Republic of the Philippines
Department of Finance
Securities and Exchange Commission
Commission *En Banc*

TIMSON SECURITIES, INC., PHILIP LAUDE and ABIGAIL C. LORICA,
Appellants,

- versus - **SEC En Banc Case No. 11-15-391**

CAPITAL MARKETS INTEGRITY CORPORATION, rep. by its President, ATTY. CORNELIO GISON,
Appellee.

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DECISION

Before this Commission is the *Memorandum of Appeal* dated 26 November 2015 filed by Appellants Timson Securities, Inc. ("TSI"), Philip Laude, and Abigail C. Lorica praying that the Letter-Decision dated 19 August 2015 (the "Assailed Decision") of Appellee Capital Markets Integrity Corporation ("CMIC") be set aside and an order be issued directing the refund of the total penalty of P40,000.00 paid pursuant to the Assailed Decision.

THE PARTIES

Appellant TSI is a corporation duly organized and existing under Philippine laws, with SEC Registration No. CS201306194, and duly licensed as a securities broker/dealer. Its business address is at Suite 3310 Robinsons Tower, ADB Avenue, Pasig City.

Appellant Philip Laude is of legal age, Filipino, a Nominee of TSI and was made respondent in this case in such capacity, and with business address at Suite 3310 Robinsons Tower, ADB Avenue, Pasig City.

Appellant Abigail C. Lorica is of legal age, Filipino, an Associated Person of TSI and was made respondent in this case in such capacity, and with business address at Suite 3310 Robinsons Tower, ADB Avenue, Pasig City.

Appellee CMIC is a domestic corporation duly authorized and licensed to act as a Self-Regulatory Organization (SRO), with SEC Registration No. CS201104274. Its business address is located at 10th Floor PSE Tower, 5th Ave. Corner 28th St., Bonifacio Global City, Taguig City. -

THE RELEVANT FACTS

TSI is engaged in the business of stock brokerage having an initial paid-up capital of P100 Million when it commenced operations in October 2013.

For the year 2014, CMIC conducted its Annual Regulatory Audit as per its letter dated 9 December 2014, and Risk Based Capital Adequacy (RBCA) Ratio Spot Audit as per its letter dated 16 February 2015, where it found TSI fully compliant with its rules and regulations.

Subsequently, pursuant to Article II, Section 5(b) of the CMIC Rules, the CMIC conducted a spot audit of TSI's RBCA Report as of 31 May 2015 which was found to be deficient as its Unimpaired Paid-up Capital ("UPC) only stood at P94,193,923.00 which was below the amount required under Article VIII-C, Section 1 of the CMIC Rules i.e. PhP100,000,000.00. Hence, on 22 June 2015, CMIC issued a Show-Cause Letter directing TSI to explain why it should not be held liable for possibly violating Article VIII-C, Section 1 of the CMIC Rules in relation to SRC Rule 28.1 (E)(v).

In its Letter-Reply dated 24 June 2015[1], TSI explained that the deficiency noted in its UPC was a result of an unrealized loss of ₱19,806.077.00 from marketable securities which resulted to Retained Earnings amounting to ₱14,806,077.00. TSI thus argued that its UPC cannot be considered impaired because the decrease in its retained earnings was caused by the unrealized loss.

On 10 August 2015, CMIC issued another show cause letter stating that as per its continuous monitoring of TSI's RCBA Report, it found that the deficiency in TSI's UPC has increased from ₱5,806,077.00 as of 31 May 2015 to PhP14,557,663.00 as of 30 June 2015, and was asked to explain why it should not be held liable for violation of Article VIII-C, Section 1 of the CMIC Rules in relation to SRC Rule 28.1 (E)(v).

On 11 August 2015, CMIC received TSI's Letter-Reply to the second show cause letter where it merely reiterated its position that its UPC should not be considered deficient since the unrealized loss from trading securities should be added back to net income computation as the same had not yet been realized. Moreover, TSI informed CMIC of its plan to apply for additional capital in line with its future expansion for online trading.

