fraction of the total value of the plan | Php0.50 for every Php500 or fraction | Php0.40 for every Php200 or fraction |
| Certificate of damage | On each certificate | Php15.00 | Php30.00 |

Source: Author's compilation.

Nevertheless, the TRAIN law inserted a provision on VAT exemptions for services of bank, non-bank financial intermediaries performing quasi-banking functions and other non-bank financial intermediaries.[449]

### 3.5.5. Regulations on technologies in financial services

The following is a brief survey of issuances of financial regulators with respect to e-commerce.

*3.5.5.1. E-Money.* The BSP defined E-money under Section X780.2 of the Manual of Regulation for Banks. The provision refers to e-money as monetary value represented by a claim on its issuer, that is:

a. Electronically stored in an instrument or device;
b. Issued against receipt of funds of an amount not lesser in value than the monetary value issued;
c. Accepted as a means of payment by persons or entities other than the issuer;
d. Withdrawable in cash or cash equivalent; and
e. Issued in accordance with Section X780 of the MORB

Electronic money issuers (EMI) may be either a bank (EMI-Bank); a non-bank financial institution supervised by the BSP (EMI-NBFI) or non-bank institutions registered with the BSP as a monetary transfer agent under Sec. 4511N of the MORNBFI (hereinafter called EMI-Others). E-money products may come in the form electronic instruments or devices such as cash cards, e-wallets accessible via mobile phones or other access device, stored value cards, and other similar products.[450] However, E-money issued by banks shall not be considered as deposits.[451] Prior to the issuance of e-money, EMIs should ensure that they have the prescribed minimum systems and controls in place.[452]

Banks intending to be an EMI-Bank should apply in accordance with Sec. X701, MORB relating to the guidelines on electronic banking services and with Sec. X162, MORB on outsourcing of banking functions, when applicable.[453]

Banks wishing to provide and/or enhance existing electronic banking services shall submit to the BSP an application describing the services it will offer or enhance and how it fits the bank's overall strategy. One of the BSP's tasks before allowing any BSFI to engage in electronic banking is to ensure that the applicant bank's overall financial condition can adequately support its electronic banking activities and that it should have complied with certain comprehensive

[449] Section 109 (V), Tax Code, as amended by R.A. 10963.
[450] Section X780.2, MORB.
[451] *Id.*
[452] Section x708.4 (h), MORB.
[453] Section X780.3, MORB.

prudential requirements.[454] The application is further subject to review and approval by the Monetary Board.

For foreign banks wishing to acquire local banks and conduct business as an EMI-Bank. It is well to note that recently, the BSP has liberalized its rules on the entry of foreign banks in the Philippines. Foreign banks are now allowed to be wholly owned by foreigners.

The BSP also issued regulations to govern money service business operations of non-bank entities.[455] These deal with the operations and reporting obligations of non-bank entities engaged in remittance, money changing, and foreign exchange dealing.[456]

The BSP defined a Remittance and Transfer Company, which refers to any entity that provides Money or Value Transfer Service (MVTS). MVTS refers to financial services that involve the acceptance of cash. checks, other monetary instruments or others stores of value and the payment of a corresponding sum in cash or other form to a beneficiary by means of communication, message, transfer or through a clearing network.[457]

An RTC needs to register with the BSP to operate. An RTC could be a Remittance Agent, a Remittance Platform Provider, or an E-money Issuer. An E-money issuer under the MORNBFI is an entity authorized by the BSP under Subsection X780.2 of the MORB that provides money transfer or remittance services using electronic stored money value system and similar digital financial services.[458]

A non-bank EMI, in order to register with the BSP, must have a benchmark capital of at least Php100 Million.[459] The application is initiated by submitting to the BSP its application letter together with its business plan with target markets and its list of owners and controlling shareholders, directors, and principal officers. The BSP reviews these and if deemed eligible, the EMI would continue its application for registration.

The EMI's partners, directors, and principal officer should be fit and proper.[460] Integrity, probity, physical and mental fitness, competence, relevant education, financial literacy and training, diligence and knowledge and experience are factors used to determine whether one is fit and proper.[461] It should commence operation within three months from the issuance of its Certificate of Registration by the BSP.[462]

The EMI should also register with the Anti-Money Laundering Council Secretariat.[463] Its personnel are also mandated to undergo training in a BSP or AMLC- accredited seminar before starting its operations. The AMLC also prescribes rules for wire transfers. It mandates that transfers be made electronically than through manually initiated fund transfer instructions.[464]

*3.5.5.2. National Retail Payment System.* The BSP issued Circular No. 980 establishing the National Retail Payment System Framework. The framework requires BSP

454 Section X701.2, MORB.
455 Circular No. 942, s. 2017.
456 Section 4511N, MORNBFI.
457 Section 4511N,1, MORNBFI; See also Circular No. 942, s.2017.
458 Section 4511N.1 (f), MORNBFI.
459 Section 4511N.2 (a), MORNFBI.
460 Section 4511N.2 (b) (1), MORNBFI.
461 Section X141.2, MORB.
462 Section 4511N.2 (b), MORNBFI.
463 Section 4511N.2 (d), MORNBFI.
464 Rule IX-A (4) (d), 2016 Implementing Rules of the AMLC.

Supervised Financial Institutions (BSFI) to ensure that the retail payment systems where they participate demonstrate sound risk management, and effective and efficient interoperability.[465] Under the NRPS Framework, BSFIs shall enable its clients to move or receive funds to or from accounts with other BSFIs, or, at a minimum, receive funds.[466]

The Circular mandates that all clearing shall be done within the NRPS governance structure, wherein exclusive bilateral clearing arrangements are not allowed.[467] Bilateral clearing arrangements refer to payment arrangements that facilitate inter-institutional payments or fund transfers without going through the Clearing Switch Operator (CSO).[468] Such arrangements are contrary to the objectives of NRPS to promote efficiency, create common standards, and form a single connection to the clearing system to enable the streamlined, more cost-effective and efficient exchange of payment instructions with other participants.[469]

Sound governance of the NRPS shall be handled by a payment system management body (PSMB), an industry-led self-governing body that is duly recognized and overseen by the BSP.[470] On 12 January 2018, the Monetary Board, in its Resolution No. 59 dated 11 January 2018, recognized the Philippine Payments Management, Inc. (PPMI) as the payment system management body (PSMB) under the NRPS Framework.[471]

The NRPS framework covers all retail payment-related activities, mechanisms, institutions and users. lt applies to all domestic payments which are denominated in Philippine Peso, and which may be for payments of goods and services, domestic remittances or fund transfers.[472] Retail payments under the NRPS Framework are payments that meet at least one of the following characteristics:

a. The payment is not directly related to a financial market transaction;
b. The settlement is not time-critical;
b. The payer, the payee, or both are individuals or non-financial organizations; and
c. Either the payer, the payee, or both are not direct participants in the payment system that is processing the payment.[473]

BSFIs shall immediately credit the account of its clients after receipt of a clearing advice.[474] The recipient shall not pay for electronic crediting to recipient's account and the recipient shall receive the amount in full. Such account to account fund transfers shall not be considered as domestic remittance transactions.[475]

The NRPS is not mandatory, but all BSFIs are highly encouraged to join the NRPS governance structure provided they meet the qualification criteria.[476] Nevertheless, it espouses non-discriminatory participation.[477]

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465 BSP Circular No. 980.
466 BSP Circular No. 980.
467 BSP Circular No. 980.
468 BSP Memorandum No. M-2018-012.
469 BSP Memorandum No. M-2018-012.
470 BSP Circular No. 980.
471 Circular Letter No. CL-2018-05.
472 BSP Circular No. 980.
473 BSP Circular No. 980.
474 BSP Circular No. 980.
475 BSP Circular No. 980.
476 BSP Circular No. 980.
477 BSP Circular No. 980.

At the moment the NRPS consists of two switch platforms, which are PesoNet and InstaPay. The main distinction between the two is that cap on the amounts that may be transferred. PesoNet has no limit while InstaPay transfers are limited to amounts no more than Php50,000.00. This is so because PesoNet, managed by the Philippine Clearing House Corporation, clears the amounts with the drawee bank and ensures that there are funds available for the payment and thus, there is some delay in the crediting of the transfer. With InstaPay, however, the funds are immediately transferred.

Nevertheless, participation in the NRPS appears to be lukewarm. In PesoNet for instance, while all member banks allow the receiving of funds, end to end transactions are done only by a small number of banks. Only 13 banks provide in their online banking service the ability for an individual to send funds to another account. For corporate accounts, 22 banks allow their clients to send funds online. Only eight banks can send and receive funds from individuals' accounts through mobile banking. Only one bank provides the mobile sending service for corporate accounts.[478]

In any event, Republic Act No. 11127 was recently signed into law, which would govern all payment systems in the country.

*3.5.5.3. Payment Systems Act.* On 15 November 2018, the President of the Philippines signed Republic Act No. 11127 or the Payment Systems Act.

