Corruption and Weak Markets: The BW Resources Stock Market Scam

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Introduction

The BW Resources price manipulation scandal rocked the local stock market in 1999. The case provided the backdrop for one of the most dramatic moments in the impeachment trial of then President Joseph Estrada – the testimony of former Finance Secretary Edgardo Espiritu against his former boss. Its inclusion in the impeachment charges against Estrada signaled the growing importance of the stock market in our national life. It also showed that the stock market cannot be divorced from the larger social and political context.

The stock exchange is the icon of a free market where prices are determined solely by the interaction of supply and demand and transactions are carried out on an arm's-length basis. But as the BW scandal indicated, market performance is only as good as the quality of institutions within and outside the market. (Lim, 2001) In this case, the interaction of anachronistic market institutions and political corruption in the context of a liberalized but poorly regulated market produced a crisis of unprecedented scale.

From P2 at the start of 1999, the price of shares of stock of BW Resources Corp. (henceforth, BW) reached a high of P107 on October 11 of the same year. (**Fig. 1**) Acquired by Dante Tan, an Estrada crony, BW was hyped as a listing vehicle for Estrada's various business interests, particularly in gaming and property development. Massive trading in the stock overwhelmed a lethargic market. The average value of daily trades reached P3.1 billion in 1999, as compared with P2.7 billion in 1996 when emerging markets like the Philippines were at their peak. At the height of the bubble, trading in BW shares accounted for as much as half of total market turnover. Within a week after it peaked, the stock lost 60 percent of its value. By February 2000, it had dropped to P3 a share.

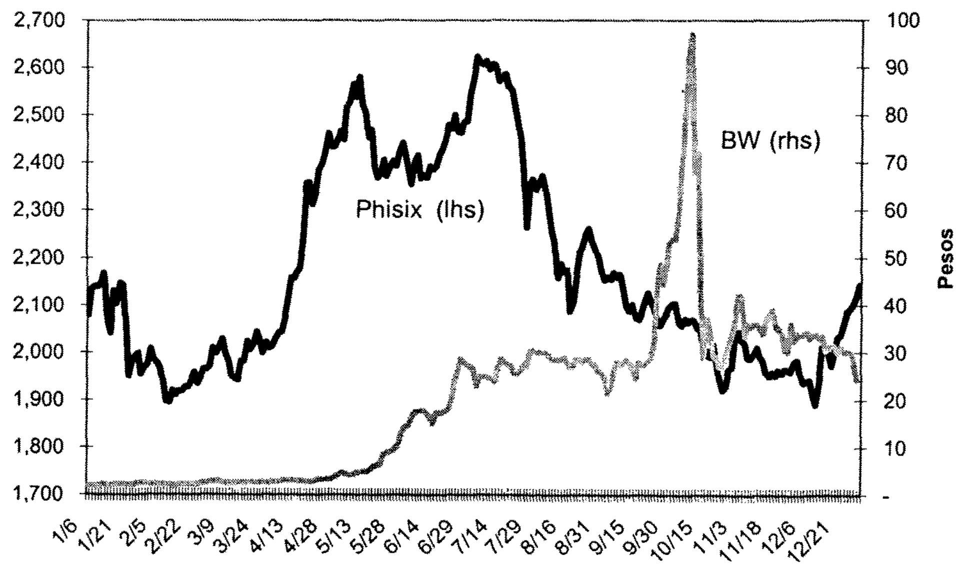

Figure 1.
Price of BW Shares and the Phisix, 1999
(Source of basic data: Technistock)

The phenomenal rise and fall in the price of BW shares was a classic stock market bubble. But it was more than just a bubble: it was also a swindle of a scale unprecedented in the history of the exchange. Investigations by the Philippine Stock Exchange (PSE) and the Securities and Exchange Commission (SEC) revealed a grand scheme of market manipulation. It involved several Estrada cronies led by

Tan, a close circle of friends and relatives and a group of influential brokers. Perpetrated for the benefit of Estrada and the members of his family, it combined elements of political corruption and financial fraud or market manipulation.

This paper examines the role of political corruption in the scandal, the nature of institutions within the stock exchange and the state of market regulation. The BW scandai provides a fascinating study of how political corruption during the Estrada administration underwent significant transformation in both magnitude and scope. Gains acquired through traditional methods of political corruption – grants of franchises, government contracts and behest loans – were leveraged in the securities market for greater profit, albeit through fraud. The use of state-controlled financial institutions to abet this process marked another milestone in the history of corruption in the Philippines.

