Best World Resources Stock Scandal of 1999 and Enactment of the Philippine Securities Regulation Code of 2000

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Abstract: The Philippine Stock Exchange (PSE) experienced the biggest insider trading scandal in 1999. The BWR scandal was so immense that the closure of the PSE was considered. A positive offshoot of the scandal was the enactment of the Philippine Securities Regulation Code (SRC) of 2000. The new code added new regulations on insider trading, and separated the broker and dealer function to avoid conflicts of interest. The BWR insider trading scandal not only served as a lesson on the value of regulatory-compliance and honest trading practices, but also showed the importance of long-term investing potential over the short-term gains of unethical financial market schemes.

Overview

The Best World Resources (BWR) Stock Scandal of 1999 is the biggest insider trading scandal to hit the Philippine Stock Exchange (PSE) to date. The scandal was so large and controversial that the closure of the bourse was contemplated in its aftermath. The BWR stock scandal was also a primary reason why a former Filipino President, Joseph Estrada, was forced to leave his office in January 2001. The independent government investigation found conflicts of interest in the issuance of gambling licenses, and the former President's involvement in the insider trading scandal. The Philippine Securities Regulation Code (SRC) of 2000 was the positive offshoot of the scandal, and was enacted to regain public trust in the PSE.

According to Aggarwal & Wu (2003) all informed insider parties in a corporation are likely to be manipulators, thus, strong guidelines should be implemented to

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minimize, if not totally eliminate transfer of private information to the detriment of public investors. The SRC contained new prohibitions on insider trading and related transactions, which separated the broker and dealer function to prevent market abuse and fraud. The BWR scandal offered a lesson of being regulatory-compliant, and the importance of seeing the long-term investment promise of sound fundamentals over the short-term gains of market manipulation.

Case Objectives

This case examines the biggest stock trading scandal in the Philippines stock market, and illustrates how stock market reforms regained the trust of both foreign and local investors. First, it describes the events that led to the BWR insider trading scandal, and how conflicts of interest of major players contributed to the financial market scam. Second, the case also explains how the SRC empowered the Securities and Exchange Commission (SEC) in preventing insider trading, and in investigating market irregularities. Lastly, the case discusses how the involved personalities were punished, and shares lessons that every investor can learn from this scandal.

Business and Political Connections

Best World Gaming and Entertainment Corporation (BWGE) was formed by Mr. Dante Tan in early 1998. During the same period, a leisure and tourism company, Greater Asia Resources, headed by a soon-to-be business partner, changed its name to BWR. In December 1998, BWGE was awarded the exclusive 10-year contract to operate a nationwide online Bingo franchise, and the more popular Quick-Pick-2, a two number lottery game. The contract from the government came from the Office of the President, and was allegedly due to the close relationship between Mr. Tan and the former Philippine President, Mr. Joseph Estrada. During the first half of 1999, BWGE became a subsidiary of BWR when Mr. Tan bought a majority stake of BWR, and was given full control of the gaming company. When Mr. Tan decided to make BWR public, the former PSE Chairman, Mr. Jose Pardo said *"I've been hearing the phenomenon of BW (Resources) as an exciting listing because it had all the elements of a successful listing."* (Del Monte, 2016). In 1999, the ventures of BWR were expected to yield high returns, because it was seen as a precursor of the new age of the local gaming industry.

The Philippine government-owned enterprise, Philippine Amusement and Gaming Corporation (PAGCOR) announced in the middle of 1999 its intention to operate a casino in Sheraton Marina Square near Manila Bay, which was owned by the companies of Mr. Tan. It was also during this time when both BWR and BWGE became co-borrowers of a PHP600 million loan from the Philippine National Bank, which was then a government-owned bank. Additional investments were also expected to pour in when Macau's gambling mogul, Mr.

Stanley Ho was announced to become BWR's chairman. These promising developments, which started in the 4th quarter of 1998, attracted massive investor interest in BWR stock that fueled further stock buying.

Insider Trading and Stock Manipulation

Despite the bearish general economic sentiment coming from the 1997 Asian Crisis, BWR's stock price continued to rise until it reached it's peak in October 1999 at PHP145.00 (approximately USD2.70 using 4Q 2018 rate), from a measly PHP0.80 a year ago, October 1998. The stock of BWR even became the most traded stock in the PSE, and accounted for 50% of total trades, or an equivalent of PHP3.19 billion worth of trading volume (Business World Archives, 2009).

The hefty and irregular price movements, especially from the last month of its climb, from PHP53.000 in September 1999, prompted investigations by the SEC and PSE. Both unearthed price manipulation and illegal insider trading on the part of the owner and some top executives of brokerage firms. Investigators found heavy buying by the owner from February to May of 1999 giving BWR's initial gains. Then from June to October 1999, the owner sold shares to friends and clients at a discount. These trades were executed on the PSE board at prices sometimes over twice the amount actually paid. They were made to boost trading volume, and to create an impression BWR's stock was actively traded. The investigation found the daily turnover circulated only among 10 brokerage firms. Both the SEC and PSE also discovered that BWR was engaging in *"wash sales"* or stock transactions wherein the buyer and seller are the same.