The underlying state policy of the law recognizes that payment systems are crucial parts of the country's financial infrastructure and thus, it is essential that payment systems function safely and efficiently. The ultimate goal is stability and effectiveness of the Philippine monetary and financial system.[479] For this policy, the BSP is designated by law to oversee the payment systems in the Philippines. It has supervisory and regulatory powers to ensure the stability and effectiveness of the monetary and financial system.[480]

Under the law, a payment system is a set of payment instruments, processes, procedures, and participants that ensures the circulation of money or movement of funds.[481] In this regard, a payment instrument is anything, whether tangible or intangible that allows a person to transfer funds.[482] The law aims to facilitate fund transfers not only domestically, but across borders as well.[483] While the law does not specifically prescribe electronic means of payment, with the supervision and regulation of payment systems entrusted to the BSP, the underlying thrust of the law would then include a shift to electronic payments.

The law defines an Operator as one who provides clearing or settlement services in a payment system. It could also refer to the one who defines, prescribes, designs, controls or maintains the operational framework of the payment system.[484] The operator of a payment system must be a stock corporation,[485] but the SEC cannot register any corporation intending to be an operator of a payment system without a certificate of authority to register from the Monetary Board.[486]

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[478] Pesonet website, available at https://www.pesonet.info.
[479] Section 2, R.A. 11127.
[480] Section 5, R.A. 11127.
[481] Section 4(p), R.A. 11127.
[482] Section 4(n), R.A. 11127.
[483] Section 9, R.A. 11127.
[484] Section 4(l), R.A. 11127
[485] Section 11, R.A. 11127.
[486] Section 12, R.A. 11127.

Acquisition of shares in an operator of a designated payment system is also regulated by the law. The acquisition of any shares resulting in more than 10% of the voting or controlling shareholders is subject to monetary board approval.[487] Without such approval, the transfer shall have no legal effect.[488]

Any operator of a designated payment system must first obtain an authority to act as such from the BSP.[489] Nevertheless, the BSP allows self-regulation of a payment system through a payment system management body consisting of participants in the payment systems.[490] The BSP accredits such payment system management body.

The operator of a designated payment system is primarily responsible in maintaining and operating a safe, efficient, and reliable payment system.[491] It is tasked in developing a process for selection, monitoring and self-regulation.[492] This process is subject to BSP review.

The law aims to prevent or minimize systemic risks. These risks occur when one participant in a payment system fails to meet its required obligations, which will cause other participants or financial institutions to be unable to meet their obligations and thus, threatening the systems' stability.[493] In such situations, the BSP designates[494] the payment system posing a systemic risk.[495]

When there is a threat to the safety, efficiency, and reliability of the designated payment system that would affect the country's monetary and financial stability, the BSP, with the Monetary Board's approval, without hearing, appoint a manager to manage the operations of the operator of the designated payment system.[496] The manager should have recognized competence in payment systems.[497] The Monetary Board shall issue guidelines on the governance of the payment system.

There is a threat when the operator violates any law, rule or regulation or it fails to comply with a Monetary Board order.[498] There is also a threat when the operator's assets are not sufficient to protect participants or end-users or any other financial condition of the operator that may adversely affect participants, end-users or the public.[499]

A participant refers to the operator, issuer, service provider, or any person involved in the payment system other than the end-user.[500] A participant needs to notify an operator in writing of the participant's insolvency, bankruptcy, rehabilitation or placement in receivership or liquidation immediately upon its receipt of the legal notice.[501] Once the operator receives the

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487 Section 13, R.A. 11127.
488 *Id.*
489 Section 6 (b) (2), R.A. 11127.
490 Section 6 (c), R.A. 11127.
491 Section 14, R.A. 11127.
492 *Id.*
493 Section 4 (t), R.A. 11127.
494 The use by BSP of the term "designation" is confusing, as it appears to be used on two occasions under the law: one is to name a payment system and the other when a payment system poses systemic risk. The IRR may shed light on this.
495 Section 6(a), R.A. 11127.
496 Section 17, R.A. 11127.
497 *Id.*
498 *Id.*
499 *Id.*
500 Section 4(m), R.A. 11127.
501 Section 16, R.A. 11127.

notification, it should stop any pending payment order involving the participant.[502] It should also notify the other participants and the BSP of such state of the participant.[503]

Netting refers to an agreed offsetting of obligations by participants of payment systems.[504] In instances of a participant's insolvency, bankruptcy, rehabilitation or placement in receivership or liquidation, the operator may effect the netting of all payment orders received prior to any notice of insolvency, bankruptcy, rehabilitation or placement in receivership or liquidation. The netting shall be considered valid in such proceedings.[505]

Settlement refers to an act that discharges obligations in respect of fund transfers between two or more parties.[506] Settlements effected in accordance with agreed procedures under a payment system shall be final and revocable. The law prescribes a policy of finality of settlement where settlement cannot be reversed for whatever reason.[507] Even if the payor establishes that the fund paid was not legally due, the transaction would not be reversed. Instead, the amount settled would legally be a monetary obligation by the payee to the person who caused the payment.[508]

It appears that the law also aims to facilitate securities trading, as it specifically provides for coordination with the SEC as regards an efficient trading clearing and settlement system in securities trading.[509]

The Monetary Board is tasked to issue the implementing rules and regulations of the law.

*3.5.5.4. Electronic Insurance Policies.* Republic Act No. 10607 or the Insurance Code provides for the issuance of an insurance contract in electronic form.[510] In light of such provision and the growing use of e-commerce, the IC issued Circular Letter No. 2014-47 or the Guidelines on Electronic Commerce of Insurance Products. Even in electronic commerce, insurance providers must only use policies, bonds, and other forms approved by the Insurance Commission.[511]The Circular Letter emphasizes that the insurance provider offering insurance online should provide the consumer as complete information as possible on its website and allow the consumer opportunities to correct his application for insurance before it is processed.

The IC mandates that insurance providers shall not hold consumers liable for any charges related to a transaction in the following circumstances:

a. The transaction was not authorized by the consumer;
b. The insurance product is different from that applied for by the consumer;
c. The insurance provider failed to provide material information about the insurance product;
d. The insurance policy was not delivered in the time specified;
e. There was no adequate opportunity for the consumer to cancel an inadvertent transaction when the consumer acted reasonably provided that insurance provider is immediately notified of the cancellation of the transaction.[512]

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502 *Id.*
503 *Id.*
504 Section 4(j), R.A. 11127.
505 Section 18, R.A. 11127.
506 Section 4(s), R.A. 11127.
507 Section 15, R.A. 11127.
508 *Id.*
509 Section 9, 2nd par.
510 Section 50, Insurance Code.
511 Sub-guideline 8.11, Insurance Commission Circular Letter No. 2014-47.
512 Sub-guideline 7.14, Insurance Commission Circular Letter No. 2014-47.

The IC also requires that the insurance company's primary web servers, books and records be maintained in the Philippines in order to enable the Insurance Commission to inspect them.[513] The requirement of having web servers in the Philippines may be confusing. Inspection of web servers is outside the ambit of the IC's competence. It also does not take into account the current trend of cloud computing where servers may be hosted in other jurisdictions. It would be better if the IC defines the information it needs to inspect and mandate that such information should be readily available for inspection.

The use of a mobile application should be with the prior approval of the IC. In the first place, the mobile application should be registered with a major digital platform like Apple, lnc. App Store and Google, lnc. Google Play and Microsoft Windows Marketplace and must possess the requirements of the IC and applicable to the website of the insurance provider.[514]

The IC also identified insurance aggregation as an alternative distribution channel through which a customer can obtain insurance. lt gathers related insurance products from different insurance providers wherein the prospective client can choose through the internet or mobile application.[515] As defined by the Insurance Commission, an Insurance Aggregator is an internet-based platform that accumulates and provides insurance policy quotations from various insurance companies based on a predetermined set of needs specified by the prospective client and from which the prospective client can choose from. lt is also called a "price comparison website".[516]

An insurance aggregator must obtain a license from the IC. It must possess a juridical personality as either a corporation, partnership or cooperative.[517] Its sole business must be that of web-based aggregation and should certainly not be in business as an insurance agent or broker.[518]

An insurance aggregator should not have any exclusive arrangement with insurance companies or other regulated entities. The contents of the website shall be unbiased and factual in nature. Their website should also display authentic product information that is based solely on information received from the insurers or other regulated entities. In addition, product comparisons that are displayed on the website should be up to date and reflect the true picture of the product.[519]

The IC can cancel the insurance aggregator's license on the ground of violating any of the provisions of the lnsurance Code and Circulars of the IC; or furnishing wrong or false information for obtaining a license; or concealing or failing to disclose material facts in the application submitted for obtaining a license.[520]

The financial industry may also benefit from the Ease of Doing Business Act, which allows issuance of permits with electronic signatures. The law also mandates a central depository of government registrations, licenses, and permits so that companies would not need to submit them repeatedly.

