Republic of the Philippines
Department of Finance
Securities and Exchange Commission
SEC Building, EDSA, Greenhills, Mandaluyong City

16 April 2015

Re: Issuance of Securities of a Mutual Fund Company Apart From Its Authorized Capital Stock

VALERIE N. PAMA
Chief Operating Officer
SUN LIFE ASSET AND MANAGEMENT COMPANY
SUN LIFE OF CANADA (PHILIPPINES) INC.
The Enterprise Center
15th Floor, Tower 2
6766 Ayala Avenue cor. Paseo de Roxas
Makati City

Dear Ms. Pama:

This refers to your letter dated 14 October 2011 requesting for a favorable action that will allow Sun Life Asset and Management Company (SLAMC), being a mutual fund, to sell securities other than shares of its own authorized capital stock pursuant to the Investment Company Act of 1960[1] (ICA), vis-à-vis the Implementing Rules and Regulations of the said law (ICA Rule 35-1, as amended).

To recall, SLAMC requested, in its Letter dated 14 December 2009, that it be allowed to invest in off-shore domiciled mutual funds. However, the Corporation Finance Department (CFD)[2] of the Commission informed SLAMC that the Commission *En Banc* in its meeting on 14 July 2011 resolved to deny such request.[3] Thereafter, the undersigned and the representatives of SLAMC, including yourself, attended a meeting at the office of the undersigned in which the issue as to whether a mutual fund can sell other securities was discussed.[4] On 17 October 2011, the undersigned received your request letter dated 14 October 2011 and the Commission noted that the issues raised therein *partake of the nature of a request for an opinion.*

The Commission conducted public consultations and requested mutual fund companies, mutual fund holders, victims of investment companies, other related

[1] Republic Act No. 2629.
[2] Now known as the Corporate Governance and Finance Department (CGFD).
[3] Letter of the CGFD addressed to SLAMC dated 21 July 2011.
[4] Meeting held on 12 October 2011.

stakeholders and the general public to submit their comments. However, only SLAMC submitted its position paper.[5]

In short, you are of the view that the ICA, the law governing mutual funds, permits a mutual fund to sell securities other than its shares of stock, contrary to the more restrictive interpretation of the Commission, *i.e.*, that a mutual fund can only issue its shares of stock.

Thus, in order to properly address your queries, the following issues shall be addressed: (1) the use of the term "securities" under the ICA and the Securities Regulation Code (SRC);[6] and (2) the over-all intent of the ICA and its implementing rules relative to the sale of "securities" of a mutual fund other than their own shares of stock.

Plain meaning of "Securities" under the ICA and SRC.

An "Investment Company" is defined by the ICA as "any issuer which is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading **in securities**".[7] Particularly, an "Open-end company", or commonly also known as a **"Mutual Fund"**, is an investment company which is **offering for sale or has outstanding any redeemable security** of which it is the issuer;[8]

A plain reading of the aforesaid provisions of the ICA uses the term "securities". The ICA's definition of "securities,"[9] essentially a word-by-word definition under the old Securities Law of 1936, encompasses different kinds of securities, of which "shares of stock" are just a specific form of securities. Republic Act No. 8799, the Securities Regulation Code (SRC) provides a similar definition in Section 3.1 thereof, to wit:

> "3.1. "Securities" are shares, participation or interests in a corporation or in a commercial enterprise or profit-making venture and evidenced by a certificate, contract, instrument, whether written or electronic in character. It includes:

[5] Position Paper received on 20 October 2014.
[6] Republic Act No. 8799.
[7] Section 4, Republic Act No. 2629.
[8] Section 5, *Id.*.
[9] Section 3 (bb), *Id.* *"any note, **stock**, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a 'security' or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing."* (Emphasis ours)

> "(a) **Shares of stock**, bonds, debentures, notes, evidences of indebtedness, asset-backed securities;
>
> "(b) Investment contracts, certificates of interest or participation in a profit sharing agreement, certificates of deposit for a future subscription xxx"

Again, it would appear that the term "securities" as used in the SRC encompasses a broad scope, i.e. aside from shares of stock, there are other forms of securities. In this regard, no such distinction can be made by means of interpretation or application. *Ubi lex non distinguit, nec nos distinguere debemus.*[10] Hence, the use of the term security cannot be confined to "shares of stock" alone but must likewise refer to other kinds and forms of securities pursuant to the ICA in relation to the SRC, considering that it has used the term "securities" rather than "shares of stock", which is only a specie of the former.