During the height of the investigation of the BWR stock scandal, a well-known Public Relations (PR) man of the President, Mr. Salvador Dacer, was kidnapped and murdered together with his driver. Police investigators believed that it was connected with the BWR scandal because the PR man knew about Mr. Estrada's connection with Mr. Tan, and their involvement in the stock price manipulation and insider trading scandal. It was also later found out, that Mr. Tan had a USD1 million bounty assassination contract on his head from the members of the Manila Chinese Community because of his shady business dealings. What made the scandal more controversial was the discovery that the government investigation was also pushed by the Catholic Church, an influential institution in Philippine politics, which was opposed to the planned visit of BWR's Chairman. Mr. Ho was accused of being part of the mafia organization, Kung Long Chinese Triad. This resistance from the Catholic Church increased public attention, and created a sudden decline in BWR's stock price. From its peak of PHP145.00, the stock plunged to just below PHP30.00 in a matter of weeks when the Catholic Church became involved. The BWR stock continued to fall, and even reached PHP1.00. Thousands of unwitting traders and investors lost millions.

Vigilant Reforms

The Philippine SEC, in March 2000, suspended the PSE's license to operate, and started to implement reforms through the enactment of the Philippine SRC (Republic Act 8799) or the Securities Act of 2000, in July 2000. The Act aimed to improve transparency in the capital market, to uphold self-regulation in the securities industry, to guarantee the protection of all investors, and to encourage full and fair disclosure and eliminate fraud and manipulation. The SRC sent a strong signal that the SEC was firmly committed to improving the local capital market and protecting its local and foreign investors. The SEC also entered into demutualization, wherein a majority of the board of directors had to be non-brokers to limit conflicts of interest and ensure the organization acts in the interest of investors and not brokers (SEC Philippines, 2009). Significant features of the SRC are listed below.

a) The SRC gave additional powers to the SEC to enforce securities law and address market abuses. The SRC also mandated the SEC to do a complete overhaul of the organization, and allowed the organization to pay more competitive salaries to attract more capable and ethical staff needed to restore its credibility.

b) The SRC mandated that investors be provided with up-to-date material information to enable investors to make informed investment decisions. This full-disclosure approach required the SEC to review the compliance of disclosure documents. The Republic Act 8799 also made the signatories (i.e., issuer, underwriters, corporate secretary, directors and related parties) of the registration and disclosure documents, administratively and criminally liable if wrongdoings were uncovered.

c) The SRC improved the integrity of the securities market by requiring the PSE to go through a demutualization process and become a publicly held corporation. The SRC also required the PSE to be managed by an independent and professional group, a majority of which are non-brokers to minimize conflicting interests.

d) The SRC provided better protection to minority shareholders to attract a more diverse group of foreign and local investors. The Republic Act 8799 required mandatory tender offers to an investor or a group of investor planning to acquire 15% of a listed company, or intending to buy at least 30% of the public company over a year.

The SRC generally gave the SEC flexible governance to enable it to resolve cases expeditiously during a financial market investigation. The BWR insider trading scandal became the focal point of the government policy to minimize, if not totally eliminate insider trading. The market is now highly regulated under Sections 23 and 27 of the SRC to eradicate bias in market activities on the part of insiders against the investing public. This suggests a strong role for government regulation to discourage manipulation while encouraging greater competition for information (McGee, 2004). The SRC has limitations and insider trading can't be avoided, but lines should be drawn to set the limits.

People Power and the Rule of Law

The BWR insider trading scandal along with its political and social ramifications was so glaring and extensive that it scared away a large number of investors, both foreign and local. The uncertainty plaguing the financial market, caused it to fall in late 1999 until the fourth quarter of 2000. During this period, criminal cases against Mr. Tan and the parties involved, and the impeachment trial of Mr. Estrada hardly moved despite the strong evidence presented. However, because of the growing political indecision and the unethical conduct of Mr. Estrada, the Filipino people showed growing disenchantment with the administration and ousted the former President through a People Power Revolution from January 17 to 20, 2001. Hundreds of thousands of Filipinos gathered in the streets and forced Mr. Estrada to leave office.

In March 2002, and with the crony in government of Mr. Tan removed, insider trading charges were filed against him and his cohorts. The accused filed a motion to void the charges. Given the influence and wealth of Mr. Tan's group, the ruling of the lower court granted their motion in August 2007, and dismissed their offenses. The government elevated the case to the Court of Appeals, and was able to reverse the ruling of the lower court to dismiss the accused parties in April 2009. The higher court upheld the charges against the group of Mr. Tan in connection with insider trading and price manipulation of BWR's stock.

Lessons Learned

The serious flaw in financial markets especially those in the growing stage, is the limited protection of minority investors or the investing public in a stock market with high concentrated ownership. A paper by De Ocampo (2000) on corporate ownership and governance explains that insider trading is a special case of conflict of interest that should be prevented through well-defined trading regulations. Many Filipino public investors made their money from the BWR stock, and were able to sell on near peak levels. However, most unwitting outsider investors also rode the wave, and bought at near peaks only to lose money.

Greed certainly came into play when the BWR stock price was continuously rising. The increasing stock trading due to *"wash sales"* and fake volumes mattered more despite fundamental analysis that BWR's value was intrinsically dependent on Mr. Tan's relationship with Mr. Estrada, and that follow-up projects had no solid future. The Net Present Value was even negative at some point on BWR's cash flow. Technical analysis indicated that BWR's Relative Strength Index showed strong overbought signals, and the stock was overpriced. However, nothing beats the returns investors experience in the short-run, and the atmosphere or negligent optimism and greed took over.

Bainbridge (2000) argues that the property right to inside stock information should be transparent. Both insiders from the corporation and investing public should mutually benefit. The BWR insider trading scandal served as a lesson to the value of being a regulatory-compliant company, and that corporate insiders should be ethically driven. The case further illuminates the long-term investing potential of solid fundamentals over the short-term gains of hype and unethical financial market schemes.

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