

Outline Reviewer

Securities Regulation Code

Nature of the Securities Regulation Code (RA 8799)

- It is a *blue sky law*, enacted to protect the public from unscrupulous promoters who proffer to the public business or venture claims which have *no real bases*

State policies

- It is a "truth in securities act," and intended for the following:
 - o Preservation of excesses and fraudulent transactions, merely by requiring that details be revealed
 - o Placing in the market during the early stages of the offering of a security a body of information which will tend to produce a more accurate appraisal of a security
- Seven core principles:
 - o Self-regulation
 - o Encouragement of the widest participation of ownership in enterprises
 - o Enhancement of the democratization of wealth
 - o Promotion of capital market development
 - o Protection of investors (*unifying principle*)
 - o Ensuring full and fair disclosure about securities
 - o Minimization of insider trading and other fraudulent/manipulative devices and practices

Registration of securities

- **General rule:** No securities shall be sold or distributed, nor offered for sale or distribution in the Philippines:
 - o Without SEC approved registration statement; and
 - o Prior to sale, information shall be made available to each prospective purchaser
- Securities covered by the prior registration rule:
 - o Debt instruments – Bonds, debentures, notes and other evidence of indebtedness, asset-backed securities
 - o Equity instruments – Shares of stock, certificate of interest or participation in a profit sharing agreement, certificates of deposit for a future subscription; proprietary or nonproprietary membership certificates in corporations
 - o Investment instruments – Investment contracts, fractional undivided interests in oil, gas or other mineral rights
 - o Derivatives – Like options and warrants

- o Trust instruments – Certificates of assignments or participation, trust certificates, voting trust certificates or similar certificates
- o "Catch-all" – Other instruments as may in the future be determined by the SEC
- *Customer's contract* – An investment contract falling within the definition of "securities," when what is involved is a foreign exchange trading transaction
- Investment contract – Covers a transaction, contract or scheme whereby a person:
 - o Makes an investment of money
 - o In a common enterprise
 - o With the expectation of profits
 - o To be derived solely from the efforts of others (*Howey Test*)
- SRC follows a "flexible concept," for it defines an investment contract as a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits *not solely but primarily from the efforts of others*.
- To be a "security" subject to SEC regulation, an investment contract must be proved to be:
 - o An investment of money
 - o In a common enterprise
 - o With expectation of profits
 - o Primarily from efforts of others
- Check is a commercial paper evidencing indebtedness of any person, financial or nonfinancial entity falling within the definition of Sec. 2 of the Revised Securities Act.
- Exchange traded fund (ETF) – An investment product like a mutual fund that tracks the yield of a market index of an Exchange, or a commodity or a basket of assets like an index fund, but traded through a single security in the Exchange.
- Crowdfunding (CF) – Are internet-based alternative financing for the purpose of raising capital for start-ups in exchange for equity, interests and others of return on investment.

Exempt securities – Those which may be sold/offered for sale without need of prior SEC registration:

1. Issued/guaranteed by the government
2. Issued/guaranteed by a foreign government which has diplomatic ties with the Philippines
3. Issued by receiver/trustee in a proper insolvency proceeding
4. Sale/transfer of which, by law, is under the supervision and regulation of the OIC, HLURB or BIR
5. Issued by a bank, except its own shares

Exempt transactions – Securities sold/offered for sale in the following transactions are exempt from SEC registration:

1. Any judicial sale, or sale by an executor, administrator, guardian, receiver or trustee in insolvency or bankruptcy
2. Those sold/offered for sale:
 - a. By pledgee, mortgagee, or other lienholder to liquidate a *bona fide* debt

- b. In an isolated transaction, subscription or delivery by owner or for his own account
- 3. Distribution by corporation actively engaged in business of securities to its stockholders as a stock dividend or by way of distribution of surplus
- 4. Sale of capital stock by the corporation to its own stockholders exclusively
- 5. Share subscriptions *prior to incorporation* or in pursuance of an increase of authorized capital stock
- 6. Following transactions of Issuer:
 - a. Sale to fewer than 20 persons in the Philippines during any 12-month period
 - b. Issuance of security in exchange for another security
 - c. Exchange of securities with existing security holders exclusively
- 7. Broker's transactions executed upon customer's orders
- 8. Issuance of secured bonds/notes
- 9. Sale to any of the following qualified buyers:
 - a. Banks, investment houses/companies, insurance companies
 - b. Pension/retirement funds plans maintained by Government or managed by a bank
 - c. Such other person as SEC determines as qualified buyers