Issuance of securities other than its own shares is supported and recognized by the ICA and ICA Rule 35-1

Using the plain meaning of the term "securities", it would now appear that the ICA permits a mutual fund company to issue **securities other than its shares of stock**. An exhaustive analysis of the ICA would reveal such intent by the law, thus:

(1) The definition of an open-end fund refers to its nature: its "**offering for sale or has outstanding any redeemable security** of which **it is the issuer;**"

(2) Section 7 (b) (4) requires in the investment company's Registration Statement "the information and documents which would be required to be filed in order to register under the Securities Act **all securities (other than short-term paper) which the registrant has outstanding or proposes to issue**;"

(3) Section 16 (f) on the safe custody of securities and investments: "Every registered investment company **shall place and maintain its securities and similar investments** in the custody of (1) a duly organized local commercial bank of good repute; or (2) a company which is a member of a securities exchange as defined in the Securities Act, subject to such rules and regulations as the Commission may from time to time prescribe for the protection of investors; or (3) such registered company, but only in accordance with such rules and regulations or orders as the Commission may

---

[10] SEC-OGC Opinion 12-19, October 11, 2012, addressed to Romulo Mabanta Buenaventura Delos Angeles and Sayoc, citing Agpalo, Ruben E. Statutory Construction, 6th Edition (2009), pp. 289-290. (Citations omitted)

from time to time prescribe for the protection of investors. Rules, regulations, and orders of the Commission under this subsection, among other things, **shall make appropriate provision with respect to such matters as the earmarking, segregation, and hypothecation** **<u>of such securities and investments</u>** x x x"

(4) Section 22 on the distribution, redemption and repurchase of securities:

"(a) No **registered investment company** **<u>shall sell any redeemable security issued by it</u>** to any person except either to or through a principal underwriter for distribution or at a current public offering price described in the prospectus, and, if such class of security is being currently offered to the public by or through an underwriter, no principal underwriter of such security and no dealer shall sell any such security to any person except a dealer, a principal underwriter or the issuer, except at a current public offering price described in the prospectus: xxx"

x x x

"(c) No **registered open-end company shall restrict the transferability or negotiability** **<u>of any security of which it is the issuer</u>** except in conformity with the statements with respect thereto contained in its registration statement nor in contravention of such rules and regulations as the Commission may prescribe in the interests of the holders of all of the outstanding securities of such investment company.

"(d) No registered open-end company **<u>shall issue any of its securities</u>** (1) for services; or (2) for property other than cash or securities (including securities of which such registered company is the issuer), except as a dividend or distribution to its security holders or in connection with a reorganization.

(5) Finally, Section 24 provides for **procedures** **<u>for the registration of securities</u>** in accordance with law (at present, complying with Registration Requirements under Section 17 of the SRC);

Verily, the ICA recognizes the possibility that a mutual fund may issue its own securities other than its shares. Taking into consideration the term "securities" as plainly defined by the ICA in relation to the SRC, used in the aforesaid provisions, would connote that IT MAY ISSUE other securities. Besides, an otherwise restrictive interpretation would defeat the purpose of a mutual fund – that it **continually offers its shares for sale to the public and redeems its own shares, so that an investor**

purchases its shares from, and resells them back to the mutual fund, rather than from or to another investor.[11]

Apropos to the nature of a mutual fund - the continuous movement of its investments and active trading resulting from these being sold and resold to the mutual fund itself – is its susceptibility from the regular increase or decrease of its capital stock. Relative thereto, an ordinary corporation cannot at its own instance immediately increase or decrease its authorized capital stock without the approval of its board of directors and stockholders. As provided in Section 38 of the Corporation Code:

> "No corporation shall increase or decrease its capital stock or incur, create or increase any bonded indebtedness unless approved by a majority vote of the board of directors and, at a stockholder's meeting duly called for the purpose, two-thirds (2/3) of the outstanding capital stock shall favor the increase or diminution of the capital stock, or the incurring, creating or increasing of any bonded indebtedness. x x x"

In order to address this, **Section 22 (e)**[12] **of the ICA provides that the rules related to voting and approval requirements in the increase/decrease of capital stock does not apply to an investment company.**[13] By placing such exemption, mutual funds would be allowed to increase or decrease its authorized capital stock without need of undergoing tedious voting and approval procedures pursuant to the Corporation Code. Likewise, in allowing flexibility in the movement of the authorized capital stock, it follows that a mutual fund, in order to accommodate other investors, may now issue additional securities and papers in the furtherance of its business.