What set the BW scam apart from the equally grand schemes of corruption during the Estrada administration was the combination of political corruption and financial fraud. But why is the Philippine stock market vulnerable to this new type of corruption? This paper argues that the answer may be found in the nature of institutions within the stock exchange and in the poor regulatory framework that governs the market. Ownership and control of the stock exchange by family-controlled houses, high ownership concentration among listed stocks, the influence of informal networks and the absence of an independent, effective regulatory mechanism render the exchange vulnerable to corruption. These institutions work against a transparency of transactions and the fair price formation essential to the growth of capital markets.

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Weak market institutions and poor governance pose a serious challenge to deregulation, liberalization and the growth of markets. Weak market institutions allow a corrupt state to extend its 'grabbing hand' beyond its traditional spheres of influence either in the public sphere or at the interface of the public and private spheres. In such a context, the growth of the market could imply greater volatility and risk of crisis. As the BW scam shows, the growth of the Philippine stock market as a result of capital account liberalization in the early 1990s magnified the risk of financial fraud and crisis. The reorganization of the exchange (two bourses were merged into a single exchange) and the opening up of the market to foreign players did not alter the structure of economic interests that underlay the market. Partly as a consequence, market regulation barely improved. The result was a greater risk of crisis as the potential gains from financial fraud increased even as market regulation remained poor.

The discussion below is divided into three parts. The first part discusses the role of political corruption in the BW scam. The second part examines market manipulation and identifies features of the stock exchange that render it vulnerable to financial corruption. The third part shows the failure of market regulation with respect to the BW case. It traces weak governance to the structure of interests in the stock exchange, weak regulatory capacity and the permeability of regulatory agencies to the influence of vested interests and political pressure.

Political corruption: old and new

The first element of the BW stock market scam – which received the most attention – is political corruption. The case showed the persistence of old forms of corruption and the emergence of new ones. The grant of franchises, government contracts and behest loans by state agencies (government-owned or -controlled corporations) are familiar tricks of the trade among the politically corrupt. Moreover, the nature of these privileges, the way they were approved, contested and confirmed betrayed the powerful hand of the President. What was new in the BW case was the capture of the stock market by the President and his cronies to leverage assets acquired through corruption for greater profits.

Scams do not always have to begin as one. Tan's foray into stock trading could have been inspired by a legitimate business idea: to transform BW Resources (formerly Greater Asia Resources Corp) into the gaming stock of the market. The viability of this plan hinged on two major projects. The company's flagship project was the construction of Sheraton Marina Square Hotel, a hotel-gaming complex acquired from Megaworld Holdings, Inc through a share-for-property swap. In June 1999, BW Resources signed a tenancy agreement with the government owned Philippine Amusement and Gaming Corporation (PAGCOR) to occupy 30,000 square meters of the hotel for a monthly rental fee of P55 million or P15,000 per square meter.

The other major project involved the merger of Best World Gaming and Entertainment Corp (BWGEC), a company registered with Dante Tan as controlling owner, and which was granted a franchise and license to operate a nationwide online Bingo[1]. A second franchise was granted BWGEC in 1999 to operate an online version of the popular numbers game, *jueteng*. With a projected income of P14 billion a year from the Bingo business alone, the possible merger of BWGEC and BW Resources made the latter an attractive bet. In July of the same year, Tan acquired a P600 million loan from the government-controlled Philippine National Bank (PNB) with BW Resources and BWGEC as co-borrowers, using the former's principal asset as collateral. The money was supposedly intended to develop the Bingo business.

Talks of the merger began in early 1999, but it was not until the end of the year that a memorandum of agreement was signed, formalizing the acquisition of the capital stock of BWGEC in exchange for BW Resources shares. At that point, the online Bingo business had yet to begin. The merger was called off in February the following year as the share price dropped to P3.

Franchises, government contracts and behest loans are tried-and-tested technologies of political corruption. But the BW case went beyond the old boundaries. In this case, the fruits of corruption were not simply appropriated but leveraged in the stock market for even greater profits, albeit through fraud. The combination of political corruption and financial corruption set the BW scam apart from the many grand schemes of corruption seen in the previous administration. It is to the aspect of financial corruption that we turn below.

Corruption in the stock market

Price manipulation creates the appearance of active trading in a certain stock to drive up its price. There are many ways of manipulating the market – wash sales, matched order, painting the close and transfer of shares to various accounts then selling the shares back to the original owners among them. Tan and his group managed to do most of these– and more.