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[1] Annex "B" of the Appeal

During the exit conference conducted by CMIC which was attended by TSI's representatives, the latter again reiterated the position of the company that the unrealized loss should not be deducted from its retained earnings considering that TSI did not incur nor realize the said loss. The CMIC however justified its finding of deficiency by applying the International Accounting Standard (IAS) 39 which provides that a gain or loss on financial asset/liability classified as at fair value through profit or loss shall be recognized in profit or loss, while a gain or loss on an available-for-sale financial asset shall be recognized in other comprehensive income. The CMIC argued that since the shares held by TSI in its dealer account are classified as financial assets at fair value through profit or loss and not as an available-for-sale financial assets, the adjustments to record increase or decrease in market price should be recorded as unrealized gain or loss.

On 19 August 2015, CMIC issued the Assailed Decision penalizing TSI as follows:

(1) Fine of P30,000 for the first violation of Article VIII-C, Section 1 of the CMIC Rules in relation to SRC Rule 28.1 (E)(v), with a directive to submit a capital build-up plan; and

(2) Fine of P10,000 for the first violation of Article VI, Section 2 of the CMIC Rules, in relation to SRC Rule 28.1 (4)(G), with a directive to comply with the requirements of the rule.

On 3 September 2015, TSI moved for reconsideration of the Assailed Decision based on the following grounds: (1) that its RCBA Report showed a ratio of 135%; (2) that the unrealized loss was caused by uncontrollable market price fluctuations and merely a paper loss; (3) that it is willing to infuse additional capital; and (4) that it has a good track record.

On 10 November 2015, CMIC denied TSI's request for reconsideration for lack of merit which resulted in the filing of the instant *Appeal.*

On 21 December 2015, CMIC filed its *Reply Memorandum* praying that the instant Appeal be denied for lack of merit and basis.

ISSUE/S

Whether TSI violated Article VIII-C of the CMIC Rules, in relation to SRC Rule 28.1 (E)(v) on the minimum paid up capital requirement.

Whether TSI violated Article VI, Section 2 of the CMIC Rules, in relation to SRC Rule 28.1 (4)(G) on the responsibilities of its Associated Person.

RULING

After a careful review of the arguments and the evidence presented, the Commission finds the instant *Appeal* without merit and hereby denies the same.

I. The failure of TSI to maintain a PhP100,000,000.00 UPC constituted a violation of Article VIII-C of the CMIC Rules, in relation to SRC Rule 28.1 (E)(v).

In the Assailed Decision, CMIC ruled that the unrealized loss from marketable securities should be deducted from TSI's Retained Earnings because its dealer account are classified as financial assets at fair value through profit or loss and not as an available-for-sale financial assets, and under the International Accounting Standard ("IAS") 39: Financial Instruments: Recognition and Measurement, a gain or loss on a financial asset or financial liability classified as at fair value through profit or loss shall be recognized in profit or loss, while a gain or loss on an available-for-sale financial asset shall be recognized in other comprehensive income.

In its Appeal, TSI countered by maintaining that CMIC committed reversible error in penalizing the company because the same is based on an erroneous interpretation of Rule 49(B) under SEC Memorandum Circular No. 16, series of 2004 which TSI alleged requires an appropriation to maintain unimpaired capital on an annual basis. TSI argued that the deficiency noted by CMIC was temporary in nature and was thus reversible given the intricate behavior of stock market prices.[2] TSI also reiterated its position that its UPC was not deficient because the unrealized loss should not be deducted from its retained earnings considering the same are merely paper losses.

The arguments of TSI fail to convince.