If a mutual fund would undergo such normal procedure in complying with the voting requirements of the Corporation Code as to the increase its authorized capital stock, it would be run against the fast-paced nature of the mutual fund. Instead of encouraging the free movement in the trade of its shares and securities, it would still be subject to voting procedures that would slow down its trade. By subscribing with the restrictive interpretation of limiting it to shares of stock, it will not in the first place facilitate any increase or movement in the capital stock, as a mutual fund is expected to

---

[11] 45 Am Jur 2d 902.

[12] "(e) The pertinent provisions of section seventeen of the Corporation Law (Act Numbered Fourteen hundred and fifty-nine, as amended) or any other provision of the said law in conflict with this section, **shall not apply to a registered open-end company**."

[13] **Section 17 of the Corporation Law is now Section 38 of the Corporation Code.** It must be emphasized that Section 22 (e) of the Investment Company Act was not expressly repealed by the Corporation Code. Considering that the specific provision refers to exception as to the rule on "increase and/or decrease of capital stock" which is also enunciated in the Corporation Code, such exception shall remain to be in legal force and effect.

issue more shares and securities to prospective investors above its original authorized capital stock to generate improved market movement and eventual return of investments.

ICA Rule 35-1 complements the ICA; nothing in the said implementing rules would indicate any restriction in the sale of other securities.

The implementing rules and regulations of the ICA is encompassed in ICA Rule 35-1. Initially conceived in 1989,[14] further revisions were made before it formally became effective in 1998. The salient features of ICA Rule 35-1, include the limiting the sale of securities other than its own shares, a high capital requirement (Php 50 Million paid-up capital) and minimum size of investment (Php5,000.00, no installments), made in order to protect investment companies from the unforeseeable, as well as to prevent any attempt at fraud.

A reading of the ICA Rules would reveal that it acknowledges the difference between "shares" and "securities". In Section (b) (2) of ICA Rule 35-1, the said implementing rules provide for the registration of mutual fund securities as provided by the then Revised Securities Act (now Section 17 of RA 8799):

> "**Any securities proposed to be issued and distributed or sold by the investment company** shall be registered in accordance with the Revised Securities Act and rules adopted pursuant thereto."

Likewise, in Section (c) of ICA Rule 35-1, referring to "Sale of Securities":

> "(c) Sale of Securities
>
> "(1) Unless the Commission shall otherwise prescribe, the minimum size of investment by any single investor in **shares/securities** issued by an investment company shall be the amount P5,000.00. Securities sold by an investment company shall be on a cash basis. Installment sales are hereby expressly prohibited.
>
> "(2) All proceeds from the sale of **shares/securities**, including the **original subscription/payments** at the time of incorporation constituting the original paid-in capital of the investment company shall be held by a custodian bank as required in paragraph (h) hereof.

---

[14] As published in the January 1990 SEC Bulletin, p. 117.

> "(3) The original proponents of the investment company who have subscribed and paid for the original capital of the investment company, shall not be allowed to sell, transfer, convey, encumber or otherwise dispose of their **shares/securities** within twelve (12) months from registration of said investment company.
>
> "(4) In case of open-end investment funds, the investment company may establish a network of redemption centers acceptable to the Commission."

It must be emphasized that Section (c) itself provides for the title "Sale of Securities", and provides for rules and limitations to "shares/**securities**" which connotes an "or" distinction. In particular is number (2) of the same Section, which states "proceeds from the sale of **shares/securities**, including the **original subscription/payments** at the time of incorporation constituting the original paid-in capital of the investment company shall be held by a custodian bank". **It must be emphasized that "original subscription" refers to "shares," while "payment" refers to securities.**

The closest perception of restriction can be found in the provisions of the ICA Rule 35-1 concerning reportorial requirements of the mutual fund. Section 10.3 of the 1989 version of ICA Rules provided for the reportorial requirements of a mutual fund before the Commission, thus:

> "10.3 Within thirty (30) days from effectivity of the Order approving the registration of the investment company, and within the first 5 days of every month thereafter, the investment company shall submit to the Commission a report under oath executed on its behalf by its Treasurer or any other officer, showing the total amount received **from the sale of its shares/securities** and the **percentage of such shares/securities** owned by Filipino investors and non-Filipino investors it being understood, that if **no shares/securities had been sold during the period**, a letter of advice to that effect shall be submitted to the Commission."