Such manipulative schemes are amply documented in the reports issued separately by the PSE (Philippine Stock Exchange) and the SEC (Securities and Exchange Commission). Wash sales in which the buyer and seller of the shares are the same person was one way. The SEC documented 45 such sales by Tan involving over 40 million shares worth some ₱216 billion at the market price.[2] In a slight variation of the same scheme, Tan sold his shares to a dummy, Mario Juan, in a matched order – a pre-arranged sale in which the buying and selling brokers synchronized the posting of their transactions on the PSE's computer system to ensure that the orders matched. The shares were then transferred back to the account of Tan.

Another manipulative scheme used was the 'over-the-counter' transfer of BW shares from Tan's accounts to that of various individuals. Such transfers did not go through the exchange (hence, over-the-counter). Tan subsequently bought back the same shares, this time using matched orders through the exchange. In a single month, Tan moved 141 million shares from his accounts to various individuals. The single biggest recipient was Lucio Co, another Estrada crony, who received some 92 million shares from Tan. In turn, the shares were distributed to various accounts.

To raise fresh funds to finance his trading activities, Tan entered into 'private placement with lock up' agreements with various investors, mostly affiliates and clients of PCCI Securities. In a typical transaction, Dante Tan acted as seller of BW shares via an investment contract outside the exchange. The contract provided that the buyer/investor could not sell within a certain period, say, 180 days. In return, the shares were sold at a discount. If the market price fell below a prior agreed upon level, then the shares were to be freed from the lock up provision. The aim was to create a shortage of BW shares by locking them up in these contracts while raising money to finance Dante Tan's manipulative transactions. The device was successful in driving up the price of BW shares. **Fig. 2** shows the volume of shares locked up under these agreements during the period from May-October 1999. The rise in the number of shares taken from the market coincided with the steep rise in the share price over the same period.

The BW scam is remarkable for its sheer boldness. The average value of daily trades in 1999 reached P3.1 billion compared with P2.7 billion in 1996 at the height of the stock market boom. (See **Fig. 3**) At the beginning of the year, BW shares, which then traded at P2 per share, accounted for a mere one-fourth of one percent of total market turnover. By October 11, the value of trades of BW shares hit P3.2 billion or half the market turnover. The share price reached an astonishing P107 during the day only to collapse the following day and then lost 60 percent of its value within the week.

The BW scam involved more than a few brokers, including influential members of the PSE. Investigations conducted by the Compliance and Surveillance Group (CSG) of the PSE and the SEC identified 19 domestic brokerages which had repeatedly violated trading rules and regulations. Six of those implicated occu-

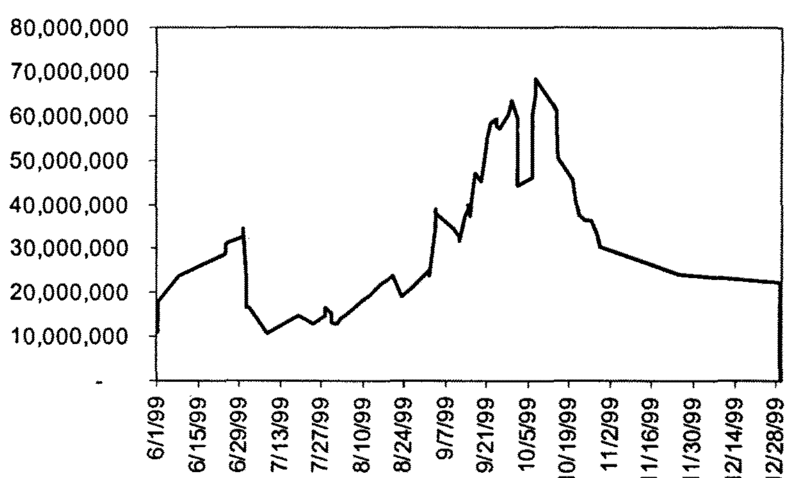

Figure 2.
Number of BW Shares Shares Under Lock Up Agreement

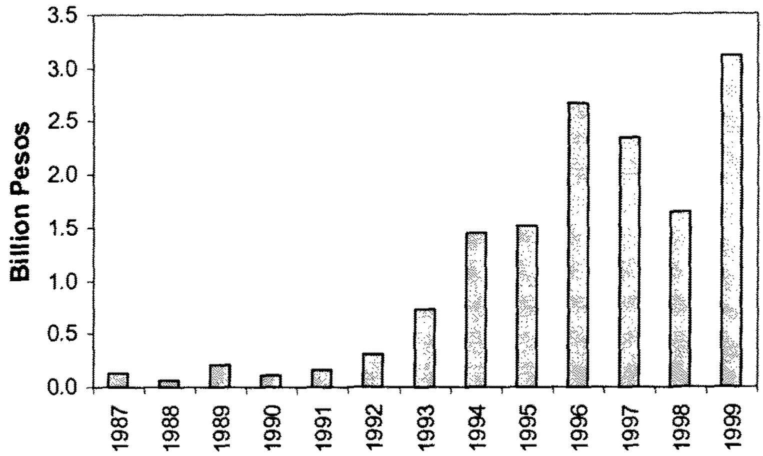

Figure 3.
Average Daily Market Turnover
(Source of basic data: Technistock)