At the outset, the Commission notes that TSI's argument relative to the alleged erroneous interpretation of Rule 49(B) under SEC Memorandum

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[2] Pars. 23 and 24 of the Appeal

Circular No. 16, series of 2004 by CMIC is misplaced considering that it is being penalized not on the basis of the said regulation, but for violating Article VIII-C of the CMIC Rules in relation to in relation to SRC Rule 28.1 (E)(v). The Assailed Decision could not be clearer on the rules violated, to wit:

> "Based on the above discussion, CMIC resolves to impose the following sanctions and directives against TSI for its failure to comply with the relevant provisions of the Securities Regulation Code (SRC), its implementing rules and regulations (the SRC Rules), CMIC Rules and other relevant rules and regulations, *viz*:
>
> a) Major Violation (please refer to Annex 1)
>
> Fine of P30,000 for **TSI's first violation of Article VIII-C Section 1 of the CMIC Rules, in relation to SRC Rule 28.1 (E)(v)**, with a directive to submit a capital build up plan, within two (2) days from receipt of this letter, on how TSI intends to substantially, diligently, and continuously comply with the capitalization requirements and to observe the rules on UPC and such plan shall be achieved by TSI within ninety (90) calendar days from the receipt of this notice.
>
> Fine of P10,000 for a **first violation of Article VI, Section 2 of the CMIC Rules on *Supervision*, in relation to SRC Rule 28.1 (4)(G)**, with a directive to comply with the requirements of the rule." (Emphasis supplied)

Article VIII-C, Section 1 of the CMIC Rules provides:

> Article VIII. Capitalization Requirements of Trading Participants
>
> C. Minimum Paid-up Capital Requirement
>
> Section 1. The unimpaired paid-up capital requirement is One Hundred Million Pesos (PhP100,000,000.00) for the following types of Trading Participants:
>
> (a) First time registrants who will be participating in a registered clearing agency upon the effectivity of the Code;
> (b) Those acquiring the business of existing Trading Participants pursuant to SRC Rule 28.1, paragraph 2 and will be participating in a registered clearing agency;
>
> Provided, however, that the Commission may authorize a lower capitalization for applicants not participating in a registered clearing agency. (Emphasis and underscoring supplied.)

The requirement relating to the maintenance of a minimum paid-up capital is intended to ensure the financial soundness of the brokers to enable them to comply with their obligations to their clients.[3] Section 28.4(b) of the SRC specifically requires as a condition for the registration that broker dealers satisfy the minimum capitalization requirement prescribed by the Commission to ensure compliance with the provisions of the code.

Relative thereto, the Commission has implemented and approved the following regulations:

(1) Article VIII, Section 1 of the CMIC Rules:

> "Section 1. Definition and Coverage. x x x
>
> **Every Trading Participant is covered by the RCBA rules and requirements under SEC Memorandum Circular No. 16 Series of 2004.**" (Emphasis supplied)

(2) Article VIII-C, Section 1 of the CMIC Rules:

> "Section 1. **The unimpaired paid-up capital requirement is One Hundred Million Pesos (Php100,000,000.00)** for the following types of Trading Participants: (a) First time registrants who will be participating in a registered clearing agency upon effectivity of the Code; (b) Those acquiring the business of existing Trading Participants pursuant to SRC Rule 28.1, paragraph 2 and will be participating in a registered clearing agency; Provided, however, that the Commission may authorize a lower capitalization for applicants not participating in a registered clearing agency." (Emphasis supplied)

(3) Rule 49.1 (A) of SEC MC No. 16, Series of 2004:

> "Rule 49.1 (A) **PAID UP CAPITAL REQUIREMENT**
>
> Unless otherwise prescribed by the Commission, **the paid-up capital of every Broker Dealer covered by the RCBA shall be governed by the existing requirement of SRC Rule 28.1 (E)(v).**" (Emphasis supplied)

(4) SRC Rule 28.1 (E)(2)(v) states:

> "a. **Unimpaired paid up capital of One Hundred Million (100) Million pesos** for the following types of Broker Dealers: x x x" (Emphasis supplied)

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[3] Decasa, L., Securities Regulation Code Annotated, 2013, p. 110

In relation to the instant case, we agree with CMIC that Article VIII-C, Section 1 of the CMIC Rules and the afore-quoted regulation apply to Appellant TSI as the prescribed minimum paid-up capitalization partakes of the nature of a continuing requirement for brokers and dealers provided in Rule 28.1 (E)(v) which TSI failed to meet. This is shown in the Certificate of Registration issued to TSI which provides that the grant of the license to act as broker-dealer in securities is always subject to TSI's full compliance with the applicable laws, rules and regulations which the Commission may now or hereafter issue. Lest it should be forgotten, the need to update and strictly implement regulations is warranted by the fact that the business of broker dealers is imbued with public interest as it directly impacts the national economy. To hold otherwise as what TSI is suggesting to this Commission, would sanction a situation where new regulations on capitalization requirement will no longer bind existing broker dealers who can conveniently argue that they have already complied with the regulation(s) existing at the time of their registration. This certainly, is not the intent of the law.

