

**[SEC MEMORANDUM CIRCULAR NO. 2, S. OF 2002,
APRIL 5, 2002, April 05, 2002]**

CODE OF CORPORATE GOVERNANCE

In accordance with the State's policy to actively promote corporate governance reforms aimed to raise investor confidence, develop capital market and help achieve high sustained growth for the corporate sector and the economy, the Commission, in its Resolution No. 135, Series of 2002 dated April 04 2002, approved the promulgation and implementation of this Code, which shall be applicable to corporations whose securities are registered or listed, corporations which are grantees of permits/licenses and secondary franchise from the Commission and public companies. This Code also applies to branches or subsidiaries of foreign corporations operating in the Philippines whose securities are registered or listed.

I. *Definitions*

A. *Board of Directors* — refers to the collegial body that exercises the corporate powers of all corporations formed under the Corporation Code. It conducts all business and controls or holds all property of such corporations.

B. *Corporate Governance* — refers to a system whereby shareholders, creditors and other stakeholders of a corporation ensure that management enhances the value of the corporation as it competes in an increasingly global market place.

C. *Independent Director* — refers to a person other than an officer or employee of the corporation, its parent or subsidiaries, or any other individual having any relationship with the corporation, which would interfere with the exercise of independent judgment in carrying out the responsibilities of a director. This means that apart from the directors' fees and shareholdings, he should be independent of management and free from any business or other relationship which could materially interfere with the exercise of his independent judgment.

D. *Public Company* — refers to any corporation with a class of equity securities listed in an Exchange or with assets in excess of Fifty Million Pesos (P50,000,000.00) and having two hundred (200) or more stockholders each holding at least one hundred (100) shares of a class of its securities.

E. *Management* — refers to the body given the authority to implement the policies determined by the Board in directing the course/business activity/ies of the corporation.

F. *Executive Director* — refers to a director who is at the same time appointed to head a department/unit within the corporate organization.

G. *Non-executive director* — refers to a Board member with non-executive functions.

H. *Non-audit work* — refers to other services offered by the external auditor to a corporation that are not directly related and relevant to its statutory audit function. Examples include accounting, payroll, bookkeeping, reconciliation, computer project management, data processing or information technology outsourcing services, internal auditing, and services that may compromise the independence and objectivity of the external audit.

I. *Internal control* — refers to the process effected by a company's Board of Directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the effectiveness and efficiency of operations, the reliability of financial reporting, and compliance with applicable laws, regulations, and internal policies.

J. *Internal control environment* — refers to the framework under which internal controls are developed, implemented, alone or in concert with other policies or procedures, to manage and control a particular risk or business activity, or combination of risks or business activities, to which the company is exposed.

K. *Internal auditing* — refers to an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

L. *Internal Audit Department* — refers to a department, division, team of consultants, or other practitioner(s) that provide independent, objective assurance and consulting services designed to add value and improve an organization's operations.

M. *Chief Audit Executive* — refers to the top position within the organization responsible for internal audit activities. In a traditional internal audit activity, this would be the internal audit director. In the case where internal audit activities are obtained from outside service providers, the chief audit executive is the person responsible for overseeing the service contract and the overall quality assurance of these activities, and follow-up of engagement results. The term also includes such titles as general auditor, chief internal auditor, and inspector general.

N. *Independence* — refers to that environment which allows the person to carry out his/her work freely and objectively.

O. *Objectivity* — refers to unbiased mental attitude that requires the person to carry out his/her work in such a manner that he/she has an honest belief in his/her work product and that no significant quality compromises are made. Objectivity requires the person not to subordinate his/her judgment to that of others.

P. *Standards for the Professional Practice of Internal Auditing (SPPIA)* — refers to the criteria by which the operations of an internal auditing department are evaluated and measured. They are intended to represent the practice of internal auditing as it should be, provide a framework for performing and promoting a broad range of value-added internal audit activities and foster improved organizational processes and operations.

II. The Board Governance

The Board of Directors (Board) is primarily responsible for the governance of the corporation. It needs to be structured so that it provides an independent check on management. As such, it is vitally important that a number of board members be independent from management.

1. Composition of the Board

The Board shall be composed of at least five (5) but not more than fifteen (15) members elected by shareholders. Public companies shall have at least two (2) independent directors or such independent directors shall constitute at least twenty percent (20%) of the members of such Board, whichever is the lesser. All other companies are encouraged to have independent directors as well.

The Board may include a balance of executive and non-executive directors (including independent non-executives), having a clear division of responsibilities such that no individual or small group of individuals can dominate the Board's decision making.

The non-executive directors should be of sufficient qualifications, stature and number to carry significant weight in the Board's decisions. Non-executive directors considered by the Board to be independent shall be identified in the annual report.

2. Multiple Board Seats

The Board may consider guidelines on the number of directorships for its members. The optimum number is related to the capacity of a director to perform his duties diligently in general. The Chief Executive Officer and other executive directors may submit themselves to a low indicative limit on membership in other corporate Boards. The same low limit may apply to independent, non-executive directors who serve as full-time executives in other corporations. In any case, the capacity of directors to serve with diligence shall not be compromised.