pied a seat in the PSE Board of Governors either concurrent with or in the last four years at that time. Among them was the Chairman Emeritus. Over a period of 10 months, an eternity by stock market reckoning, almost every rule in the book was violated. Tan and his accomplices, brokers and officials of BW Resources, were found to have violated a dozen rules, all for a single purpose: to drive up the price of BW shares.[3]

Vulnerable institutions

The apparent ease with which the stock market was transformed into a playground of Estrada and his cronies raises a number of questions. For one, price manipulation was independent of political corruption. It did not require the exercise of state prerogatives or political power, although it did refer to assets acquired through political corruption and the backing of the Office of the President. Moreover, Tan, a distributor of imported tires before becoming a business partner of the Estradas, was new to the stock market, naive in the cunning ways of stockbrokers and dealers. He could not have planned or orchestrated the scheme. He had to work through a group of brokers familiar with the intricacies of stock trading and price manipulation. This raises the question: why is the stock exchange vulnerable to manipulation and corrupt trading practices? The answers are found in the history and institutional nature of the stock exchange.

First, the PSE is a cartel controlled and managed by brokers. Stock trading in the country takes place in the PSE which is an organization of brokers and traders. The result of a merger in 1993 of two rival exchanges, the Manila Stock Exchange and the Makati Stock Exchange, the PSE is the sole stock exchange in the country with membership limited to 200. Members elect a Board of Governors on a one-seat-one-vote basis. The Board of Governors oversees the management of the exchange and the enforcement of rules. It appoints members to the various committees, including the Listing and Disclosures Committee (LDC) and the Business Conduct and Ethics Committee (BCEC). The latter decides on sanctions against erring members based on the recommendations of the Compliance and Surveillance Group (CSG) and the PSE President.

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Despite the existence of a professional staff to manage the daily affairs of the exchange, the Board of Governors and the various committees exercise enormous influence over management, creating serious problems of conflict of interest. The conflict of interest engendered by the current setup was played out for all to see in the BW case when the BCEC refused to endorse the findings of its own CSG investigation into the case, prompting the latter to resign en masse. As discussed below, the same ownership and control structure has created a weak regulatory mechanism within and outside the stock market.

Second, small privately-held brokerages dominate the leadership of the PSE. While a handful of brokerages, mostly foreign, are affiliates of large financial institutions such as banks and investment houses listed in their respective countries, the majority of securities firms in the PSE are privately held, family-controlled businesses. Of 174 active members of the PSE, 36 are foreign houses accounting for 40 to 45 percent of market share. Serving mainly foreign institutional investors, eight are in the list of top 10 brokers in terms of sales.

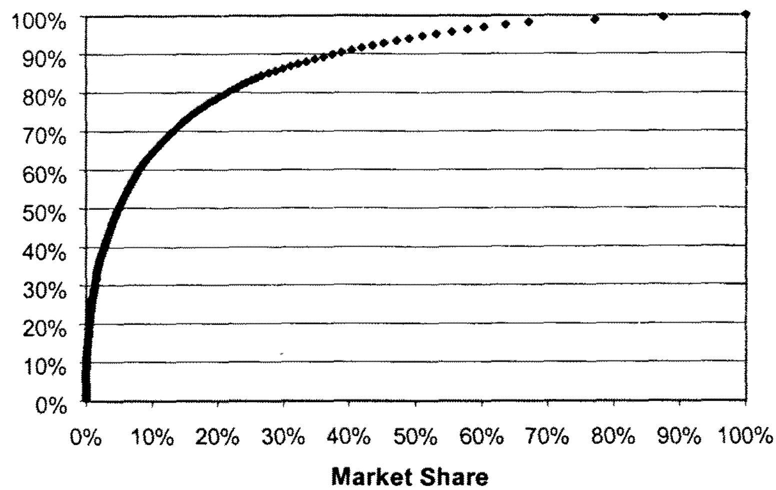

Figure 4.
Cumulative Voting and Market Shares of PSE Member Brokers, 1998
(Source of basic data: Technistock)

The rest of the market is divided among domestic corporate members (120) and individual members (63). Except for a few established brokerages and local bank affiliates, domestic brokerages are mom-and-pop operations which have their roots in the old stock exchanges catering to domestic retail clients – high networth individuals – and making money trading their own accounts. **Fig. 4** plots the cumulative market share of member firms against votes held, illustrating the disproportionate influence of small brokerages over the PSE.