Note that the foregoing used the term "sales/**securities**" in the 1989 version, showing that there is a distinction as to the reporting of the mutual fund of **either its sold shares of stock** or **its sold securities**, as the case may be.

However, in Section (i) (2) the ICA Rule 35-1 issued in 1998, the abovementioned provision was slightly modified **that it removed the term "securities" and only retained "shares"** for reporting by the mutual fund before the Commission:

> "(2) Within thirty (30) days from effectivity of the Order declaring effective the registration of the investment company, and within the first ten (10) days of every month thereafter, the investment company shall submit to the Commission a report under oath executed on its behalf by its Treasurer or any other officer, showing the following information:
>
> "A) the total amount received from **sale of shares**;
> "B) the total amount of redemptions;
> "C) the **number of shares outstanding** at the beginning of the month;
> "D) the **number of shares sold** during the month;
> "E) the **number of shares redeemed** during the month;
> "F) the **number of shares outstanding** at the end of the month; and
> "G) the **percentage of the outstanding shares** owned by Filipinos.

The 1998 revisions of ICA Rule 35-1 would seem to show the Commission's intent on restricting mutual funds to only selling its own shares, for indeed what is being asked for reporting is the "shares", not any other type of securities.

The policy of the Commission to be stringent in the regulation of mutual funds can be traced to the history of mutual funds in the Philippines. The ICA was enacted in 1960 as a result of the collapse of mutual funds companies in the 1950's, thus when it was passed into law, it made it a point in its declaration of policy that the ICA is primarily passed to protect national public interest and the interest of investors.[15]

---

[15] SECTION 2. *Declaration of policy.* — It is hereby declared that the policy and purposes of this Act in accordance with which the provisions of this Act shall be interpreted, are to mitigate and, so far as is feasible, **to eliminate the following conditions which adversely affect the national public interest and the interest of investors**:

(a) When investors purchase, pay for, exchange, receive dividends upon, vote, refrain from voting, sell, or surrender securities issued by investment companies **without adequate, accurate, and explicit information fairly presented**, concerning the character of such securities and the circumstances, policies, and financial responsibility of such companies and their management;

(b) When investment companies are organized, operated, managed, or their portfolio securities are selected, in the interest of directors, officers, investment advisers, depositors, or other affiliated persons thereof, in the interest of underwriters, brokers, or dealers, **in the interest of special classes of their security holders, or in the interest of other investment companies or persons engaged in other lines of business**, rather than in the interest of all classes of such companies' security holders;

(c) When **investment companies issue securities containing inequitable or discriminatory provisions, or fail to protect the preferences and privileges of the holders** of their outstanding securities;

(d) When the **control of investment companies is unduly concentrated through pyramiding or inequitable methods of control, or is inequitably distributed,** or when investment companies **are managed by irresponsible persons**;

It took nine (9) years from the passage of the ICA, or in 1969, before Trinity Shares Inc. and Pacific Funds Inc. pioneered the first mutual funds in an attempt to "to break the stigma that tainted the names of its predecessors."[16] However, that did not last long, as combined by unforeseen circumstances, such as the thin equity market and the political instability of the early 1970's, which led to the failure of mutual funds and the Commission banning the sale of mutual funds in 1973.[17] In which case, the Commission did not impose an arbitrary regulation in laying down stringent requirements on mutual funds since such regulation was due to above-stated experiences.

In fact, the Commission is empowered to reasonably regulate – either relax or restrict under given circumstances – the affairs of the mutual funds, whether involving issuing securities or other concerns arising thereto. Generally, this is in keeping with the Commission's rule-making power under Section 5(g) of the SRC to formulate policies and recommendations on issues concerning the securities market.[18] Moreover, Section 35 of the ICA authorizes the Commission to promulgate rules as to investment companies.[19]

Considering the foregoing, and in line with the stance of allowing other securities to be sold by a mutual company, the conflicting provision in Section (i) (2) of ICA Rule

---

(e) When investment companies, in keeping their accounts, in maintaining reserves, and in computing their earnings and the asset value of their outstanding securities, **employ unsound or misleading methods, or are not subjected to adequate independent scrutiny**;

(f) When investment companies are reorganized, become inactive, or change the character of their business, or when the control or management thereof is transferred, **without the consent of their security holders**;

(g) When investment companies by excessive borrowing and the issuance of excessive amounts of senior securities increase unduly the speculative character of their junior securities; or

(h) When investment companies **operate without adequate assets or reserves**.