[513] Guideline 14, Insurance Commission Circular Letter No. 2014-47.
[514] Sub-guideline 7.18, Insurance Commission Circular Letter No. 2014-47.
[515] Insurance Commission Circular Letter No. 2018-51.
[516] Section 2, Insurance Commission Circular Letter No. 2018-51.
[517] Section 4 (c), Insurance Commission Circular Letter No. 2018-51.
[518] Section 5, Insurance Commission Circular Letter No. 2018-51.
[519] Section 5, Insurance Commission Circular Letter No. 2018-51.
[520] Section 6, Insurance Commission Circular Letter No. 2018-51.

### *3.6. Regulatory issues and challenges*

The Philippines is a signatory to various free trade agreements. It has obligations under the General Agreement on Trade in Services. The general principles to be observed under GATS are:

a. Most favored nation treatment;
b. Transparency
c. Market Access; and
d. National Treatment.

Meanwhile, the ASEAN Framework Agreement on Services states the following overarching goal:

> "Article III : Liberalisation
>
> Pursuant to Article 1 (c), Member States shall liberalise trade in services in a substantial number of sectors within a reasonable time-frame by:
> 1. (a) eliminating substantially all existing discriminatory measures and market access limitations amongst Member States; and
> (b) prohibiting new or more discriminatory measures and market access limitations."

It may also be relevant to assess the compatibility of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership with the Philippine setting. This treaty has a specific chapter on the financial services sector. It provides commitments on not imposing quantitative restrictions on the number of financial institutions; the value of transactions; or by requiring a particular type of legal entity or joint venture to provide the service. It also applies the principles under the GATS.

In addition, the regulations surveyed above were evaluated as to whether they are:

a. Restrictions on access to and operation in a market enshrined in laws and regulation;
b. Quantitative and qualitative measures, which may or may not be discriminatory in intention or effect; and
c. Restrictions imposed by informal administrative practices (Molinuevo and Saez 2014).

This evaluation also took into account the four modes of supply of services, namely: (1) cross-border supply, (2) consumption abroad, (3) commercial presence; and (4) movement of natural person. Hence, one test if barriers exist is whether regulations impede the delivery of services in any of the above modes.

Compared to other sectors of the economy, in particular those involved in public utilities and media, the financial sector is not subject to constitutional restrictions on nationality. Hence, it can be seen that legislation over the decades have been enacted lifting foreign restrictions on ownership. It can be said that regulations on the financial sector stem from prudential policies rather than protectionist intentions. Nevertheless, restrictions exist that inhibit entry of foreign investment.

#### 3.6.1. Barriers to trade in the financial services sector

From the above review of laws and regulations in the financial sector, it appears that the thrust of liberalization continues to be counterbalanced by restrictive regulations on trade in services. While the move is towards a perfect national treatment of foreign-owned enterprises, there remain to be varying degrees of treatment of foreign-owned enterprises.

*3.6.1.1. Cross-border Trade.* The liberalization of trade in services appear to be focused on commercial presence. Mode 1 of trade in services or cross-border trade in the financial sector happen through the convergence of the financial and ICT sectors. Mode 1 would clearly be manifested through financial services undertaken by the BPO industry. Other trade in services in the financial sector are difficult to determine due to the nature of the activities.

In a 2012 survey by the BSP on the ICT sector, it was identified that BPOs in the country provide backroom operations and shared financial and accounting service. While these kinds of operations were lumped under "other services," and thus there is no granularized data to show how much trade in such services is done, the significant takeaway from the survey is that there is clear cross-border trade in services happening in the financial sector through the BPO sector.

Certain banking services from the Philippines may be carried across borders. With the progress of electronic banking, clients may avail of banking services even while abroad. Through ATMs, one may be able to withdraw physical money in most parts of the world. Meanwhile, as long as one has internet, one can access one's account from anywhere in the world and make transactions under certain circumstances.

However, the delivery of such banking services is contingent on one having an account with a bank in the Philippines. The BSP mandates that the opening of deposit accounts may only be done at the bank's head office, branches, and extension offices.[521] The BSP also mandates that there should be a face-to-face encounter and interview of the customer before opening his account[522] unless the account is opened through a trustee, nominee or agent. Thus, a person cannot open an account from overseas by himself.

Such restrictions fall under anti-money laundering regulations. While they may restrict trade in services, the overarching interest of many states in stopping the flow of money from illegal activities is foremost in this aspect.

This is no coincidence since there are more regulatory restrictions in the retail financial services than in the wholesale segment of the industry (Committee of Financial Markets 2000). This is so since, aside from money laundering concerns, retail customers and investors are less sophisticated than wholesale customers and investors (Committee on Financial Markets 2000). The restrictive regulations also stem from difficulties for unsophisticated customers in pursuing legal rights abroad and apart from such regulations, the different legal regimes also constitute an impediment in transacting with foreign-based firms (Committee on Financial Markets 2000).

It appears though that there is a move to depart from the traditional definition of cross border trade. Cross-border trade in financial services refers to the provision of financial services by a financial firm located in one country to a customer residing in another country without the establishment of a commercial presence, such as a branch or subsidiary, in the host country

[521] Section X151, MORB.
[522] Section X806.1, e, MORB.

(Committee on Financial Markets 2000). In the Comprehensive and Progressive Agreement for Trans-Pacific Partnership, the traditional definition of cross-border trade appears to eliminate the literal element of crossing borders.

Under Article 11 of the treaty, cross-border supply of services happens in the following instances:

a. From the territory of a Party into the territory of another Party;
b. In the territory of a Party to a person of another Party; or
c. By a national of a Party in the territory of another Party.

Noticeably, cross-border trade, by this definition, may happen within the same territory since it is not only geographical presence which defines the transaction as being "cross-border," but the nationality of one of the parties involved in the transaction. This may promote retail trade in financial services counterbalancing regulations on money laundering and consumer protection.

The treaty, nevertheless, mentions a caveat that it "does not include the supply of a financial service in the territory of a Party by an investment in that territory." By definition though, this caveat refers to commercial presence in one territory.

Article 11.5 of the treaty is significant since it provides conditions that signify the absence of barriers to trade in services. The Philippines may not be able to comply with the commitment of not imposing quantitative restrictions on the number of financial institutions; on the value of transactions; or the number of foreigners a financial services company may employ. In the banking industry, as already shown, these restrictions remain.

*3.6.1.2. Commercial Presence.* Recent legislation shows that the legislative trend in liberalization has been to lift ownership restrictions. This liberalization trend should promote commercial presence or Mode 3 in trade in financial services. A few years ago, bank liberalization was enacted, which allowed banks in the Philippines to be 100% owned by foreigners. Likewise, Republic Act No. 10881 struck out restrictions in foreign ownership of financial companies like Investment Companies.

However, there remains barriers to commercial presence in the financial sector. For instance, as pointed out, in order to set up a fully foreign owned bank, there are pre-qualification criteria set by the law. In short, while the law espouses equal treatment of foreign and domestic banks, foreign entities are not extended the nationality treatment. The pre-qualification criteria for foreign participants in the banking industry are barriers to entry. Meanwhile, once a foreign bank is established, there remains the industry regulation capping foreign ownership.

The distinction between foreign owned companies and domestic companies is very pronounced in the insurance industry. There are more stringent requirements to put up and operate a foreign-owned insurance company than a domestic one. The risk of a foreign-owned insurance company packing up and leaving its clients holding an empty bag is real. However, the same risk holds true for a domestic company, which has no more assets to answer for its clients' claims.

Thus, with the goal of having more Filipinos and their assets secured by insurance, insurance legislation and regulation should allow a more alike treatment of domestic and foreign-owned insurance companies. Further study should be made if regulations on foreign owned insurance companies actually mitigate the risk. If not, then such regulations should be lifted to facilitate more investment in the insurance industry.

One of the most cited objectives to trade in services is private sector efficiency and competitiveness (Aldaba 2012). Included in this concern is the high cost of doing business in the Philippines coupled with an environment conducive to growth (Aldaba 2012).

These issues came to fore in the key informant interviews conducted by the authors with the IC. One instance cited in the discussion and also raised above is the case of the Philippine Crop Insurance Corporation. Private sector insurance firms simply could not compete with the PCIC since it is constantly supported by government funds.

It was also pointed out that tax issues inhibit the growth of private insurance in the country. In this regard, the high cost of non-life insurance for consumers is significantly increased by the taxes imposed on the non-life policy. Similarly, the attractiveness of microinsurance is dampened when the documentary stamp tax for a coverage is almost the same as the premium paid.

Relatedly, in the equities market, the new taxes under the TRAIN law were identified to have contributed to the decline in turnover in the local equities market. The new taxes are considered by brokers and traders to be added friction costs, which go against the trend in the region of removing added costs in the trading of equities. Hence, with the convergence of ICT and financial services, financial technology infrastructure assists investors to easily shift their focus to markets with less friction costs.

