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

SEC-MRD Opinion No. 01
Series of 2011

15 September 2011

J.P. Morgan Chase Bank, N.A.
31 Floor Philamlife Tower, Paseo de Roxas
Makati city
Fax: 885-7924; 8857925

Attention: *Ms. Rachel R. Young*

Subject: *Delivery versus Payment (DVP)*

Gentlemen:

This refers to your request for opinion on the issue whether or not the settlement procedures of your bank with qualified institutional buyers (QIBs) with regard to your government securities (GS) transactions outside of the eDVP system of PDEX achieve delivery versus payment, and hence compliant with SEC Memorandum Circular No. 14, series of 2006, otherwise known as the Rules Governing the Over-the-Counter (OTC) Market.

In particular, you cited Section 20 (B) of the OTC Rules which requires that "the clearing and settlement arrangement in the exchange of assets subject of the trade shall be delivery versus payment (DVP) scheme".

In reply, herein below is our response to your query:

This is not the first time our office is addressing this issue. In *SEC-MRD Opinion No.1 dated 28 July 2008*, we described the different approaches of achieving DVP in securities transactions. We also discussed extensively the different settlement systems in the domestic equities and fixed income markets.

The process of clearing and settling securities trade includes several key steps. *First*, the confirmation of the terms of trade by the market participants. *Second*, the calculation of the obligations of the counterparties resulting from the confirmation process which is known as clearance. *Third*, the final transfer of securities (delivery) in exchange for the final transfer of funds (payment) in order to settle the obligations which is known as settlement.

A DVP system is a securities settlement system that provides a mechanism that ensures that delivery occurs if and only if payment occurs. It is a procedure by which the buyer's payment for securities is due at the time of delivery. The purpose of DVP system is to ensure that counterparties are not exposed to principal risk, that is, the risk that the seller of a security could deliver but not receive payment or that the buyer of a security could make payment but

not receive delivery. *[CPSS, Delivery Versus Payment in Securities Settlement Systems (BIS, September 1992)]*

Strictly speaking, DVP does not require simultaneous final transfers of funds and securities. When a central securities depository does not itself provide cash accounts for settlement, it first blocks the underlying securities in the account of the seller or his custodian. It then requests transfer of funds from the buyer to the seller in the settlement bank. The securities are delivered to the buyer or his custodian if and only if the central securities depository receives confirmation of settlement of the cash leg from the settlement bank. *[CPSS, Recommendations For Securities Settlement Systems (BIS, November 2001)]*

In your request, you seek confirmation that the settlement procedures of J.P.Morgan Chase Bank, N.A.("JPMorgan") relative to your GS transactions with QIB clients achieve DVP. Based on your letter, your bank's settlement procedures can be described as follows:

Settlement Modes Outside eDVP:

I. Securities
- RoSS via Reuters Telerate
- RoSS Via PDEx Registry Direct
- RoSS Manual Instruction to BTr
- PDTC – eCs System

II. Cash
- QIB DDA account with JPMorgan
- Managers Cashier Check
- Corporate Check
- Through their Settlement Agent Bank which is PhilPass member

JPMorgan –Buyer	**JPMorgan - Seller**
RoSS via Reuters Telerate and PDEx Registry Direct	
➢ QIB/QIB custodian will initiate securities transfer instruction in Telerate/Registry direct to move securities from their RoSS account to JPMorgan RoSS account. ➢ Upon confirmation that the securities have been transferred, JPMorgan will transfer funds to QIB.	➢ QIB/QIB agent bank shall do a fund transfer to JPMorgan. ➢ Upon confirmation of the availability of the funds JPMorgan shall transfer the securities to QIB/QIB Custodian.
Within Depository via e CS	
➢ QIB and JPMorgan will both initiate securities transfer instruction in eCS to move securities from their QIB to JPMorgan account. ➢ Details of both instructions should matched to move the securities. ➢ Upon confirmation that the securities have been transferred JPMorgan will transfer funds to QIB.	➢ QIB/QIB agent bank shall do a fund transfer to JPMorgan. ➢ Upon confirmation of the availability of funds JPMorgan shall transfer the securities to QIB/QIB Custodian.
Manual transfer Instruction to Bureau of Treasury	
➢ QIB send settlement instruction (confirmation of Outright Sell) to BTr to transfer securities from their RoSS account to JPMorgan RoSS account. JPMorgan will	➢ QIB/QIB agent bank shall do a fund transfer to JPMorgan. ➢ Upon confirmation of the availability of

send settlement instruction (Confirmation of Outright Purchase) to BTr to confirm and accept the transfer of the securities. ➢ JPMorgan to confirm with BTr the transfer of the securities and pay the sale proceed to QIB/QIB Custodian only after the securities have been transferred.	funds JPMorgan shall transfer the securities to QIB/QIB Custodian by sending the settlement instruction (Confirmation of Outright Sale) to BTr to match the Confirmation of Outright Purchase by the QIB/QIB Custodian.

Under the aforementioned procedures, it appears that settlements will be done on a per deal basis and will not involve netting or off-setting of transactions.

These procedures and safeguards ensure that each transfer of securities is effected only when payment occurs or assured within the settlement cycle. As earlier mentioned, DVP does not require simultaneous final transfers of funds and securities. It is essential though that the securities are delivered to the buyer or his custodian if and only if it is confirmed that the cash aspect of the transaction is paid. Thus, in our view, the settlement arrangements described in your letter and Manual of Procedures achieve DVP.

It is understood though that the foregoing opinion is rendered based solely on the facts you disclosed and described in the query and relevant solely to the particular issue raised therein and shall not be used in the nature of a standing rule binding upon the Commission in other cases whether of similar or dissimilar circumstances. *[SEC Memorandum Circular No. 15 (2003)]*

Finally, you are directed that JPMorgan's Manual of Procedures for GS transactions with QIBs be made part of your records and that the same shall be disclosed to your counterparties and form part of the client agreement.

For your guidance.

Very truly yours,

JOSE P. AQUINO
Director

Paid: Filing Fee
OR # 0622991
September 25, 2011
Amount P5,000.00