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

MARKET REGULATION DEPARTMENT

SEC-MRD Opinion No. 4
Series of 2009

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FAXED ON 8/7/2009 10:32 AM
By: Cheryl 912-4273

METROPOLITAN BANK & TRUST COMPANY
Metrobank Plaza, Sen. Gil Puyat Avenue,
Makati City

Attention: Ms. Mariquita L. Agena
Ms. Josefina T. Tuplano
Senior Vice Presidents, Trust Group

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. We also made a ruling on similar issue in *SEC-MRD Opinions No. 2 and 3 dated 8 October and 13 November of 2008 respectively.*

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 by Metropolitan Bank and Trust Company (MBTC) relative to your GS transactions with QIB clients achieve DVP. Based on your letter and Manual of Procedures, you describe that GS Transactions of QIBs who are non Trading Participants are mapped by its counterparty (the Dealing Participant) in the Cross Trade or Dealer QI Facility system of PDEx. Moreover, you stated that the transactions are settled on a delivery-versus-payment system called DVP-RoSS facility. Your settlement procedures, as provided in your Manual of Procedures can be described as follows:

A. Input and Matching of GS Transaction

1. The Seller, through its Treasury Operations Department, initiates the input of the following transaction details in the Telerate Moneyline System, the main component of the DVP-RoSS Facility:

   a. Counterparty
   b. Value Date
   c. Interest Indicator (Buy or Sell)
   d. ISIN
   e. Settlement Mode (DVP or Value Received)
      "Value Received" is indicated if the cash settlement is done outside PhilPaSS-RTGS facility, i.e. debit to an account, check payment.
   f. Face Value
   g. Rate

2. In the Telerate MoneyLine System, the Buyer verifies the details of the GS transaction and if complete and in order, acknowledges and confirms the transaction by encoding the settlement amount.

3. The Seller then sees the confirmation of the Buyer in the system, checks the settlement amount encoded by the latter and if correct, authorizes the GS transaction.

B. GS Transaction Settlement – The transaction authorized by the Seller will be processed as follows:

1. The DVP-RoSS system checks the Securities Account of the Seller to determine if the GS is indeed free and available for trading.

2. If available, the DVP-RoSS system temporarily earmarks and blocks the amount from the Securities Account of the Seller. The Seller expressly warrants and confirms that such blocked face value of the security shall not be used for any other purpose, i.e. liquidity or collateral purposes until such amount has been unblocked through the DVP-RoSS system. If the securities account of the Seller is insufficient to settle the GS transaction, it shall be put on queue until the securities account is properly funded before the cut-off time.

3. Once the GS has been earmarked/blocked in the Securities Account of the Seller, the GS transaction shall be transmitted to PhilPaSS for the cash (peso) settlement. The settlement instruction authorizes the BSP to debit the be Buyer's Demand Deposit Account (DDA) and credit the Seller's DDA for the value of the GS transaction. The PhilPaSS checks if the Buyer's DDA has sufficient has sufficient balances to effect the Peso debit. If the Buyer's DDA is adequate, PhilPaSS immediately debits the Buyer's DDA and credit the Seller's DDA.

If the Buyer's DDA balance is insufficient, the GS transaction shall be held in queue until the balance of the Buyer becomes sufficient for settlement until the cut-off time for peso funding of DVP-RoSS transactions.

4. Once the peso settlement is done, the PhilPaSS sends an electronic settlement confirmation to the DVP-RoSS System. Settlements at the PhilPaSS shall be final and irrevocable.

5. As soon as the electronic confirmation of the Peso leg of the GS transaction is received from PhilPaSS by the Buyer, the DVP-RoSS System immediately debits the Securities Account of the Seller and credits the Securities Account of the Buyer in the RoSS.

6. The DVP system tags the transaction "Completed".

For a Non-Trading Participant QIB's that have Securities RoSS Accounts but do not have the Telerate MoneyLine Terminal, the following are observed for settlement of securities:

1. BTr forms are used: the Seller prepares the Confirmation of Outright Sale of Government Securities (COS-yellow form) while the Buyer prepares the Confirmation of Outright Purchase of Government Securities (COP-green form). The following details are indicted in both forms:

a. Transaction Number - provided by the GS Seller that shall also be used by the GS Buyer
b. Value Date
c. Details of the security (ISIN, Term, Issue Date and maturity Date)
d. Face Amount
e. Settlement Amount
f. Test Key

2. The Buyer forwards the COP to the Seller.

3. The Seller matches the details of the GS transactions as indicated in the COS and the COP.

4. If in order, the Seller initially faxes the COS and COP to the Registry of Scripless Securities (BTRy-RoSS). The original copies of the COS and the COP are submitted to the BTRy-RoSS not later that the following banking day.

5. The BTRy-RoSS checks the COS and the COP. If in order, encodes the GS transaction details in the Telerate MoneyLine System. The transaction is processes similar to the above procedures.

6. The BTRy-RoSS stamps the COS and COP "Posted"; provides the GS Seller and the GS Buyer a copy of the COS and COP.

7. The Cash portion is settled in the following mode:

a. Seller debits the account of Buyer QIB (if QIB has a settlement account with the Seller's Bank)
b. Assumed by Seller if it has a Bills Purchased line (against check payments) for the Buyer QIB Client
c. Payment can be done via RTGS transfer through the QIB depository bank.

Under the aforementioned Manual of 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 MBTC'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

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