Procedure for registration of securities

- 1. Registration statement (verified), accompanied by:
 - a. Prospectus
 - b. Other information (e.g., nationality of ownership)
 - c. Written consent of expert
 - d. Certification by selling stockholders
 - e. Fees
 - f. Notice and publication (2 newspapers of general circulation, once a week for 2 consecutive weeks)
- 2. Withdrawal – A registration statement may be withdrawn by Issuer only with the consent of SEC
- 3. Ruling – Within 45 days after filing, the SEC shall declare effective or rejected
 - a. Grounds for rejection/revocation:
 - i. Issuer has been judicially declared insolvent; violated the SRC or its IRR; been/is engaged/about to engage in fraudulent transactions; made any false/misleading representation of material facts in any prospectus; or failed to comply with any registration condition
 - ii. Registration statement is on its face incomplete/inaccurate in any material respect
 - iii. Issuer, its officer, director or controlling person, or any underwriter has been convicted of an offense involving moral turpitude and/or fraud

- iv. Issuer refused to comply with order for production of books/papers, administration of oath, or examination of its officers

Civil liabilities for false registration statement – Any person acquiring security, who suffers damage based on a registration statement—unless it is proved that he knew of such untrue statement or omission—may sue in courts:

- Every person who signed the registration statement
- Director of, or any person performing similar functions, or a partner Issuer at the time of the filing of the registration statement, with respect to which liability is asserted
- Every director/partner of Issuer and whose written consent thereto is filed with registration statement
- Every professional who gives authority to a statement made by him who has been named as having prepared or certified any part thereof
- Every underwriter

Defenses:

- 1. For directors/officers – Before effectivity of part of registration statement to which his liability is asserted:
 - a. He had resigned/taken steps to resign/ceased/refused to act
 - b. He has given written notice to SEC and the Issuer
- 2. Nonexpert:
 - a. He had reasonable grounds to believe and did believe that the statement was true and there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading
- 3. Expert:
 - a. He had reasonable grounds to believe and did believe that the statement was true and there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading
 - b. It did not fairly represent his statement as an expert
- 4. Public official – On that part purporting to be a statement made by a public official, or to be from a public document:
 - a. He had reasonable grounds to believe and did believe that the statement was true
 - b. There was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading
 - c. Such part did not fairly represent the statement made by the public official, or was not a fair copy/extract from public official document he issued

Civil liabilities arising from prospectus – A person is liable to his buyer:

1. Through the use of any means/instruments of transportation communication; or by means of a prospectus or oral communications which includes an untrue statement of a material fact, or omits to state a material fact necessary to make the statements;
 2. With purchaser not knowing they were made of such untruth or omission; and
 3. Such liable person shall fail in the burden of proof that he did not know, and in the exercise of reasonable care, could not have known, of such untruth or omission
- It is unlawful for any beneficial owner, director, or officer directly or indirectly to sell any equity security of Issuer if the person selling the security:
 - Does not own the security sold, or
 - If he owns it, does not deliver it within 20 days
 - To prevent unfair use of information which may have been obtained:
 - Any profit realized by him from any sale within a period of less than 6 months shall inure to and be recoverable by the issuer, irrespective of intention on purchase/repurchase for period exceeding 6 months
 - Unless: The security was acquired in good faith with a debt previously contracted

Some salient reportorial requirements

- Reports by 5% holders of equity shares
 - Beneficial owner – First, to indicate interest of beneficiary in trust property (“equitable ownership); second, to refer to power of a corporate shareholder to buy/sell the shares, though the shareholder is not registered in the corporation’s books
 - It is distinguished from *naked ownership*, which is the enjoyment of all the benefits and privileges of ownership, as against possession of the bare title to property
- Civil liabilities in connection with communications and reports – Any person who (i) shall make/cause to be made any statement in any report/document filed; (ii) which statement was false or misleading with respect to any material fact shall be liable to any person who:
 - Not knowing that such statement was misleading
 - Relying upon such statement; and
 - Purchased/sold a security at a price affected by such statement, for damages caused by such reliance
 - Defense: When he is able to prove that he acted in good faith and had no knowledge that the statement was false/misleading