The records show that as of 30 June 2015, the UPC of TSI was PhP14,557,663.00 short of the required PhP100,000,000.00, and its allegation, devoid of evidence, that its UPC is not deficient was not able to trounce the evidence presented by CMIC which is embodied in the latter's audit report.

On the basis thereof, we find no cogent reason to disturb the finding of CMIC that TSI violated Article VIII-C of the CMIC Rules in relation to SRC Rule 28.1 (E)(v).

To make up for the absence of proof to support its claim that its UPC is not deficient, TSI passed the blame to CMIC by insisting that the shortage of its UPC was brought about by CMIC's erroneous deduction of the unrealized loss from its retained earnings. TSI argued that the unrealized loss from the decrease in the market value of its marketable securities should not be considered in computing the company's Retained Earnings because the same had not yet been realized.[4] This, according to TSI, was an erroneous treatment of its unrealized losses.

We do not agree with TSI.

The applicable standard to determine the proper treatment of the unrealized loss due to decrease in the market value of marketable securities is

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[4] Paragraph 28 of the Appeal

the International Accounting Standard ("IAS") 39 – Recognition and Measurement of Financial Instruments, to wit:

> Par. 9 of IAS 39 on Definitions of four categories of financial instruments –
>
> "**A financial asset** or financial liability **at fair value through profit or loss is a financial asset** or financial liability **that meets either of the following conditions**:
>
> (a) It is **classified as held for trading**. A financial asset or financial liability is classified as held for trading if:
>
> (i) **It is acquired or incurred principally for the purpose of selling or repurchasing it in the near term**;
> (ii) On initial recognition it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking; or it is a derivative (except for a derivative that is a financial guarantee contract or a designated and effective hedging instrument). x x x" (Emphasis supplied)

The application of the afore-quoted standard is consistent with Rule IX, Section 2 of the CMIC Rules which requires all trading participants to comply with IAS and the Philippine Financial Reporting Standards.[5] Moreover, Par. 46 of IAS 39 on Subsequent measurement of financial assets provides:

> "After initial recognition, an entity shall measure financial assets, including derivatives that are assets, at their fair values, without any deduction for transaction costs it may incur on sale or other disposal. x x x"
>
> Par. 55 of IAS 39 on Recognition of gains and losses for financial instruments –
>
> "**A gain or loss arising from a change in the fair value of a financial asset** or financial liability that is not part of a hedging relationship shall be recognized as follows. (a) **A gain or loss on a financial asset** or financial liability **classified as at fair value through profit or loss shall be recognized in profit or loss**." (Emphasis supplied)

The afore-quoted provisions clearly mandate that changes in the fair value of the marketable securities should be recognized in profit or loss and

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[5] "**Section 2.** ***Accounting Standards***. All Trading Participants shall comply with the International Accounting Standards (IAS) and the Philippine Financial Reporting Standards as issued by the Board of International Accounting Standards."

closed to retained earnings. Therefore, CMIC properly treated the unrealized losses from marketable securities when it deducted the unrealized losses from TSI's Retained Earnings. CMIC's finding that TSI's UPC is deficient, having been based on a treatment of its unrealized losses prescribed under the IAS, should not be disturbed in the absence of clear showing that the said standard is not applicable.