It may also be relevant to note the seeming back and forth in organizing regulated financial institutions. For instance, before a bank could even register with the SEC, it needs a certificate of authority from the Monetary Board. Once incorporated, the entity must secure another certificate of authority from the BSP. A similar procedure is observed in the establishment of an insurance company, where prior to incorporation, the entity must be backed by a recommendation from the IC and after incorporation, the Insurance Commission issues a license to the insurance company. This registration procedure may be reviewed and made shorter since the initial endorsement or recommendation from the Monetary Board or the Insurance Commission is not an assurance that the entity would be licensed to do business in the Philippines.

It is readily apparent from a review of relevant laws that the Philippines enacts a significant number of social legislation, which even permeates the financial services sector. These pieces of legislation are an added layer of regulation that are not regularly taken into account by trade partners, which generally take note of barriers to entry such as foreign ownership restrictions and capital requirements. For instance, Republic Act No. 6977 (as amended by Republic Act No. 8289 and Republic Act No. 9501) or the Magna Carta for Small Enterprises requires lending institutions to allocate a part of their credit resources for small enterprises. Likewise, Republic Act No. 10000 or the Agri-Agra Reform Credit Act which mandates all banks to set aside 25% of its loanable funds to agriculture and fisheries credit and 10% of which should be set aside for beneficiaries of agrarian reform.[523] Universal and commercial banks have never been able to directly comply with this longstanding statutory restriction on their credit allocation. Provisions that allow them alternative ways of meeting this requirement

[523] Section 6, R.A. 10000.

demonstrate its overall ineffectiveness in meeting its objective. This is not to say that the credit needs of the targeted sectors are not valid, but the issue is the effectiveness of directed credit. Simply put, mandatory credit requirements such as this, well-meaning they may be, cost the economy in terms of distorting the efficient allocation of credit.

These pieces of legislation may affect the entry of investors in the banking and financial industry. If a lending institution is geared towards a particular set of borrowers as part of its business strategy, it would inevitably have unused funds to comply with such regulations and such may not be seen as wise for any business. Hence, targeting financial institutions involved in serving specific sectors of society may be more practical. For instance, in the nineties, the Philippine government's policies were designed to promote rural banking and enhance their role in financing micro-entrepreneurs (Meslier-Crouzille, et al 2012). Its credit policy in the rural areas also shifted to a market-based approach (Meslier-Crouzille, et al 2012). This resulted in an increase of credit-servicing by rural banks where their loan market share grew to 24% from 11% (Meslier-Crouzille, et al 2012). With rural banks now open to foreign capital, other lending institutions may be allowed to concentrate on serving their target consumers.

Microfinance NGOs, by legislation, are provided various incentives. Financial incentive to microfinance NGOs comes in the form of a preferential tax treatment. However, such preference for non-profit oriented microfinance NGOs may crowd out investments in microfinance when financial inclusion is a continuing thrust of the government. While there is a general conception that microfinance is serviced by non-profits, highly capitalized institutions are well-involved in the microfinance sector. Thus, with the preferential tax treatment of microfinance NGOs, companies serving the sector may find it difficult to compete. In addition, the growth of the microfinance NGO may be inhibited by its structure since it cannot issue securities in exchange for investment in capital.

Philippine legislation allows cooperatives to perform a number of financial services. It appears from the thrust of the legislation, that cooperatives are not openly geared to offer such services to the public, as usually, only members could generally avail of them. The cooperatives offering financial services to its members must also have entirely Filipino membership and also managed entirely by Filipinos as members of the Board of Directors. Thus, the cooperative is viewed in the restrictive sense as providing benefits to its members rather than functioning as a business entity.

Professionals are issued licenses to exercise their profession after long academic study and passing rigorous examinations. The same process is usually followed when the professional focuses on an aspect of his profession and becomes an expert in a more particular area of his field. However, regulators impose additional requirements for a licensed professional in the Philippines to practice his profession.

For instance, an auditor regularly practicing his profession in the Philippines is given to have passed the licensure examination for certified public accountants. This allows them to audit various companies. However, as shown above, the Insurance Commission and the Cooperative Development Authority require auditors to be accredited by them before conducting an audit of entities under their respective jurisdictions. The SEC also requires auditors of an Investment Company, a Fund Manager or Fund Distributor to be accredited by it. These accreditation hurdles provide an additional requirement in the practice of the accounting profession which is already regulated by the Professional Regulatory Commission.

For foreigners, this is an additional requirement when they have submitted what is needed to the PRC to practice accountancy in the Philippines. As regards foreigners' practice of the accounting profession, while the law has allowed them to do so in the Philippines, such is limited to short periods and only when there is no Filipino who can perform the job. They are also allowed to practice for academic purposes and when they are considered experts. Hence, the profession has not been truly liberalized.

In fact, the requisite that there should be no Filipino performing the job practically closes the industry to foreigners. It has been said that countries' general commitment to Mode 4 are limited to intra-corporate transfer of managers, executives, and specialists (Mattoo 2010). In this regard, the Philippines does not even ride with the general trend.

*3.6.1.3. Data Flows.* The IC requires issuers of electronic policies to maintain their web servers in the Philippines. As discussed above, the IC's purpose for the regulation is inspection. In the usual practice, such requirement is characterized as a local data storage requirement. It is relevant in this regard to touch on an increasingly contentious matter in international trade and that is regulations on cross-border flow of data. Many jurisdictions have started to enact data storage localization laws or regulations.

Local data storage requirements may be prompted by data protection issues (National Board of Trade 2014). However, forced localization of data may be grounded on investment creation goals (National Board of Trade 2014). In any event, local data storage requirements have been viewed by companies as intrusive and costly and affect their decision to invest in a particular jurisdiction (National Board of Trade 2014).

There appears to be a benign regulatory environment on data flow in the Philippines. One can make the connection that with the vibrant BPO industry in the Philippines, restrictions on data flow may inhibit further growth of the industry or worse, lead to its decline. The Philippine Data Privacy Act even explicitly allows cross-border transfers of data, which are only subject to any future international convention on such matter.[524]

The BSP is liberal in its approach in this regard. It is in fact one of about only 50 jurisdictions reporting to the Bank of International Settlements on cross-border data. It allows outsourcing of domestic non-core bank services, subject only to a requirement that the service provider operates in jurisdictions which uphold confidentiality.[525] In addition, the BSP allows offshore outsourcing if it would be able to examine the service provider's facilities in the other jurisdiction.[526] The Philippines continues to have a bank secrecy law.[527] To a certain extent, this could be considered a data protection legislation since all deposits are considered absolutely confidential and the BSP would wish to maintain that confidentiality when bank data is sent abroad for processing.

### 3.6.2. Some conclusions

Based on the foregoing discussion, financial liberalization in the Philippines could be described as uneven. In particular, there seems to be a dichotomy between the expression of intention and support to liberalize foreign entry, and actual implementation. There is also misalignment between fairly liberal regulations on entry and restrictive domestic regulations. The degree of

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[524] Section 21, Republic Act No. 10173.
[525] Section X162.8, MORB.
[526] *Id.*
[527] Republic Act No. 1405.

liberalization is also uneven across the different financial services subsectors. There is no apparent standard on how far the state policy on liberalization should go even if such liberalization thrust is embodied in pieces of legislation.

For instance, requiring the Monetary Board to ensure that the control of at least 60% of the resources or assets of the entire banking system is held by domestic banks which are majority owned by Filipinos, while less restrictive than the previous 70% stipulation, still effectively acts as a limit on the entry and size of foreign banks since the Monetary Board may resort to suspension of entry of additional foreign bank subsidiaries and branches, and suspension of license upgrade or conversion to subsidiary of existing foreign bank branches. Ultimately, it serves to protect domestic owned banks. But domestic banks per se are not necessarily better for domestic savers and borrowers than foreign banks; well supervised and regulated banks are, whether they are domestic or foreign owned. Increased foreign participation in the banking sector could also serve to widen the ownership base of domestic banks, why are typically part of family-owned conglomerates.

In the insurance sector, in contrast to the liberalized policy on entry, the requirements of the new Insurance Code on investment policies and practices retained much of the provisions of the old Insurance Code ordained in 1974, which were highly prescriptive in terms of identifying the specific investments allowed and up to what degree[528]. This constrained the growth and development of the industry because of the bias it introduced in favor of holding various type of government securities (Milo 2002). And as noted earlier, the financial requirements on foreign insurers effectively act as entry barrier. Especially with the IC's recent adoption of a risk-based capital approach, allowing insurance companies flexibility in the way they manage their assets is part and parcel of their risk management. This move by the IC is part of the ongoing implementation of the global Insurance Core Principles (ICPs) of the International Association of Insurance Supervisors (IAIS) by member insurance supervisors to strengthen the protection of policyholders.

The ease of entry of foreign interests in the banking sector differs from the insurance sector where there are less restrictions on foreign ownership. Within the banking sector, whether it is a mere oversight that the restriction on foreign participation in a thrift bank's board of directors was retained, the fact remains that even if a thrift bank is fully foreign-owned, only a handful of seats may be occupied by its owners. Despite lifting restrictions on foreign management of financial institutions, other entities like an investment company, continue to have foreign management limits.