Indeed, the composition of the Board of Governors reflects the collective power of small brokerages over the exchange. Between 1996-2000, 25 brokerages held 79 Board seats[4] available to members. Of the 25 brokerages whose nominees were elected to the Board, only six were in the list of top 20 brokers during their year of tenure; the rest were small firms whose market share ranged from 0.03 percent to 0.76 percent. It was only in 2000 that nominees of foreign brokerages[5] were elected to the Board.

The structure of ownership and control of the PSE explains many facts regarding the BW case. For one, all of the brokers implicated in the scandal were domestic brokers,[6] each controlled by one or a few large shareholders.[7] While some of the key players in the scandal had a corporate/institutional character – PNB Securities is the brokerage arm of PNB and PCCI Securities is part of an investment group of the same name – the mother institutions were also dominated by large single shareholders, Lucio Tan and the government in the case of PNB and the Galang and Lopez (of Meralco fame) families in the case of PCCI. The presence of effective minority shareholders put pressure on the controlling shareholders to disclose information about the firms' operations. In the securities industry, minority shareholders acted as a counterbalance against the controlling shareholders decisions and actions, including engaging in fraudulent trading.

Moreover, six[8] of the brokers implicated by the PSE and SEC reports were members or had been members of the Board of Governors. Most notable was Belson Securities owned by the Lims. Belson nominee Federico C. Lim was Governor from 1997 to 1999; Eduardo C. Lim Sr. is the Chairman Emeritus of the PSE and presidential adviser to Estrada.

Formal control over the PSE is reinforced by kinship, friendship and business ties. Social ties were indispensable in manipulating the market owing to the illegal nature of the transactions involved. In the BW case, a web of relationships leading all the way to the President kept the parties together and ensured loyalty to the group's objective.

To give a few examples, Eduardo 'Moonie' Lim Jr, President of BW Resources is the son of Lim Sr, a presidential adviser. A veteran broker, he is believed to have orchestrated the price manipulation scheme.

Moonie Lim's daughter is married to Francisco Liboro, the chief executive officer of PCCI Securities which facilitated the private placement of BW shares. Liboro moved to PCCI from Belson-Prime East Securities which he used to head until it folded up following the Asian crisis, bringing with him his traders and staff. He is known to be a close friend of Raul de Castro who runs the family-owned A.T. de Castro Securities. PCCI is owned by the Galangs and the Lopez family (of Meralco), a scion of which recently married Estrada's daughter.

Armstrong Securities, which is owned by the family of George Go (of Equitable PCI Bank), an old friend of the Estradas, is another local broker found to have violated trading rules by the CSG. Go's name is mentioned in the PSE report as the original recipient of 10 million shares from Tan's account with Armstrong.

Tan later instructed Armstrong to transfer the shares to the account of Ramon Lee. The same report noted that the Tektite branch of Equitable PCI allowed a check with payee '3707' to be deposited to a checking account maintained in the bank.

The same social ties bound the individuals involved in the scam. Besides Dante Tan, others implicated were known presidential cronies Lucio Co and Carmelo Santiago. Co brought his wife, two sisters-in-law, a business associate and several friends into the picture. Ramon Lee, who figured in the transfer of shares to various accounts, was a business associate of Tan and a former Director of BW Resources. Most of the shares sold through private placement arranged by PCCI were bought by members of the Galang family, various investment accounts of PCCI and staff members.

The third factor that renders the stock exchange vulnerable to corrupt trading practices is the fact that companies listed in the exchange are publicly owned only in name. For most of these companies, operating (simple majority) and strategic control (two-thirds majority) were in the hands of a few large shareholders. Ownership data for 194 listed firms in 1997 reveal that the top shareholders owned an average 41 percent of the market value of non-financial companies and 27 percent of financial companies. The same data show that the top five shareholders controlled 65 percent of listed non-financial companies and 59 percent of financial ones. In other words, five shareholders had majority control over a typical listed company. Control was virtually complete for the top 20 shareholders: 76 percent for both financial and non-financial sectors.