Moreover, the Commission notes that in computing the UPC, the CMIC is mandated under Article VIII, Section 2 of the CMIC Rules to deduct any deficiency in the Retained Earnings account from the total paid-up capital, to wit:

> "Section 2. RBCA Guidelines. In monitoring compliance with the RBCA framework, CMIC, shall observe the following guidelines:
>
> 2.1 Prudential and Financial Measures.
>
> A. Paid Up Capital Requirement. Unless otherwise prescribed by the Commission, the paid-up capital of every Trading Participant covered by the RBCA shall be governed by the existing requirements of SRC Rule 28.1 (E) (v).
>
> For this purpose, the term paid up capital shall include the following:
>
> (1) Capital contributions of partners or par value or stated value of Common Stock
> (2) Payment made on Subscribed Common Stock
> (3) Par or Stated Value of Preferred Stock
> (4) Payment made on Subscribed Preferred Stock
> (5) Common Stock to be Distributed (arising from a Stock Dividend Declaration)
> (6) Additional Paid in capital for both Common and Preferred Stocks
> (7) Donated Capital
>
> xxx
>
> B. Reserved Fund
>
> xxx
>
> **(4) Consistent with the general usage under SRC Rule 28.1 (E) (v), the term "Unimpaired Paid Up Capital" shall refer to the firm's Total Paid Up Capital less any deficiency in the Retained Earnings account."** (Emphasis supplied)

Applying the foregoing provision, CMIC correctly computed TSI's UPC as of 30 June 2015, as follows:

Paid Up Capital	PhP109,000,000.00
Less: Deficit in Retained Earnings	23,55,663.00
UPC	PhP 85,442,337.00

II. TSI and its Associated Person's failure to implement an effective compliance function and supervisory system violated Article VI, Section 2 of the CMIC Rules in relation to SRC Rule 28.1 (4)(G)

The failure of TSI to comply with the UPC requirement affirms the finding of CMIC that it consequently violated Article VI, Section 2, Paragraph (iii) of the CMIC Rules as it shows the concomitant failure on the part of TSI, through its Associated Person, Ms. Abigail Lorica, to implement an effective compliance function and a supervisory system, to wit:

> "**Section 2. Supervision.** (a) **The management of every Trading Participant shall establish and maintain an appropriate and effective compliance function within the firm which is independent of all operational and business functions. The compliance function shall be performed by an Associated Person** who shall be registered with the Commission and required to report directly to the board of directors and the company President. The management shall ensure that the Associated Person/s performing the compliance function possesses sufficient training and experience in securities regulation matters and an understanding of the securities activities of the firm enabling them to effectively execute their duties.
>
> (b) **Associated Persons shall be responsible**, in addition to the duties enumerated under SRC Rule 28.1 (4)(G) **for maintaining a system to supervise the activities** of all persons employed by the Trading Participant who are directly or indirectly **related to the conduct of its securities business.**
>
> (c) Although the final responsibility for proper supervision shall rest with the Trading Participant, diligence of a good father of the family is required from the Associated Person/s in the conduct of their compliance functions.
>
> (d) **Associated Peron/s shall promptly report to management all occurrences of material non-compliance by the firm or its staff with the legal and regulatory requirements**, as well as with the

> firm's own policies and procedures. Management shall then promptly notify CMIC. For this purpose, the Associated Person shall maintain a logbook of all material non-compliance reports with the appropriate notation of the action taken by management on said occurrences. Such logbook must be duly registered with the Commission within fifteen (15) days from issuance of the Associated Person/s new/renewal license. xxx" (Emphasis supplied)

The failure of TSI to maintain the minimum amount prescribed for its UPC constitutes a material non-compliance which TSI and its Associated Person failed to address. This violated the afore-quoted provision that warranted the imposition of the appropriate penalty.

The Commission thus finds no cogent reason to disturb the findings of the CMIC and hereby resolves to affirm the Assailed Decision.

WHEREFORE, premises considered, the instant *Appeal* filed by Timson Securities, Inc., Philip Laude, and Abigail C. Lorica is hereby **DENIED** for lack of merit. The Letter-Decision dated 19 August 2015 of the CMIC is hereby **AFFIRMED**.

SO ORDERED.

Pasay City, 15 April 2021.

EMILIO B. AQUINO
Chairperson

EPHYRO LUIS B. AMATONG
Commissioner

JAVEY PAUL D. FRANCISCO
Commissioner

KELVIN LESTER K. LEE
Commissioner

KARLO S. BELLO
Commissioner