3. The Chairman and the Chief Executive Officer

The roles of the Chairman and the Chief Executive Officer ("CEO") may be separate to ensure an appropriate balance of power, increased accountability and greater capacity of the Board for independent decision-making. The company shall disclose the relationship between the Chairman and the CEO upon their election.

Where both positions of the Chairman and CEO are unified, there is clearly one leader to provide a single vision and mission. In this instance, checks and balances should be clearly provided to help ensure that independent, outside views, perspectives, and judgments are given proper hearing in the Board.

The Chairman's responsibilities may include:

- a. schedule meetings to enable the Board to perform its duties responsibly while not interfering with the flow of the company's operations
- b. prepare meeting agenda in consultation with the CEO;
- c. exercise control over quality, quantity and timeliness of the flow of information between Management and the Board; and

- d. assist in ensuring compliance with company's guidelines on corporate governance.

The responsibilities set out in the above guidelines may pertain only to the Chairman's role in respect to the Board proceedings. It should not be taken as a comprehensive list of all the duties and responsibilities of a Chairman.

4. Qualifications of Directors

Every director shall own at least one (1) share of the capital stock of the corporation of which he is a director, which share shall stand in his name in the books of the corporation.

The Board may provide for additional qualifications of a director such as, but not limited to the following:

- a. Educational attainment
- b. Adequate competency and understanding of business
- c. Age requirement
- d. Integrity/probity
- e. Assiduousness

5. Disqualification of Directors

The following shall be grounds for the disqualification of a director:

a. Any person who has been finally convicted by a competent judicial or administrative body of the following: (i) any crime involving the purchase or sale of securities, e.g., proprietary or non-proprietary membership certificate, commodity futures contract, or interest in a common trust fund, pre-need plan, pension plan or life plan; (ii) any crime arising out of the person's conduct as an underwriter, broker, dealer, investment company, investment adviser, principal distributor, mutual fund dealer, futures commission merchant, commodity trading advisor, floor broker; and (iii) any crime arising out of his relationship with a bank, quasi-bank, trust company, investment house or as an affiliated person of any of them.

b. Any person who, by reason of any misconduct, after hearing or trial, is permanently or temporarily enjoined by order, judgment or decree of the Commission or any court or other administrative body of competent jurisdiction from: (i) acting as an underwriter, broker, dealer, investment adviser, principal distributor, mutual fund dealer; futures commission merchant; commodity trading advisor, or a floor broker; (ii) acting as a director or officer of a bank, quasi-bank, trust company, investment house, investment company or an affiliated person of any of them; (iii) engaging in or continuing any conduct or practice in connection with any such activity or willfully violating laws governing securities, and banking activities. Such disqualification shall also apply when such person is currently subject to an effective order of the Commission or any court or other administrative body refusing, revoking or suspending any registration, license or permit issued under the Corporation Code, Securities Regulation Code, or any other law administered by the Commission or Bangko Sentral ng Pilipinas, or under any rule or regulation promulgated by the Commission or Bangko Sentral ng Pilipinas, or

otherwise restrained to engage in any activity involving securities and banking. Such person is also disqualified when he is currently subject to an effective order of a self-regulatory organization suspending or expelling him from membership or participation or from associating with a member or participant of the organization.

c. Any person finally convicted judicially or administratively of an offense involving moral turpitude, fraud, embezzlement, theft, estafa, counterfeiting, misappropriation, forgery, bribery, false oath, perjury or other fraudulent act or transgressions.

d. Any person finally found by the Commission or a court or other administrative body to have willfully violated, or willfully aided, abetted, counseled, induced or procured the violation of any provision of the Securities Regulation Code, the Corporation Code, or any other law administered by the Commission or Bangko Sentral ng Pilipinas, or any rule, regulation or order of the Commission or Bangko Sentral ng Pilipinas, or who has filed a materially false or misleading application, report or registration statement required by the Commission, or any rule, regulation or order of the Commission.

e. Any person judicially declared to be insolvent.

f. Any person finally found guilty by a foreign court or equivalent financial regulatory authority of acts; violations or misconduct similar to any of the acts, violations or misconduct listed in paragraphs (a) to (e) hereof.

g. Any affiliated person who is ineligible, by reason of paragraphs (a) to (e) hereof to serve or act in the capacities listed in those paragraphs.

h. Conviction by final judgment of an offense punishable by imprisonment for a period exceeding six (6) years, prior to the date of appointment.

The Board may also provide for the temporary disqualification of a director for the following reasons:

a. Refusal to fully disclose the extent of his business interest as required under the Securities Regulation Code and its Implementing Rules and Regulations. This disqualification shall be in effect as long as his refusal persists.

b. Absence or non-participation for whatever reason/s for more than fifty percent (50%) of all meetings; both regular and special, of the Board of directors during his incumbency, or any twelve (12) month period during said incumbency. This disqualification applies for purposes of the succeeding election.

c. Dismissal/termination from directorship in another listed corporation for cause. This disqualification shall be in effect until he has cleared himself of any involvement in the alleged irregularity.

d. Being under preventive suspension by the corporation.

e. If the independent director becomes an officer or employee of the same corporation he shall be automatically disqualified from being an independent director.