Manipulative practices and insider trading

- Manipulation of security prices – It is unlawful for any person, for himself or through a dealer or broker, directly and indirectly:
 - For purpose of creating false/misleading appearance of active trading to:
 - Effect any transaction which involves *no* change in beneficial ownership thereof
 - Enter order/s with the knowledge that a simultaneous order/s of the same size, time, and price has/will be entered by different parties
 - Similar acts where there is no change in beneficial ownership
 - To effect alone or with others a series of transactions, with the purpose of inducing the sale/purchase of any security that:
 - Raises/depresses the price of a security to induce sale/purchase
 - Creates active trading to induce such purchase/sale through manipulative devices
 - By circulation/dissemination of information to the effect that the price of any such security will/is likely to rise/fall because of market operations
 - Making any false/misleading statement on any Exchange-registered security with respect to any material fact, which he knew/had reasonable ground to believe is false/misleading
 - Effecting series of transactions for the purpose of pegging, fixing or stabilizing the price of security trade in an Exchange
- Short sale or stop-loss order
 - Short sale – Any sale of a security which the seller does not own or any sale which is

SRC provision on protection of shareholders’ interests

- Tender offer – A publicly announced intention by a person acting alone or in concert with others to acquire equity securities of a company listed on an exchange
 - It is an offer by the acquiring person to stockholders of a public company for them to tender their shares therein on the terms specified in the offer
- Proxy solicitations – Must be in writing, signed by stockholder/duly authorized representative and filed before scheduled meeting with the corporate secretary
- Related transactions of directors, officers, principal stockholders

consummated by the delivery of a security borrowed by or for the account of the seller

- Stop-loss order – No broker, dealer or salesman shall guarantee a customer against loss in any securities account
- Fraudulent transactions:
 - Employing any device, scheme or artifice to defraud
 - Obtain money or property through any untrue statement of a material fact, or any omission to state a material fact
 - Engage in any act, transaction, practice or business which operates/would operate as a fraud or deceit

Some manipulative devices

1. Marking the close – Buying and selling securities at the close of market to alter the closing price of the security
2. Painting the tape – Engaging in a series of transactions that are reported publicly to give the impression of activity or price movement
3. Squeezing the float – Taking advantage of a shortage of securities by controlling demand side, and exploiting market congestion during such shortages in a way as to create artificial prices
4. Hype and dump – Buying activities at increasingly higher prices and then selling securities in market at higher prices
5. Improper matched orders – Transactions where both the buy and sell orders are entered at the same time with the same price and quantity by different but colluding parties
6. Boiler room operations – A well-organized operation where in a room, there would be well-trained salesmen operating over several phones and using high-pressure sales talk to get investors to invest in securities
7. Scalping – A person purchases securities for his own account before recommending that security, and then sells the share at a profit upon rise in market price following the recommendation
8. Daisy chain – A pattern of fictitious trading activity by a group of persons to lure innocent people into the scheme
9. Flipping – One buys a particular stock for customers, while another office simultaneously recommends that its customers sell the stock, with the stock being shifted from one office to another, and the firm makes a profit and the brokers earn commissions

Insider trading – It is unlawful for “insider” to sell/buy a security of Issuer, if he knows a fact of special significance with respect to Issuer of the security that is not generally available to the public, unless:

1. Insider proves that the information was not gained from such relationship
2. Insider proves that the fact is generally available, thus:
 - a. If insider disclosed such information to the other party to the transaction
 - b. Insider had reason to believe that other party also has possession of such information

Presumption of insider trading

- A purchase/sale of security made by an Insider or his spouse or relatives within the 2nd degree shall be *presumed* to have been effective while in possession of material nonpublic information, if transacted after such information came into existence, but prior to the public dissemination of such information, and lapse of reasonable time for the market to absorb such information

Who are insiders?

1. Issuer
2. Director/officer of, or a person controlling/controlled by/under common control with the Issuer
3. Person whose relationship, current/former, to Issuer gives/gave him access to a fact of special significance with respect to Issuer of the security that is not generally available to the public
4. Person (tippee) who learns such a fact from any of the foregoing insiders with knowledge that the person from whom he learns the fact is an insider

Information is ‘material non-public’

- It has not been publicly disclosed and would likely affect market price of security after being publicly disseminated and lapse of a reasonable time for market to absorb information, or
- Would be considered by a reasonable person important under the circumstances in determining his course of action (whether to buy, sell or hold)
- A fact is material if it induces/tends to induce or otherwise affect the sale/purchase of its securities

Securities Market Professionals – They must be registered with the SEC:

1. Broker – A person engaged in the business of buying and selling securities *for the account of others*
2. Dealer – Any person who buys and sells securities for *his own account* in the ordinary course of business
3. Associated person of a broker/dealer – An employee thereof who directly exercises supervisory authority, but does not include a salesman, an agent, or a person whose functions are solely clerical/ministerial
4. Salesman – A natural person employed as such, or as an agent, by a dealer, Issuer or broker, to buy and sell securities; but for purposes of registration, shall not include any employee of an Issuer whose compensation is not determined directly or indirectly on sales of securities of the Issuer