Social legislation permeates industries in the Philippines. As a developing country, there is a strong state policy to give preference to the marginalized or to give support to certain sectors of the economy. These laws should be more targeted and should not cut across the financial sector. There is no available data on how such legislation may have discouraged investment in the financial sector. However, it is clear that such legislation imposes additional requirements in order to operate in the Philippines. For instance, the requirement of reserving a certain percentage of a financial institution's loanable funds to a defined group would disrupt a foreign company's established business strategy. Likewise, the view on cooperatives as serving primarily a specific class should also be altered.

[528] Chapter 3/Title 4 of RA 10647 relative to Chapter 3/Title 4 of PD 612.

Relatedly, government has intervened to protect public interest or provide service in an underserved area of the economy. However, this social thrust of the government has given government institutions an undue advantage in the market. As already explained above, it is difficult to carve a share in the crop insurance sector when the PCIC would never lose money because of direct government funding. Government has reduced its presence in the banking industry and this move has been considered a catalyst in the growth of the industry in the last decade or two. But the government's total share in assets effectively make it the second biggest in a highly concentrated sector. It goes without saying that, similar to PCIC, government owned banks enjoy certain advantages, even an implicit guarantee, because of their direct link to the government. Ultimately, the issue that needs to be addressed is whether there is crowding out[529]. Thus, the government needs to revisit its role in direct provision of financial services, and study areas in the financial industry where it would be best to reduce its presence in order to allow and promote private sector activity.

Taxation is also key. While there is a move by the government to lower income taxes, the burden on industry players come in transactional costs, which include taxes on the particular transaction, including documentary stamp taxes. In some respect, tax exemptions in favor of certain institutions with legislative charters also provide an uneven playing field that may inhibit the entry of players in a financial sector or service. National taxation is not the end of it. Businesses, as illustrated above, also have to deal with the taxes local governments in each locality charge.

Thus, all in all, there is still much that the Philippines could do in liberalizing trade and investment in the financial services sector. It has been slow, inconsistent, and uneven, but in general, the country has positively moved towards liberalization over the years. The challenge is to ensure that the domestic regulatory environment is consistent with the goals of liberalizing trade and investment in financial services because the regulatory framework itself is an important determinant of the structure and development of the financial system.

It augurs well for the sector that the three financial regulators have all undergone reorganization within the past decade, and the BSP again most recently, to better implement their updated and strengthened regulatory frameworks and better fit their structure to their changing and expanding functions and responsibilities. A mindset that accepts, even anticipates change is especially important among regulators as the supervision and regulation of financial institutions need to regularly evolve along with highly innovative financial institutions and markets. There is an incentive to limiting the behavior of regulated institutions in that it would minimize the regulator's own risk exposure. But over-regulation or outdated regulation lessens competitive pressure and imposes efficiency costs. Regulators will always play catch-up with the market, and the danger is when the gap becomes too wide. Here, the respective international organizations of financial regulators (BIS, IOSCO, and IAIS), which count the regulators in the Philippines as members, have played an important role in terms of increasing the pressure to modernize financial regulation in the country. Regional initiatives, especially those under ASEAN and APEC, also play a pushing for harmonizing regulation toward global best practices.

Finally, the review showed that financial regulators are updating and putting in place necessary financial infrastructure and regulatory frameworks. These include those covering digital financial services and financial technology. As the review of the state of industry showed, this

[529] Crowding out occurs when increased government involvement in a sector of the market economy substantially affects the remainder of the market.

is a new growth area in the sector. Technological progress affects every aspect of a financial transaction from product development and innovation, pricing, cost and risk structures, to marketing and delivery. Furthering its growth and development is important because it has strong potential in helping to address persistent credit needs and other gaps in financial services in the country, including those related to SMEs and agriculture. Across the world, financial technology firms are providing solutions to issues such as financial inclusion, microfinance, online payments, and anti-money laundering and terrorism financing. Fintech also has the potential to significantly expand the reach of financial service providers across borders. All these are of course are underpinned by an enabling regulatory environment. It is worth stating that it should be fintech companies providing the services, with government ensuring an enabling environment. And with respect to cross-border trade in financial services, convergence toward high quality regulation is again the linchpin in order to prevent regulatory arbitrage across borders.

### *3.7. Recommendations going forward*

The discussion on the state of the Philippine financial services sector overall indicated that there has been no significant transformation over the past decade. The dominance of the banking sector is common in developing economies. And it should be noted that the banking sector in the Philippines has proven to be resilient in the face of global financial crises, underpinned by a strong regulatory and supervisory framework. Moving forward, our goal should be a more diversified, dynamic, competitive, and resilient financial system that offers a wider range of financial products and services both to consumers and businesses through more efficient delivery channels.

Key recommendations that flow from the review of the state of the industry and regulations include among others:

1. There is a need to correct the inconsistencies in individual legislations covering the financial services sector (e.g., inconsistency between ownership and management structures) and inconsistencies across legislations;

2. Overall, there is a need to align domestic regulations, as well as mindset, with the objectives of financial liberalization;

3. Domestic regulations also need to be aligned with the country's FTA/regional commitments particularly with respect to national treatment, as detailed in Annex I of the report;

4. Review and rationalize/streamline the taxes and other fees imposed on financial instruments and transactions;

5. Promote the regulatory sandbox approach by other financial regulators, together with BSP. The concept developed as an attempt to reconcile the need for prudential regulation and the key role of innovation in promoting competition and efficiencies in the financial services sector, as well as financial inclusion. But basic and more urgent regulatory issues and challenges should first be addressed. Supporting a more enabling environment for digital financial services should be based on basic regulatory enablers and not detract from regulators' primary objectives.

Key factors that need to be considered include: (i) legal and regulatory framework; (ii) stakeholder ecosystem; (iii) capacity and available resources; (iv) market conditions; and (v) policy priorities (Jenik and Lauer 2017). Also, regulatory sandboxes need not be limited to financial regulators. In other countries, regulatory sandboxes are located in consumer protection and competition agencies.

6. Develop the BSPs vision of an inclusive financial system, which builds on the vision presented in the Philippine Development Plan 2011-2016, into a full-fledged long-term strategic action for the Philippine financial sector.

   An inclusive financial system is envisioned to have the following characteristics:
   - Presence of a wide range of financial services that serve different market segments;
   - Financial services are appropriately designed, priced and tailor-fitted to market need;
   - Presence of a wide variety of strong, sound and duly authorized financial institutions utilizing innovative delivery channels;
   - Effective interface of bank and non-bank products and delivery channels;
   - Use of technology and innovation to reach the financially excluded;
   - Adequately educated and protected citizenry confident to make well-informed financial decisions; and
   - Comprehensive and robust financial inclusion data and measurement.

   The challenge is to develop a detailed long-term (e.g., 10 years) strategic action plan to bring this vision into fruition. The ideal proponent of such a plan is the Financial Sector Forum. Regulatory reforms can then be addressed in more cohesively and comprehensively.

   Certain guiding principles also need to be clearly established in developing such an action plan, including:
   - Promote the development of domestic institutions, balanced by competition from foreign institutions/service providers. The key is effective competition. For instance, just the threat of foreign entry may be enough to compel domestic institutions to be efficient and competitive.
   - Government participation, especially in the direct provision of financial services, must have clear objective and guidelines, with a sunset provision or at least a provision to support the role of the private sector as much as possible.

7. Finally, while not directly addressed by the study, the role of prudent fiscal policy is also important. While the growth and development of the government securities market is important especially in the initial stages of capital market development, government also needs to ensure that it is not crowding out private sector firms in the capital market, as well as in the investment portfolios of financial institutions.

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## Appendix A. Binding authority of laws and other issuances, and governance framework

To understand how regulation and its implementation impact the entry and operation of the various business entities discussed above in services trade, we outline below the binding authority of various laws rules and regulations, the authority to issue the same and the power to implement these.

In addition, we will also examine the quality of institutions implementing these laws, as well as the quality of the decision-making process in these institutions.

### *A.1. Hierarchy of laws*

#### A.1.1. The Constitution as the fundamental law

In the hierarchy of Philippine laws, the Constitution (1987) is the supreme and fundamental law. It was ordained and promulgated by the people, from whom all political authority originates.[530] As the fundamental law, all laws, rules, regulations and/or executive issuances must conform to it.[531] To execute the mandate of the people, the Constitution authorized the three co-equal branches of government, to wit: (a) Congress; (b) the Supreme Court; and (c) the President, to exercise certain powers.

The Constitution grants the power to enact laws to the Philippine Congress,[532] and the power to interpret the same in actual cases and controversies, in the Supreme Court.[533] The executive power, on the other hand, is vested in the Executive or the President of the Philippines.[534] In the exercise of their functions, these branches of government issue binding declarations through statutes, rules and regulations, executive issuances, treaties and judicial interpretations. To be valid and binding, these declarations must be consistent with the powers granted by the Constitution, whether made in the direct exercise of the power or delegated to some other entity.

