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. 5
Series of 2009

11 August 2009

ING BANK NV
Manila Branch
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Ayala Triangle, Makati City
Fax: 815-1116

Attention: *Mr. Efren E. Reyes*
VP – Head of Operations/IT

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 ING Bank N.V. relative to your GS transactions with QIB clients achieve DVP. Based on your letter and manual of procedures, your bank's settlement procedures can be described in general as follows:

1. Process of clearing and settling securities trades outside the e DVP system involves three key steps:

a. The agreement of the terms of the trades with the counterparties which are usually consummated over the phone;

b. The clearing stage wherein calculations of the final trade obligations and the ING's sending of confirmations for the acceptance by the counterparties are undertaken. This stage ensures that the full details of a trade, e.g., the description of the security, the final amount, and the settlement details are agreed upon by both parties by way of a trade confirmation and that ING sends and requests the counterparty to accept. Acceptance is by way of signing on the confirmation and returning a copy to ING, or by confirming the agreement/acceptance over a recorded telephone line; and

c. The settlement stage wherein the final transfer of securities (delivery) in exchange for the final transfer of funds (payment) are then executed.

2. Settlement of trades that are done outside of the eDVP system are usually executed through the Philippine Payment and Settlement Systems (PhilPaSS) which is the real time gross settlement (RTGS) system for the peso payment, while the Registry of Scripless Securities (RoSS) of the Bureau of Treasury (BTr) handles the transfers of securities.

3. As a general rule, ING instructs the BTr to transfer the securities directly to the accounts of buyers or through their custodians only upon ING's confirmation of the receipt of funds. Conversely, funds are immediately paid to sellers only after confirming that the securities have been transferred to the Bank's account.

Specifically, QIB clients with RoSS accounts need to prepare the Confirmation of Purchase (COP) that is duly signed by their authorized signatories. This form is then sent to ING together with their payment via the RTGS. Upon the ING's verification of the receipt of funds, ING now prepare the Confirmation of Sale (COS) and sends both the COP and the COS to the BTr which will be the basis of the BTr to act in accordance with the instructions indicated in both forms, which incidentally, should have matching details. If in case a negative feedback is received from RoSS on the postings of securities and the BTr cut-off time can no longer be met, ING will discuss with the counterparty an alternative arrangement. In the meantime, funds previously remitted to the Bank will be returned via the RTGS.

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 ING'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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