Republic of the Philippines
Department of Finance
SECURITIES AND EXCHANGE COMMISSION
SEC Bldg. EDSA, Greenhills, Mandaluyong City

Market Regulation Department

SEC-MRD Opinion No. 01
Series of 2012

29 May 2012

BANCO DE ORO
BDO Corporate Center
7899 Makati Avenue
Makati City
Fax: 878-4671

Attention: *Mr. Dennis B. Velazquez*
Executive Vice President/ Central Operations Group

Gentlemen:

This refers to your request for opinion on the issue whether or not trades in BDO's Dealer-Qualified Investor Facility under the Philippine Dealing and Exchange (PDEx) System but settled ***outside*** PDEx eDVP System comply with the Delivery-vs-Payment mode 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, Section 20(B) of the Rules Governing the OTC Market 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. 2 dated 21 November 2011*, we described the different approaches of achieving DVP in securities transactions. We discussed extensively the different settlement systems in the domestic equities and fixed income markets. We also made a ruling on similar issue in subsequent opinions rendered by this Department.

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 obligation 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 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 procedure of BDO's Dealer-Qualified Investor Facility achieve DVP. Based on your letters, your bank's settlement procedure can be described as follows:

A. TRADING HOURS

For T+1 trades: from 9am to 12pm (AM Trading) and 2pm to 4pm (PM Trading)

For T+0 trades: from 9am to 12pm (AM Trading only)

B. DVP Settlement Outside PDEx System (Trades with Qualified Investors)

1. BDO-authorized trader provides or receives a Buy or Sell trade proposal via telephone to or from Qualified Investor (QIB) stating the Security ID, Face Amount and Yield.

2. If both parties agree on the details, the trade/s will be mapped in the PDEx System using PDEx Dealer QI Facility.

3. BDO-authorized trader will encode trade details from PDEx System to BDO's Treasury System Operations Processing Integrated Control System (OPICS). Trader to indicate the transaction number to be specified in the manual Confirmation of Purchase (COP) or Confirmation of Sale (COS) prescribed form of Bureau of Treasury (BTr). The transaction number is unique for each pair of COP and COS as it starts with the RoSS account number of the seller.

C. OPERATIONS

1. BDO Unibank, Inc. back office personnel prints OPICS Purchase Summary and Sale Summary.

2. BDO back office personnel prints the PDS Gateway Report and verifies if transactions encoded in OPICS match the trades in PDS Gateway. Transaction is not authorized in the PDS Gateway as DvP compliant settlement is done outside PDEx.

3. BDO back office confirms transactions with Qualified Investors (QUIBS) via phone, (*i.e.*, counterparty, ISIN, face amount, settlement amount, rate). Writes the name of QIBs' representative, date, time and phone number used in confirming the transaction in the Purchase or Sale Summary.

4. For all the transaction details tally with that of the counterparty, prepares the manual document using the BTr's prescribed forms:

   If the Bank is buying:

   - Prepares Confirmation of Outright Purchase (COP) of government securities, forwards to authorized signatories for signatories of signature.
   - Wait for the counterparty's Confirmation of Outright Sale (COS) of government securities.
   - Check details of COP against the COS.
   - If in order, fax copy of the COS and COP to BTr before 3:30 pm and the original to be sent out the following day before 4:30 pm.
   - Authorizes the deals in OPICS.

   If the Bank is selling:

   - Prepares COS of government securities, forwards to authorized signatories for signatures.
   - Wait for the counterparty's COP of government securities.
   - Check details of COS against the COP.
   - If in order, fax copy of the COS and COP to BTr before 3:30 pm and the original to be sent out the following day before 4:30 pm.
   - Authorizes the deals in OPICS.

5. In case of discrepancies:

   - Backroom to inform front desk for the difference.
   - BDO-authorized trader to review mapped trade details in PDEx System and phone recordings.

- For buying and selling transactions with *SAME counterparty*, BDO back office to prepare manual COP for the buying deal and COS for the selling trade. Likewise, QIBS shall prepare manual COS and COP for each deal. Transaction is processed in full flow for each deal.

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. The transactions will cover only qualified individual buyers.

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 letters 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 BDO's Settlement Procedures for government securities 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,

VICENTE GRACIANO P. FELIZMENIO JR.
Director

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