#### A.1.2. Exercise of legislative powers by the President

For a time and prior to the adoption of the 1987 Constitution, legislative power was vested in the President of the Philippines. When then President Ferdinand E. Marcos declared Martial Law on September 21, 1972, through Proclamation No. 1081,[535] he granted himself legislative powers to, primarily, prevent or suppress lawless violence, rebellion and insurrection.[536] Subsequently, under the 1973 Constitution,[537] President Marcos abolished the National Assembly and replaced it with an Interim National Assembly,[538] which still included him as member,[539] and where he continued to exercise legislative powers.[540]

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530 1987 Constitution, Preamble.
531 Manila Prince Hotel v. Government Service Insurance System, G. R. No. 122156, February 3, 1997.
532 1987 Constitution Article VI, Section 1.
533 1987 Constitution, Article VIII, Section 1.
534 1987 Constitution, Article VI, Section 1.
535 Entitled, "*Proclaiming a State of Martial Law in the Philippines*."
536 Proclamation 1081 (1972), pars. 23-24; *See* Proclamation No. 1104, issued on January 17, 1973, declaring the continuation of martial law.
537 Ratified on January 17, 1973, and which amended the 1935 Constitution.
538 1973 Constitution, Article XVII, Section 1.
539 1973 Constitution, Article XVII, Section 2.
540 1973 Constitution, Article XVII, Section 3.

The 1976 Amendments[541] to the 1973 Constitution then expressly granted the continuation of President Marcos' exercise of legislative powers until the lifting of Martial Law. Amendment No. 6 granted President Marcos concurrent legislative powers with the Batasang Pambansa.[542] These powers continued to be in full force and effect even after President Marcos lifted Martial Law on January 17, 1981, through Proclamation No. 2045,[543] and when the 1973 Constitution was further amended on April 1981,[544] until 1986.

After the EDSA Revolution in February 1986, then President Corazon C. Aquino issued Proclamation No. 3[545] on March 25, 1986, promulgating a Provisional Constitution where the President was mandated to continue exercising legislative powers until a legislature is elected and convened under a New Constitution.[546] The 1987 Constitution was ratified on February 7, 1987.[547] Hence, President Aquino lost her legislative powers when members of the 8th Congress were elected on May 1987 and convened on July 27, 1987 under the 1987 Constitution.[548]

Thus, from 1972 to 1976, the President enjoyed exclusive legislative powers. From 1976 to 1986, he enjoyed concurrent legislative powers with the Batasang Pambansa. From 1986 to July 27, 1987, the President again enjoyed exclusive legislative powers. From July 27, 1987 onwards, Congress regained its exclusive power to legislate.

As a consequence of this exclusive or concurrent exercise of legislative powers by the President, his/her issuances through, among others, Presidential Decrees, and Executive Orders are considered as having the validity and binding effect of law, as if these were enacted by Congress.

#### A.1.3. The power of subordinate legislation: Rule-making power of administrative agencies

While the power to enact laws is vested in Congress, it may properly delegate certain rule-making powers to administrative agencies tasked to implement the law, under the power of subordinate legislation. To be valid, Congress' delegation must establish a standard. This means that the enabling law must define legislative policy, mark its limits, map out its boundaries and specify the administrative agency to apply it. The law must indicate the circumstances under which the legislative command is to be effected. It is the criterion by which legislative purpose may be carried out. Thereafter, the executive or administrative office designated may in pursuance of the above guidelines promulgate supplemental rules and regulations. [549]

Based on the delegated authority by Congress through its enacted laws, the designated administrative agency may issue implementing rules and regulations of the law.

[541] Proclaimed in full force and effect as of October 27, 1976 under Proclamation No. 1595.
[542] 1976 Amendments, Amendments 5 and 6.
[543] Entitled, "*Proclaiming the Termination of the State of Martial Law Throughout the Philippines*."
[544] Legaspi v. Minister of Finance, G. R. No. L-58289, July 24, 1982.
[545] Entitled, "*Declaring a National Policy to Implement Reforms Mandated by the People, Protecting their Basic Rights, Adopting a Provisionl Constitution, and Providing for an Orderly Transition to a Government Under a New Constitution*."
[546] Provisional Constitution, Article II, Section 1.
[547] Senate of the Philippines, https://www.senate.gov.ph/about/history.asp
[548] 1987 Constitution, Article XVIII, Section 1.
[549] Edu v. Ericta, G. R. No. L-32096, October 24, 1970.

### A.1.4. Delegated legislative powers of local government units (LGUs)

The Constitution divides the Philippines into the following territorial and political subdivisions: provinces, cities, municipalities, barangays, and the autonomous regions in Muslim Mindanao and the Cordilleras. These are local government units that enjoy local autonomy, but are under the general supervision of the President of the Philippines.[550] They are created as both political and corporate bodies. They exercise powers as a political subdivision of the national government and as a corporate entity representing the inhabitants of their respective territories.[551]

Through the Local Government Code, Congress delegated the following powers that affect the operations of business enterprises to local government units (LGU), among others:

a. The power to generate resources: This includes the power to levy taxes, fees and other charges, which shall accrue exclusively to the benefit of the LGU.[552] Such power is exercised by the legislative arm of the LGU, the Sanggunian, through the issuance of an ordinance, and cover the local taxes, fees and charges in Table A.1 below:

**Table A.1. LGUs taxes, fees and charges**

| No. | LGU | Tax, fee or charge |
|---|---|---|
| 1 | Provinces | Tax on transfer of real property ownership |
| | | Tax on business printing and publication |
| | | Franchise tax |
| | | Tax on sand, gravel and other quarry resources |
| | | Professional tax |
| | | Amusement tax |
| | | Annual fixed tax for every truck, van, or any vehicle used by manufacturers, producers, wholesalers, dealers or retailers in the delivery or distribution of distilled spirits, fermented liquors, soft drinks, cigars, cigarettes and other products to sales outlets or consumers within the province |
| 2 | Cities | Taxes, fees and charges which the province or municipality may impose |
| 3 | Municipalities | Business tax |
| | | Tax on retirement of business |
| | | Fees and charges on business and occupation |
| | | Fees for sealing and licensing weights and measures |
| | | Fishery rentals, fees and charges |
| 4 | Barangays | Taxes on stores and retailers with fixed business establishments with gross sales receipts not exceeding PhP50,000 or less, in cities and PhP30,000 or less, in municipalities |
| | | Service fees or charges for the regulation or the use of barangay-owned properties or service facilities |
| | | Barangay clearance |
| | | Fees and charges on the commercial breeding of fighting cocks, cockfights and cockpits |
| | | Fees and charges on places of recreation which charge admission fees |

[550] 1987 Constitution, Article X, Sections 1, 2 and 4.
[551] Local Government Code, Book I, Title I, Chapter 1, Section 15.
[552] Local Government Code, Book I, Title I, Chapter 1, Section 18; Book II, Title I, Chapter 1, Section 129.

| No. | LGU | Tax, fee or charge |
|---|---|---|
| | | Fees and charges on billboards, signboards, neon signs and outdoor advertisements |
| 5 | Common to All | Service fees and charges for services rendered |
| | | Charges for the operation of public utilities owned, operated and maintained by the LGU within its jurisdiction |
| | | Toll fees and charges for the use of any public road, pier or wharf, waterway, bridge, ferry or telecommunication system funded and constructed by the LGU. |

Source: Author's compilation.

b. The power of eminent domain: This refers to the power to take property for public use, or purpose, or welfare for the benefit of the poor and landless, upon payment of just compensation;[553]
c. The power to reclassify lands: A city or municipality may, through an ordinance passed by the Sanggunian after conducting public hearings for the purpose, authorize the reclassification of agricultural lands to either residential, commercial, or industrial, subject to certain conditions and limitations. The LGUs shall also continue to prepare their respective comprehensive land use plans enacted through zoning ordinances which shall be the primary and dominant bases for the future use of land resources, in accordance with existing laws and subject to certain conditions;[554] and
c. The power to close and open roads: The LGU, through an ordinance, may permanently or temporarily close or open and local road, alley, park or square falling within its jurisdiction, subject to certain conditions. It also has the power to temporarily close national roads under certain conditions.[555]

These delegated powers are powers that are also exercised by the national government. Thus, in a number of instances, a conflict arises as to the extent of the powers of the national government and the autonomy of the LGU to exercise these powers.

#### A.1.5. Executive issuances

The President has the power of control over all executive departments, bureaus and offices. In the exercise of such power, he is bound to ensure that all laws are faithfully executed.[556]

In the execution of his/her executive powers, the President may issue the following ordinances:
a. Executive Orders: These are acts of the President that provide for rules of a general or permanent character in implementation or execution of constitutional or statutory powers.
b. Administrative Orders: These are acts of the President that relate to particular aspects of governmental operations pursuant to the President's duties as administrative head.
c. Proclamations: These are acts of the President fixing a date or declaring a status or condition of public moment or interest, upon the existence of which the operation of a specific law or regulation is made to depend.
d. Memorandum Orders: These are acts of the President on matters of administrative detail or subordinate or temporary interest which only concern a particular officer or office of the Government.