High ownership concentration encourages corrupt trading practices.

High ownership concentration encourages corrupt trading practices in two ways. First, through its impact on the quality of corporate governance in which ownership is a key element. Effective participation by minority investors in the firms improves corporate governance by ensuring that management and large shareholders do not expropriate company assets for their private benefit. Information disclosure is crucial to the ability of minority investors to effectively exercise control over company decisions. Dispersed ownership then improves transparency.

Second, ownership affects share price formation through stock liquidity. Dispersed ownership implies that a greater proportion of equity is traded in the exchange. The data on ownership however shows that listed companies barely trade the required minimum number of shares – 10 to 20 percent of outstanding shares. The lack of liquidity renders stocks vulnerable to manipulation.

A related issue is the continued trading of shell companies and the use of these companies for speculative trading and 'backdoor listing'. This practice and the danger it poses to market integrity became evident in the BW scam. If things had worked out the way Tan and his cohorts planned it, BW Resources would have served as a vehicle for the public listing of Best World Gaming and Entertainment Corp., a privately held company owned by Tan which was granted two online gaming franchises by PAGCOR. As a small capitalization stock (roughly a billion pesos at the start of 1999, 25 percent of which was floated on the exchange), BW Resources was ideal for manipulating the market.

Last in this list of institutional weaknesses is poor market governance. The absence of an effective regulatory system is a product of the history of the market, the balance of economic interests within the exchange and the nature of the political regime whose influence permeated the market. We discuss the state of market regulation in more detail below.

See-no-evil-hear-no-evil regulation

The BW case highlighted the failure of market regulation. Estrada's intervention in the investigation of the case was only the tip of the iceberg: at bottom was a system that had been rendered ineffective by deliberate design and neglect. Failure was evident at all levels of regulation — from the PSE which briefly enjoyed self-regulating organization (SRO) status, to the Securities and Exchange Commission (SEC), the watchdog of the capital market, all the way to the Department of Justice (DoJ) which is tasked to prosecute parties found in violation of the laws on stock trading. Several weaknesses are evident in the existing regulatory framework. For one, self-regulation in the context of control of the exchange by brokers gives rise to issues of conflict of interest. Moreover, regulatory capacity is weakened by the lack of clear rules governing illegal trading activities and the inability of the PSE and the SEC to implement existing rules. Finally, regulatory agencies lacking a tradition of independence are permeable to external influences.When the BW scam occurred, the PSE had just become a self-regulating organization. Using self-regulation, it writes and enforces its own rules and regulations in accordance with the Securities Act governing stock trading, even as the SEC continues to exercise its regulatory powers. There are two advantages in a system of self-regulation. First, a self-regulating body derives status, respect and self-respect since it is trusted to regulate itself, motivating it to make the system work. Second, a body in charge of its own standards and their enforcement is well placed to develop appropriate and workable methods to maintain these standards, whereas externally imposed regulation may prove inappropriate, inflexible or unworkable.

Revoked in the wake of the price manipulation scandal[9], self-regulation was doomed to fail in the face of ownership and control by brokers of the exchange. Self-regulation requires a high degree of separation and independence from the affected parties, thereafter, serious conflicts of interest arise. The dominance by small brokers of the Board of Governors and key committees of the PSE explained the reluctance of the PSE leadership to look into the BW scam and to punish the parties involved. This despite sufficient evidence gathered by the Compliance and Surveillance Group (CSG), the PSE's internal regulator, and mounting public pressure to do so.

Self-regulation is also undermined by weak regulatory capacity. The problem is not so much in the law as in its implementation. Many provisions of the RSA have no implementing rules and regulations, making it difficult to prosecute erring brokers.[10] The adoption of the system of self-regulation in 1998 was not accompanied by procedural guidelines, leaving the PSE and the SEC to do as they pleased. In some cases, the PSE and the SEC conducted joint investigations. In others, the SEC took the initiative. In the BW case, the PSE complained that it was left alone to deal with the fiasco. The SEC sent two teams of investigators to the PSE to look into the BW case, only to pull them out two days later without explanation. On November 25, 1999, the SEC suspended all investigations related to the case to avoid duplication of the PSE's efforts.

Where the rules are clear, there was readiness to set them aside. For example, the share-for-property swap between BW and Megaworld, another publicly listed company, was signed on October 1999. The agreement required BW to issue 1.2 billion in new shares, raising the company's outstanding shares to 2 billion. But a month later, the additional shares had yet to be listed with the PSE as required by the rules.