Broker-Director Rule – No broker/dealer shall deal in or buy/sell *for its own account or for the account of customers in Exchange-listed securities* that were issued by any corporation where:

- a. Any stockholder, director, associated person or authorized clerk and all of the relatives of the foregoing within the 4th civil degree

- b. Is at that time holding office in the issuing corporation as:
- a. Director
 - b. President
 - c. Vice-president
 - d. Manager
 - e. Secretary
 - f. Treasurer
 - g. Controller
 - h. Any officer of trust and responsibility
 - i. Controlling person of issuing corporation

of trade, and in general, protection of investors and the public interest

8. Transparency in transactions, prompt and accurate clearance, and Exchange-effected settlement of transaction

Broker-Dealer Segregation Rule – It is unlawful for any member-broker of an exchange to effect any transaction on such exchange *for its own account, unless it discloses to the customer at or before the completion of the transaction that it is acting for its own account*

- Except:

- o Where it is acting in the capacity of a market maker
- o That is reasonably necessary to carry on an odd-lot transactions
- o To offset a transaction made in error
- o Other transactions of a similar nature as SEC may define
- o Initiating member-broker transmits an order for the transaction of another member-broker for execution
- o Executing member-broker is not an affiliated person of the initiating member-broker
- o Complying with the conditions mandated under the SRC Rule 34.1-2: Segregation of Broker and Dealer Rule
- o When member-broker holds unexecuted customer's order with priority, then any broker's order that takes precedence over pre-existing order shall better pre-existing highest bid or lowest offer from a customer by at least one fluctuation

Exchanges and other securities trading markets

- Exchange – An organized marketplace/facility that brings together buyers and sellers, and executes trades of securities and/or commodities
 - o It is a voluntary association organized for the purpose of furnishing to its members a convenient and suitable place to transact their business, of promoting uniformity in the customs and usages of merchants, of inculcating principles of justice and equity in trade, of facilitating the speedy adjustment of business disputes, of acquiring and disseminating valuable commercial and economic information, and generally of securing to its members the benefits of cooperation in furtherance of their legitimate pursuits

Compliance requirements:

1. Organized as a stock corporation
 - a. No person may beneficially own/control more than 5% of the voting rights
 - b. No industry/business group may beneficially own/control more than 20% of voting rights
2. Engage solely in the business of an Exchange
3. Expulsion, suspension or disciplining of member and associated persons, for the conduct/proceeding inconsistent with just and equitable principles of fair trade, and for violations of SRC, SEC-administered law, their IRRs, or exchange rules
4. Fair procedure for the disciplining of members
5. For its board to include in its composition:
 - a. President
 - b. Brokers shall not comprise more than 49%
 - c. No less than 51% of remaining members to be comprised of 3 independent directors and persons who represent the interests of issuers, investors and other market participants
 - d. No officer/employee of a member shall become an independent director
6. Equitable allocation of reasonable dues, fees and other charges
7. Prevention of fraudulent and manipulative acts and practices, promotion of just and equitable principles

Self-Regulatory Organizations

- The SEC can register as SROs which then may be granted much independence by SEC when they are organized and operated in a manner that:
 - o They become responsible for administration and enforcement of relevant provisions of SRC, its IRR and their on rules
 - o With full powers to:
 - Deny membership
 - Discipline their members under fair procedures
- Securities-Related Organizations – Organizations whose operations are related to or connected with the securities market, such as but not limited to associations of:
 - o Brokers and dealers
 - o Transfer agents
 - o Custodians
 - o Fiscal and paying agents
 - o Computer services
 - o News disseminating services
 - o Proxy solicitors
 - o Statistical agencies
 - o Securities-rating agencies

- Securities information processors
- Securities Associations – An association of brokers and dealers

Securities acquisition, transfer and settlement

- Clearing agencies – Persons who act as intermediary in deliveries upon payment to effect settlement in securities transaction
- Recognition of “uncertified securities” – A corporation whose securities are registered/listed in an Exchange may:
 - Issue shares to, or record the transfer of said shareholder, investors or intermediary in the form of uncertified securities
 - Issue all the shares of a particular class in the form of uncertificated securities
- Pledging securities – Pledge of or release of, security, including an uncertificated security properly constituted, and instrument proving right pledged, shall be considered delivered to creditor under arts. 2093 and 2095 of Civil Code, if a securities intermediary indicates by book-entry that such security has been credited to specially designated pledge account in favor of pledgee

