Republic of the Philippines
Department of Finance
Securities and Exchange Commission
SEC Building, EDSA, Greenhills, Mandaluyong City

April 18, 2013

SEC Opinion No. 13-04
Limit on Shareholdings of Independent Directors

NEGOSYONG PINOY FINANCE CORP.
6th Floor, New Semicon Building
Marcos Highway, Brgy. Dela Paz
Pasig City

Attention: **Mr. Jose Rico C. Coligado**
President

Gentlemen:

We refer to your letter, dated February 11, 2013, requesting for an opinion on the current limit on the shareholdings of an Independent Director.

In your letter, you mentioned that SEC Memorandum Circular No. 5, Series of 2012 (MC No. 5)[1] allows Independent Directors to participate in Employees' Stock Option Plans, provided that their shareholdings in the company do not exceed 2% of the outstanding shares of the corporation. Accordingly, you seek clarification on whether MC No. 5 amended SEC Memorandum Circular No. 16, Series of 2002 (MC No. 16)[2] which, according to you, provides that an Independent Director's shareholdings should not exceed 10% of the outstanding capital stock of the company.

Section 38 of the Securities Regulation Code (SRC)[3] defines an independent director as "a person other than an officer or employee of the corporation, its parent or subsidiaries, or any other individual having a relationship with the corporation, which would interfere with the exercise of independent judgment in carrying out the responsibilities of a director."

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[1] Re: Participation of Independent Directors in Employees' Stock Option Plan
[2] Re: Guidelines on the Nomination and Election of Independent Directors
[3] Republic Act No. 8799 (August 8, 2000)

To implement said Section 38 of the SRC, the Commission issued MC No. 16 filling in the details of the law on the qualification and disqualification of independent director, to wit:

> **"II. DEFINITION**
>
> A. Independent director means a person who, apart from his fees and shareholdings, is independent of management and free from any business or other relationship which could, or could reasonably be perceived to, materially interfere with his exercise of independent judgment in carrying out his responsibilities as a director in any corporation that meets the requirements of Section 17.2 of the Securities Regulation Code and includes, among others, any person who:
>
> i. Is not a director or officer **or substantial stockholder** of the corporation or of its related companies or any of its substantial shareholders (other than as an independent director of any of the foregoing);
>
> xxx----------xxx----------xxx
>
> B. When used in relation to a company subject to the requirements above:
>
> i. Related company means another company which is: (a) its holding company, (b) its subsidiary, or (c) a subsidiary of its holding company; and
>
> ii. Substantial shareholder means any person who is directly or indirectly the beneficial owner of more than ten percent (10%) of any class of its equity security."[4]

From the foregoing it appears that Section II(A) of MC No. 16 further defines independent directors as those independent of management and free from any business relationship which could materially interfere with his exercise of independent judgment in carrying out his responsibilities. Moreover, to be qualified as an independent director, he should, among others, not be a director or officer **or substantial stockholder** of the corporation.[5] A substantial stockholder is as any person who is directly or indirectly the beneficial owner of more than ten percent (10%) of any class of its equity security.[6] Thus, an independent director must not be a director or officer or a beneficial owner of

[4] Emphasis supplied.
[5] Section II (A) (i), MC No. 16
[6] Section II(B)(ii), MC No. 16

more than 10% of an equity security of corporation or of its related companies. This 10% limit was also reiterated in Section II(D)(ii) of MC No. 16, when it provides that:

> "D. No person enumerated under Section II (5) of the Code of Corporate Governance shall qualify as an independent director. He shall likewise be disqualified during his tenure under the following instances or causes:
>
> xxx----------xxx----------xxx
>
> (ii) His beneficial security ownership exceeds 10% of the outstanding capital stock of the company where he is such director; xxx"

Thereafter, on December 30, 2003, the Commission amended the Implementing Rules and Regulations of the SRC[7] (Amended IRR). As a result, the definition of an independent director as provided for in Section 38 of the SRC was further amplified by Paragraphs 2 and 6, Rule 38 of the Amended IRR which provide for the qualification and disqualification of an independent director, thus:

> **"2. As used in Section 38 of the Code, independent director means a person who, apart from his fees and shareholdings, is independent of management and free from any business or other relationship which could, or could reasonably be perceived to, materially interfere with his exercise of independent judgment in carrying out his responsibilities as a director in any covered company and includes, among others, any person who**:
>
> A. Is not a director or officer of the covered company or of its related companies or its substantial shareholders when the same shall be an independent director of any of the foregoing;
>
> B. **Does not own more than two percent (2%) of the shares of the covered company and/or its related companies or any of its substantial shareholders**;
>
> xxx----------xxx----------xxx
>
> **6. Qualifications and Disqualifications**
>
> xxx----------xxx----------xxx
>
> B. No person enumerated under Section II (5) of the Code of Corporate Governance shall qualify as an independent director. He shall likewise be disqualified during his tenure under the following instances or causes:

[7] The Amendments was published in Manila Standard on February 13, 2004.

xxx----------xxx----------xxx

(ii) His beneficial security ownership exceeds two percent 2% of the outstanding capital stock of the company where he is such director;

It is clear from paragraphs 2(B) and 6B(ii), Rule 38, of the Amended IRR that an independent director's shareholdings in the covered company and/or in its related companies or in any of its substantial shareholders should NOW not exceed 2%. It is also clear that the term "substantial stockholder" used in the first phrase of Section II(A)(i) of MC No. 16 was not carried into paragraph 2(A), Rule 38 of the Amended IRR. Consequently, the 10% limit on beneficial ownership in the covered company's equity security in which an independent director is to be elected no longer holds true.

In this connection, the Commission, when it issued MC No. 5, merely reiterated the 2% shareholder's limit in the Amended IRR considering that it is the current limit of stock ownership of an independent director in a covered company.

Parenthetically, the Repealing Clause of the Amended IRR clearly provides:

> "All rules and regulations, circulars, orders, memoranda, or any part thereof and the rules and regulations promulgated by persons required to be registered under the SRC or any part thereof, in conflict with or contrary to these Rules or any portion hereof, are hereby repealed or modified accordingly."

Thus, paragraphs 2 and 6, Rule 38 of the Amended IRR are the controlling provisions on the definition, qualification and disqualification of an independent director. In other words, a person is qualified to be elected as an independent director provided he is independent of management and free from any business or other relationship which could, or could reasonably be perceived to, materially interfere with his exercise of independent judgment in carrying out his responsibilities as a director in any covered company, and includes, among others, any person who does not own more than 2% of the shares of the covered company and/or its related companies or any of its substantial shareholders[8]. The 10% limit, provided for in paragraph 5(B) of Rule 38 of the Amended IRR is used only to determine whether or not a person (natural or juridical) is a substantial shareholder of a covered company.

In light of all the foregoing, MC No. 16 was amended by the Amended IRR with respect to the limit on shareholding of Independent Directors. Similarly, MC No. 5 amended MC No. 16 on the maximum shareholdings an independent director can hold.

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[8] Paragraph 2(B), Rule 38 of the Amended IRR

The foregoing opinion is rendered based solely on the facts disclosed in the query and relevant solely to the particular issues raised therein and shall not be used in the nature of a standing rule binding upon the Courts or upon the Commission whether of similar or dissimilar circumstances.[9] If, upon investigation, it is disclosed that the facts relied upon are different, this opinion shall be rendered void.

Very truly yours,

CAMILO S. CORREA
General Counsel

[9] SEC Memorandum Circular No. 15, Series of 2003