[553] Local Government Code, Book I, Title I, Chapter 1, Section 19.
[554] Local Government Code, Book I, Title I, Chapter 1, Section 20.
[555] Local Government Code, Book I, Title I, Chapter 1, Section 21.
[556] Administrative Code of 1987, Book III, Title I, Chapter 1, Section 1.

e. Memorandum Circulars: These are acts of the President on matters relating to internal administration, which the President desires to bring to the attention of all or some of the departments, agencies, bureaus or offices of the Government, for information or compliance.
f. General or Special Orders: These are acts and commands of the President in his capacity as Commander-in-Chief of the Armed Forces of the Philippines.[557]

A.1.6. The binding force of treaties and executive agreements

International agreements involving political issues or changes in national policy and those involving international agreements of a permanent character usually take the form of treaties.[558] Under the Constitution, all such treaties entered into by the Philippines must be concurred in by two-thirds of all the Members of the Senate to have the binding effect of law under Philippine jurisdiction.[559]

On the other hand, international agreements embodying adjustments of detail carrying out well-established national policies and traditions and those involving arrangements of a more or less temporary nature usually take the form of executive agreements. By long usage, the right of the Executive to enter into binding agreements without the necessity of subsequent Congressional approval has been confirmed. The agreements covered such subjects as commercial and consular relations, most-favored-nation rights, patent rights, trademark and copyright protection, postal and navigation arrangements and the settlement of claims.[560]

A.1.7. Decisions and rule-making power of the courts

The judiciary has the power to interpret the Constitution and laws, rules, regulations and other issuances of the different branches and instrumentalities of government. It has the power to say what the law is in specific cases and controversies. In addition, it has the power to determine whether or not there has been a grave abuse of discretion amounting to lack or excess of jurisdiction on the part of any branch or instrumentality of the Government.[561] Its interpretation and determination of abuse of discretion is binding as law, unless Congress passes a law establishing different rules or policy objectives that could change such interpretation.

The Supreme Court also has the power to promulgate rules concerning the protection and enforcement of constitutional rights, pleading, practice, and procedure in all courts, the admission to the practice of law, the Integrated Bar, and legal assistance to the underprivileged.[562]

A.1.8. Summary

Based on the above, under Philippine laws, the Constitution takes precedence over all other government issuances. Laws, including treaties, promulgated by Congress and consistent with the Constitution take precedence over issuances by the President, and other administrative bodies. Issuances by LGUs, as autonomous political entities and made within the scope of

[557] Administrative Code of 1987, Book III, Title I, Chapter 2.
[558] Commissioner of Customs v. Eastern Sea Trading, G. R, No. L-14279, October 31, 1961.
[559] 1987 Constitution, Article VII, Section 21 and Article II, Section 2.
[560] Commissioner of Customs v. Eastern Sea Trading, G. R, No. L-14279, October 31, 1961.
[561] 1987 Constitution, Article VIII, Section 1.
[562] 1987 Constitution, Article VIII, Section 5 (5).

their delegated power are considered valid and binding. Issuances by the President in the exercise of its executive and administrative functions, including entering into executive agreements, and in accordance with law and the Constitution are also valid and binding.

The Supreme Court is the final arbiter in the determination of whether a law or act of government is consistent with the Constitution and existing laws. Its decisions and interpretations have the binding effect of law, unless Congress changes the law being interpreted.

### *A.2. General governance framework*

The President of the Philippines is the executive of the National Government. As such executive, he is mandated to ensure the due execution of laws through the various departments and agencies under his power, control and supervision.

#### A.2.1. Institutional setting

*A.2.1.1. Mandate.* The Executive Department is divided into the:

a. Office of the President, which consists of the Office of the President Proper and the agencies under it. The Office of the President Proper is composed of the Private Office, the Office of the Executive Secretary, the Common Staff Support System, and the Presidential Special Assistants/Advisers System. The agencies under the Office of the President are those offices placed under the chairmanship of the President, those under the supervision and control of the President, those under the administrative supervision of the Office of the President, those attached to it for policy and program coordination, and those that are not placed by law or order creating them under any special department.[563]

b. Departments and other Agencies under the Executive Branch. The Departments are created to ensure the functional distribution of the work of the President and for the performance of their functions. Such functions are decentralized. Adequate authority is required to be delegated to subordinate officials to reduce red tape, free central officials from administrative details concerning field operations, and relieve them from unnecessary involvement in routine and local matters. Administrative decisions and actions are required, as much as is feasible, to be made at the level closest to the public. These Departments are composed of the Office of the Secretaries and staff units under it, including the Undersecretaries and personnel in their immediate offices.[564]

   Each Department also has jurisdiction over bureaus, offices, regulatory agencies, and government-owned and –controlled corporations assigned to it by law. The Department's relationship with these offices are characterized by any of the following:[565]

   - Supervision and Control, which includes the authority to act directly whenever a specific function is entrusted by law or regulation to a subordinate; direct the performance of duty; restrain the commission of acts; review, approve, reverse or modify acts and decisions of subordinate officials or units; determine priorities in the execution of plans and programs; and prescribe standards, guidelines, plans and programs. This is usually

[563] Executive Order No. 292 (the Administrative Code), Title II, Chapter 8.
[564] Executive Order No. 292 (the Administrative Code), Book IV, Chapter 1, Sections 1, 2(3), 3.
[565] Executive Order No. 292 (the Administrative Code), Book IV, Chapter 1, Section 4; Chapter 7, Section 38.

the relationship between the Secretaries of Departments and the bureaus, offices and agencies under them.[566]

- Administrative Supervision governs the administrative relationship between a department or its equivalent and regulatory agencies or other agencies as provided by law, and is limited to the authority of the department or its equivalent to generally oversee the operations of such agencies and to insure that they are managed effectively, efficiently and economically but without interference with day-to-day activities. It also includes the authority to require the submission of reports and conduct management audits, performance evaluation and inspection to determine compliance with policies, standards and guidelines of the department; to take such action as may be necessary for the proper performance of official functions, including rectification of violations, abuses and other forms of maladministration; and to review and pass upon budget proposals of such agencies but may not increase or add to them. Regulatory agencies are subject to the administrative supervision of the departments under which they are placed, except government-owned and controlled corporations (GOCCs), which are considered attached agencies to these departments.[567]

- Attachment, which refers to the lateral relationship between the department or its equivalent and the attached agency or corporation for purposes of policy and program coordination. The coordination may be accomplished by having the department represented in the governing board of the attached agency or corporation, either as chairman or as a member, with or without voting rights, if this is permitted by the charter; having the attached corporation or agency comply with a system of periodic reporting which shall reflect the progress of programs and projects; and having the department or its equivalent provide general policies through its representative in the board, which shall serve as the framework for the internal policies of the attached corporation or agency. GOCCs are usually attached to departments for policy and program coordination,[568] but enjoy a larger measure of independence from the department to which it is attached than agencies under the supervision and control or administrative supervision of the department.[569]

### A.2.2. Regulatory procedures

*A.2.2.1. General regulatory procedures.* As indicated above, administrative agencies created by law to execute the mandate of such law are granted certain rule-making and adjudicative powers by Congress, subject to specific standards. Their relationship to the President, and other government agencies responsible for implementing laws may also be mandated by the statute creating them, or upon determination of the President, in accordance with Exec. Order 292 discussed above.

Under the Anti-Red Tape Act of 2007, Rep. Act No. 9485, all government agencies including departments, bureaus, offices, instrumentalities or government-owned and/or controlled corporations, or local government or district units are required to set up their respective service standards, known as the Citizen's Charter, which should be posted at the main entrance of offices or at the most conspicuous place. The Citizen's Charter must be written either in

[566] Executive Order No. 292 (the Administrative Code), Book IV, Chapter 8, Section 39.
[567] Executive Order No. 292 (the Administrative Code), Book IV, Chapter 9, Section 43.
[568] Executive Order No. 292 (the Administrative Code), Book IV, Chapter 9, Section 42.
[569] Beja v. Court of Appeals, G. R. No. 97149, 31 March 1992.

English, Filipino or in the local dialect and should contain: (a) the procedure to obtain a particular service; (b) the person/s responsible for each step; (c) the maximum time to conclude the process; (d) the document/s to be presented by the customer, if necessary; (e) the amount of fees, if necessary; and (f) the procedure for filing complaints.[570]

When promulgating new procedures, an agency is required, as far as practicable, to publish or circulate notices of proposed rules and afford interested parties the opportunity to submit their views prior to the adoption of any rule. In the fixing of rates, no rule or final order shall be valid unless the proposed rates shall have been published in a newspaper of general circulation at least two (2) weeks before the first hearing thereon. In case of opposition, the rules on contested cases shall be observed.[571]

In relation to the above, the Supreme Court in *Commissioner of Customs, v. Hypermix Feeds Corporation*,[572] notes that "When an administrative rule is merely interpretative in nature, its applicability needs nothing further than its bare issuance, for it gives no real consequence more than what the law itself has already prescribed. When, on the other hand, the administrative rule goes beyond merely providing for the means that can facilitate or render least cumbersome the implementation of the law but **substantially increases the burden of those governed**, it behooves the agency to accord at least to those **directly affected a chance to be heard**, and thereafter to **be duly informed**, before that new issuance is given the force and effect of law." (Emphasis Supplied).