Margin, credit and borrowings

- Margin – The amount of credit that may be extended on a security.
 - Main purpose: To give a government credit agency an effective method of reducing the aggregate amount of the nation’s credit resources which can be directed by speculation into the stock market and out of other more desirable uses of commerce and industry
 - Margin allowance standard – Amount not greater than whichever is higher of;
 - 65% of the current market price
 - 100% of the lowest security market price during the preceding 36 months but not more than 75% of current market price
 - A margin account allows investor to buy securities with money that he does not have by borrowing money from broker
- Securities Borrowing and Lending (SBL) – Covers lending of securities from lender’s portfolio on a given date to borrower’s portfolio to support borrower’s trading activities with borrower’s commitment to return/deliver said securities/equivalent to lender on a determined future date:
 - Modes of conducting SBL – Either by:
 - Beneficial owner of securities (direct lending)
 - Through a lending agent

- Other SEC-evaluated methods (e.g., lending pool system, competitive auction, bid offer transactions)
- Direct lending – Only the following institutions may engage in SBL:
 - Domestic banks and branch of foreign banks
 - Investment houses
 - Investment companies
 - Securities dealers
 - Pension funds or retirement plans:
 - Maintained by the Government
 - Managed by a bank, or other persons authorized by BSP
 - Other entities so qualified by SEC
- Lending agent:
 - Must be registered with SEC
 - His personnel must demonstrate functional knowledge and sufficient technical expertise in securities lending operations
 - His securities lending system must have the basic functions and capabilities mandated by SEC
 - Must execute a Securities Lending Authorization Agreement prior to delivery of securities by beneficial owner
- What may be subject of SBL:
 - Those listed in an exchange
 - Those issued by the BTr/BSP
- Eligible collateral – An adequate collateral that may consist in cash, equity, or government securities, or a combination thereof
- Marking to Market – Borrowed and collateral securities must be marked-to-market at least once daily based on the valued method indicated
 - When the value of collateral is less than the current market value of borrowed securities, a “margin call” must be issued and the borrower shall promptly increase the amount of the collateral
 - However, when the collateral value exceeds the current market value, borrower may require release of excess collateral
 - Margin call – Notice issued to borrower to increase amount of collateral to cover amount of the outstanding borrowed securities

- Margin release – Act of the release to borrower of excess collateral
 - Securities Investors Protection Fund – A nonstock, nonprofit corporation organized for the main purpose of creating, maintaining and administering a fund:
 - For the interest and promotion of securities industry
 - To protect investors against losses in case of failure, insolvency, or frauds of a member, broker, or dealer, and effect an orderly distribution of assets of insolvent
 - To carry out measures that would promote a vigorous and effective market for securities
 - Who are not entitled to make a claim:
 - Directors, officers or stockholders of trading participants that incurred the obligations
 - Dummies of such directors, officers or stockholder
 - Customers: (i) Who were involved in failure of trading participant's business, or have unsettled obligations to trading participant; or (ii) Whose claims are part of firm's capital, or are subordinated to the claims of the creditors of the firm
- unless brought within 2 years after discovery of facts constituting cause of action, and within 5 years after such cause of action accrued
- RTC has exclusive original jurisdiction, and may award damages:
 - Actual damages – Up to thrice the amount of the transaction plus actual damages
 - Exemplary damages – In case of bad faith, fraud, malevolence or wantonness
 - Attorney's fees – Not exceeding 30% of award
 - Rule on proportional liability:
 - All persons, including Issuer held liable, shall contribute equally to the total liability adjudged
 - In no case shall principal stockholder, directors and other officers of Issuer or persons occupying similar positions, recover their contributions from Issuer
 - Issuer may recover its contribution from the guilty party
- Validity of contracts – Any stipulation or provision binding any person to waive compliance with SRC, its IRR, or Exchange rules, as well as the waiver itself, are void; and every contract made in violation of SRC, its IRR, is void
 - But it shall not:
 - Affect the validity of loan/extension of credit, unless at time of receipt, creditor had actual knowledge of violation thereof; or
 - Afford a defense to collection of any debt, or enforcement of any lien, by any person who acquired such debt or lien for value and without actual knowledge of any violation

Miscellany

- Liabilities of controlling person – Every person who, by or through stock ownership, agency, or by agreement with another person, controls any person liable under the SRC, shall also be *solidarily liable* with such controlled person
 - Unless: Controlling person proves that he has exercised due diligence without knowledge of facts upon which liability of controlled person exists
- Limitation of actions
 - Actions to enforce any liability arising from Registration Statements, prospectus, communications and reports, must be brought within 2 years after discovery of untrue statement or omission, *but not more than 5 years after security was bona fide publicly offered*
 - No action shall be maintained to enforce any liability created under other SRC provisions