Weak regulatory capacity combined with a laid-back attitude allowed the BW scam to proceed unchecked. As a rule, company disclosures are rarely, if ever, examined critically. Trading was suspended several times when the price breached the range within which it was allowed to move during the day. But no action was taken beyond asking the company the reason behind the unusual price movement. The response of company officials was unvarying: "We have no knowledge of any material information that might have affected prices."

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Neither did PSE regulators question BW officials who presented a number of acquisition plans to the public which would have involved the issuance of several billions of new shares despite the fact that the company's outstanding shares amounted to no more than 425 million. Company officials were not required to present business plans and the necessary financial projections. Instead, they adopted a company report issued by PCCI Securities as part of company disclosure, but even this was based on overly optimistic assumptions and was not supported by the necessary financial statements.

The entry of Stanley Ho into the company did not alarm the PSE regulators. Instead, Ho was shown the red carpet by PSE officials and given the honor of ringing the trading bell at the Ayala trading floor. Company officials claimed that Macau's gambling tycoon, who was elected chairman, infused some $30 million into the company. Records, however, showed he had no more than 10,000 shares to his name.

Under the existing regulatory framework, regulatory authority is lodged primarily with the SEC. Self-regulation by the PSE provides an additional layer of market regulation; it does not diminish the responsibility of the SEC to act as watchdog of the capital market.[11] Ensuring that the PSE meets its responsibilities as a self-policing institution is an important task of the SEC. Its primary function, however, is to prevent and to punish fraud in order to maintain the integrity of the securities market.

The BW case brought the long-standing weaknesses of the SEC as a regulatory institution out in the open. The watchdog of the capital market, it adopted a see-no-evil-hear-no-evil attitude in regulating the market. In its 50-year existence, no person had ever been convicted of insider trading or any illegal trading activities, a fact that speaks more of the poor state of market regulation than of the integrity of the stock market. While constitutionally independent, it has not been beyond the reach of politics and the influence of vested interests. As a quasi-judicial body, it has not avoided charges of corruption from lawyers and litigants. As a collegial body, it has, during critical moments, failed to speak with a single voice, effectively undermining its authority.

The inaction of the SEC was most evident in the BW case. It issued its first official directive regarding the trading of BW shares on 30 September 1999, only two weeks before the stock hit its peak on 11 October. The SEC directed the PSE to inform the Commission within five days of any surveillance measures the PSE was undertaking to ensure there were no irregularities in the trading of BW shares. In late October after the stock had collapsed, the SEC sent two investigating teams to the PSE but recalled them two days later. On 25 November, it suspended all investigations related to the BW.

Constitutionally independent, the SEC was subjected to intense pressure from the highest office of the land. Preparatory to the manipulation of the market, EO 63, issued on 13 January 1999, placed the SEC under the direct supervision of the Office of the President. On 6 September, the President issued Memorandum Order 73 which required that 'investigations of any transactions or entity under the supervision or regulation by the SEC shall not be conducted ... except by authority of the Commission en banc.' The order likewise provided that any case or matter handled by any hearing officer, auditor, investigating officer or examining officer shall not be reassigned to another without the consent of the Commission en banc. This order effectively clipped the powers of the SEC chief who was then at odds with Malacanang.

The President issued a gag order on the SEC Chairman. The order directed the Chairman 'to refrain from issuing public statements and policy declarations affecting the securities market... without prior clearance or approval of the Office of the President.' Finally, there was the series of calls from the Office of the President to SEC officials, including the Chairman, to influence the ongoing investigations. Malacanang's intervention took a heavy toll on the effectivity and integrity of the SEC. An SEC order issued on March 7 suspending trading in the PSE was set aside the following morning by another order signed by four commissioners, not including the SEC chairman. At a most critical period, the SEC could not get its act together.

To its credit, the SEC conducted its own probe of the scam and in the process came up with three reports which served as the basis for the filing of charges against the parties involved. Issued after the PSE report on the scam, they improved on the report and offered comprehensive documentation of the build up of the bubble until it burst in October 1999.

The emasculation of the regulatory mechanism did not end with the SEC. Malacañang's influence was likewise only too apparent when the case reached the Department of Justice (DoJ). After months of stalling, the DoJ finally issued the result of its preliminary investigation into the complaint filed by the SEC. In the midst of the impeachment process, the DoJ agreed to file charges against Tan but only for the lightest offense – nondisclosure of significant ownership of a listed company. It cleared all the brokers involved on the grounds that one could not possibly arrange a wash sale or a matched order since trading at the stock exchange was done through a computer system. This, despite documents showing that such illegal trades were done – and done many times over.