In addition, every agency is also required to file with the University of the Philippines Law Center three (3) copies of every rule it adopts. The agency is also required to maintain a permanent register of all its rules and keep it open to inspection by the public.[573]

*A.2.2.2. Standards and regulatory impact.* Philippine laws do not specifically require administrative agencies to consider international standards during the regulatory process, nor require that they justify any deviation from the same. There is also no mechanism for regulatory impact assessments for proposed rules and regulations.

*A.2.2.3. Interagency coordination.* While generally, laws require that agencies coordinate with other related agencies where the subject matter of any issuance, plan or government action involve cross-cutting issues across agencies, there is no specific mechanism established by law or regulation for inter-agency coordination.

[570] Rep. Act No. 9485, Section 6.
[571] Exec. Order 292, Book VII, Chapter 2, Section 9.
[572] G. R. No. 179579, February 1, 2012.
[573] Exec. Order 292, Book VII, Chapter 2, Section 3.

Annex I

## PHILIPPINE SECTOR MEASURES
## FINANCIAL SERVICES

### Introductory Note

1. Annex I lists existing Philippine regulatory measures that affect trade in services in the financial sector and differentiate treatment between domestic and foreign service suppliers/investors.

2. The lists specify the FTA obligations with which the regulatory measures are not in conformity.

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| **Sector** | Banking &Finance |
| **Sub-Sector** | |
| **Obligations Concerned** | National Treatment<br>Management of Company |
| **Level of Government** | Central |
| **Measure** | Section 5, R.A. 7353. |
| **Description** | Nationality of Board of Directors<br>All members of the Board of Directors of a rural bank shall be citizens of the Philippines at the time of their assumption to office. |

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| **Sector** | Banking &Finance |
| **Sub-Sector** | Investment Companies |
| **Obligations Concerned** | National Treatment<br>Management of Company |
| **Level of Government** | Central |
| **Measure** | Section 15, R.A. 2629. |
| **Description** | Nationality of Director<br>No person shall serve as a director of a registered investment company unless he is a Filipino citizen. |

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| **Sector** | Banking &Finance |
| **Sub-Sector** | Investment Companies |
| **Obligations Concerned** | National Treatment<br>Performance Requirement |
| **Level of Government** | Central |
| **Measure** | Rule 5.7.1, 2018 Implementing Rules of the Investment Company Act. |
| **Description** | Residence of Certified Investment Solicitor<br>A certified investment solicitor is a person of legal age appointed by a Fund or Fund Manager to solicit, sell or offer to sell share or units of an Investment Company to the public. In order to be licensed or certified by the SEC, one must be of legal age and a resident of the Philippines. |

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| **Sector** | Banking & Finance |
| **Sub-Sector** | |
| **Obligations Concerned** | National Treatment<br>Performance/Additional Requirement |
| **Level of Government** | Central |
| **Measure** | Section 3, R.A. 7721, as amended; Section X105.3 (e), MORB. |

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| **Description** | <u>Pre-Qualification Criteria of Foreign Entrants to Banking Industry</u><br><br>The primary qualifications of the foreign bank are that it is widely and publicly owned in its home country, unless it is a state-owned bank, and that its established, reputable, and financially sound.<br><br>The BSP also considers reciprocity in that Philippine banks should have the opportunity to establish operations in the foreign bank applicant's home country. In addition, countries of origin of applicant foreign banks with substantial financial assistance to, and loans and investments, past and present, in the Philippines; and those with which the Philippines has significant volume of trade especially to those with which the country has substantial net exports, are given greater consideration by the BSP. Likewise, the BSP also takes into account the capability of the foreign bank to promote trade with, and to bring foreign investments into, the Philippines and the existence of long standing financial and commercial relationship with, and assistance extended to, the Philippines. The BSP also ensures that there is representation from different parts of the world or international financial centers in qualifying foreign banks.<br><br>The BSP also prescribes that the foreign bank has demonstrated capacity, global reputation for financial innovations and stability in a competitive environment. The foreign bank should also be willing to share its banking technology. |

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| **Sector** | Insurance |
| **Sub-Sector** | |
| **Obligations Concerned** | National Treatment<br>Performance/Additional Requirement |
| **Level of Government** | Central |
| **Measure** | Section 197, Insurance Code. |
| **Description** | <u>Unimpaired Capital Requirement for Foreign Insurance Company</u><br><br>No insurance company organized or existing under the government or laws other than those of the Philippines shall engage in business in the Philippines unless possessed of unimpaired capital or assets and reserve of not less than One billion pesos (₱1,000,000,000.00). |

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| **Sector** | Insurance |
| **Sub-Sector** | |
| **Obligations Concerned** | National Treatment<br>Performance Requirement/Additional requirements |
| **Level of Government** | Central |
| **Measure** | Section 197, Insurance Code. |
| **Description** | <u>Security Requirement for Foreign Insurance Company</u><br><br>A foreign insurance company should have deposited with the Insurance Commissioner, for the benefit and security of its policyholders and creditors, securities covering the required capital. At least 50% of such securities should be bonds or debt instruments issued by the Philippine government or any of instrumentalities and GOCCs. |

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| **Sector** | Insurance |
| **Sub-Sector** | |
| **Obligations Concerned** | National Treatment |
| **Level of Government** | Central |
| **Measure** | Section 197, Insurance Code. |
| **Description** | Investment Restriction for Foreign Insurance Company<br><br>The total investment of a foreign insurance company in any registered enterprise shall not exceed twenty percent (20%) of the net worth of said foreign insurance company nor twenty percent (20%) of the capital of the registered enterprise, unless previously authorized in writing by the Commissioner. |

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| **Sector** | Insurance |
| **Sub-Sector** | |
| **Obligations Concerned** | National Treatment |
| **Level of Government** | Central |
| **Measure** | Section 197, Insurance Code. |
| **Description** | Additional Surplus Fund for Foreign Insurance Company<br><br>The Commissioner may, as a pre-licensing requirement of a new branch office of a foreign insurance company, in addition to the required asset or net worth, require the company to have an additional surplus fund in an amount to be determined by the Insurance Commission. |

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| **Sector** | Insurance |
| **Sub-Sector** | |
| **Obligations Concerned** | National Treatment<br>Performance/Additional Requirement |
| **Level of Government** | Central |
| **Measure** | Section 198, Insurance Code. |
| **Description** | Reserve Requirement for Foreign Insurance Company<br><br>Every foreign company doing business in the Philippines shall set aside an amount corresponding to the legal reserves of the policies written in the Philippines and invest and keep the same therein in accordance with the provisions of this section. |

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| **Sector** | Insurance |
| **Sub-Sector** | E-commerce |
| **Obligations Concerned** | Performance Requirement |
| **Level of Government** | Central |
| **Measure** | Guideline 14, Insurance Commission Circular Letter No. 2014-47. |
| **Description** | Location of Insurance Company's Web Servers<br>The Insurance Commission also requires that the Insurance Company's primary web servers, books and records should be maintained in the Philippines in order to enable the Insurance Commission to inspect it. |

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| **Sector** | Banking &Finance |
| **Sub-Sector** | Financial Cooperatives |
| **Obligations Concerned** | National Treatment |

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| | Restriction on Foreign Ownership |
| **Level of Government** | Central |
| **Measure** | Article 10, Cooperative Code, as amended. |
| **Description** | Nationality Requirement on Members of Cooperative<br>15 or more natural persons who are Filipino citizens, of legal age, having a common bond of interest and are actually residing or working in the intended area of operation, may organize a primary cooperative |

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| **Sector** | Banking &Finance |
| **Sub-Sector** | |
| **Obligations Concerned** | National Treatment<br>Performance Requirement |
| **Level of Government** | Central |
| **Measure** | Article 97, Republic Act No. 9520. |
| **Description** | Geographical Limitations on Cooperative Banks<br>The Cooperative Development Act provides geographical limitations for cooperative banks. Only one cooperative bank may be established in each province. However, an additional cooperative bank may be allowed in the same province to cater to the needs of the locality depending on the economic conditions of the province as may be determined by the BSP. In such case, the additional cooperative bank must be located in the City or municipality other that the city or municipality where the first cooperative bank is located in the province |

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| **Sector** | Banking &Finance |
| **Sub-Sector** | Financial Cooperatives |
| **Obligations Concerned** | Additional/Performance Requirement<br>Practice of Profession |
| **Level of Government** | Central |
| **Measure** | Memorandum Circular No. 2009-03 |
| **Description** | Accreditation Requirement for Auditors of Cooperatives<br>Under Memorandum Circular No. 2009-03, external auditors of cooperatives need to be accredited by the CDA. |