Concluding remarks

The change in government following the aborted impeachment trial changed the course of the BW case. The new administration has taken the first steps to close this dark chapter in the history of the stock market. The SEC filed a new complaint with the DoJ against a dozen brokers and close to 50 individuals led by Tan and other Estrada cronies, accusing them of market manipulation and other violations of the securities law. Charges of graft and corruption against Estrada on the basis of the BW scam have also been filed with the Sandiganbayan.

Beyond the legal battles, the more difficult task of reforming and of strengthening the stock market and its regulatory framework lie ahead. The current structure of economic interests that underlie the stock exchange and the market's governance mechanism renders it vulnerable to market manipulation. The major obstacles in promoting transparency of transactions and therefore of fair price formation are the dominance of small, family-controlled brokerages, high ownership concentration among listed firms, control by brokers of the PSE leadership reinforced by informal networks and channels of authority and the lack of independent regulators. Poor regulation is less an accident of history than a product of the balance of interests that has dominated the market. It is these weak institutions within the exchange that allowed political corruption as exemplified by the BW price manipulation scandal to work its way through the market.

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Our discussion of the BW case carries several implications. One, corruption is not the monopoly of the state. It also afflicts the market. What produced an explosive case like the BW crisis was the combination of state and market corruption. While related, these two processes are to a large degree independent of each other. It did not take the exercise of state prerogatives to manipulate the price of BW shares, although such manipulation referred to state franchises and contracts with government.

Two, the need for strong regulation in the financial and capital markets. Financial markets, in particular the capital market, present a special case because these markets are inherently prone to fraud. It should not be a surprise that the most sought after stock exchange in the world – the New York Stock Exchange – is also the most heavily regulated. In the absence of an effective regulatory framework, we should be very cautious about developing the capital market.

Three, the importance of institutions within the market and the link between interests and institutions. Most crucial at this point is the ownership structure and control of the PSE. Reform in this area is critical if the self-regulation adopted by the new securities code is to become meaningful. SRO or not, market regulation is implemented by or filtered through the workings of the PSE. That is why it is necessary to restructure the Exchange.

Many of the issues brought out by the BW scandal have been addressed by the Revised Securities Act of 2000. Reforms, however, have met vigorous opposition from affected parties. Reforms such as demutualization of the PSE which aims to separate ownership and management of the Exchange, the removal of the broker-dealer rule, the increased power of the SEC to examine the books of brokers, have been effectively stalled and opposed by affected brokers.

What makes the task doubly difficult is that the domestic brokers who dominate the PSE have been regaining lost ground in terms of market share as a result of the prolonged weakness in the market. The weak market recovery since the crash of 1997/1998 has been propelled mainly by local players. A strong resolve combined with creativity will be needed to sustain the momentum of reforms so far.

Notes

1 A similar application filed by Tan before Estrada assumed the presidency was rejected by PAGCOR.
2 Market price is misleading as an indicator since it is grossly inflated.
3 The illegal acts included wash sale, matched order, marking the close, over-the-counter transfer of shares, private placement with lock up, short sale rule, kiting, 'done thru' trades, improper extension of credit, net capital rule, listing and disclosure rules, broker-director rule.
4 One board position per year is counted as one. The rest of the board seats are reserved for non-brokers.
5 ING Baring and Merrill Lynch.
6 Foreign brokers did not play an active role in the scam, not only because of internal controls but also because foreign institutional investors as a rule cannot invest in stocks like BW which do not meet certain criteria such as stock liquidity, track record of dividend payments, etc.
7 Firm size does not say much about willingness to engage in fraud. Abacus, PCCI, Securities 2000, Angpin and Associates, and Wealth are among the top domestic brokers in the country found to have been actively involved in the BW scandal.
8 The following are the brokers who held a seat in the Board and the year they were members of the Board: Aurora (1998), PNB (1998), Wealth (1996), Belson (1996-1999), Abacus (1997-1999), and Angpin and Associates (1996).
9 The concept of self-regulation is formally adopted by the Revised Securities Act of 2000.
10 Until recently, the lack of clear rules and procedures was not confined to the Securities Law. In 1999, the SEC finally adopted corporate bankruptcy procedures on the basis of PD 902-A promulgated in 1972.
11 When the US Congress created the US Securities and Exchange Commission in 1934, stock exchanges had had a 140-year history of regulating their own members. The SEC was superimposed on this system of 'self-regulation' as an addition level of regulation. (Ilano and Mariano, 1995, p. 61)

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