[16] The Rebirth of Mutual Funds, by the SEC-Examiners and Appraisals Division, SEC Bulletin, Vol. IV, No. 1, January 1970, pp. 1-2

[17] History of Mutual Funds, Philippine Investment Funds Association. http://www.pifa.com.ph/philmutualfund_history.html. Retrieved on July 24, 2014, 13:02 GMT +8

[18] SECTION. 5. *Powers and Functions of the Commission.* x x x [T]he Commission shall have, among others, the following powers and functions: x x x (g) Prepare, approve, amend or repeal rules, regulations and orders, and issue opinions and provide guidance on and supervise compliance with such rules, regulation and orders;

[19] SECTION 35. *Rules, regulations, and orders; general powers of Commission.* — (a) **The Commission shall have authority from time to time to make, issue, amend, and rescind such rules and regulations** and such orders as are necessary or appropriate to the exercise of the powers conferred upon the Commission elsewhere in this Act, including rules and regulations defining accounting, technical, and trade terms used in this Act, and prescribing the form or forms in which information required in registration statements, applicants, and reports to the Commission shall be set forth. **For the purposes of its rules or regulations the Commission may classify**, persons, **securities**, and other matters within its jurisdiction **and prescribe different requirements for different classes of** persons, **securities**, or matters.

35-1 can be harmonized with the ICA and the other sections of ICA Rule 35-1 to construe that the reportorial requirements also holds true for other "securities".

It is a principle in statutory construction that "a statute should be construed not only to be consistent with itself but also to harmonize with other laws on the same subject matter, as to form a complete, coherent and intelligible system." In other words, every effort must be made to harmonize seemingly conflicting laws. It is only when harmonization is impossible that resort must be made to choosing which law to apply.[20]

The omission of "securities" in Section (i) (2) of ICA Rule 35-1 may be construed to include "securities", for most of the salient portions of ICA Rules refers to "securities" as a separate item. Moreover, Section (i) (2) of ICA Rule 35-1 merely refers to reporting of the sale, disposition and redemption of shares, which neither expressly nor out-rightly prohibit other securities.

With these observations, it would appear that ICA Rule 35-1 recognizes and accommodates the ability of a mutual fund to issue securities other than their own shares. The said implementing rules appears to complement the ICA and is cognizant of treating "securities" as defined in the ICA.

The Commission's Position

As earlier mentioned, the Commission treated your letter dated 14 October 2011 as a request for a legal opinion. However, the Commission will no longer treat your letter as a request for a legal opinion since the above-stated observations are considered as far reaching and calls for a change in the Commission's policy. Thus, the Commission deems it necessary to relax such regulatory requirements pursuant to its rule-making power under Section 5(g) of the SRC[21] and will allow SLAMC and other mutual funds to sell securities other than its own shares.

It must be noted that mutual funds and other forms of collective investment schemes (CIS) have now been thriving in the country. The increasing amount of assets under management and the growing number of investors are proof of the growing industry. However, as shown in the data of other Association of Southeast Asian Nations (ASEAN) countries, there is much room for further growth of the mutual fund industry in the country. The importance of a supportive policy environment was underscored in several studies. Commitment of the government to support the development of the mutual fund market is needed to ensure stability and consistency of regulation. The current strong macroeconomic fundamentals, which have been recognized by an upgrade in credit rating, coupled with optimistic growth forecasts, bode

---

[20] *Dreamwork Construction, Inc. v. Janiola*, G.R. No. 184861, June 30, 2009, 591 SCRA 466.
[21] See Note 18.

well for the prospects of the mutual fund market. With higher incomes, a corresponding increase in demand for investment products is expected. Improving the regulatory environment for mutual funds and other form of CIS can help increase investor confidence in the industry. To prepare for this growth opportunity, the establishment of a favorable regulatory framework where companies can operate to facilitate the flow of investments, and at the same time broaden investor participation, is necessary. CIS have been thriving in the country. The increasing amount of assets under management and the growing number of investors are proof of the growing industry.[22]

Further, the mutual fund industry in the Philippines has to be prepared for the eventual transformation of ASEAN into a region with free movement of goods, services, investment, skilled labor, including capital under the 2015 ASEAN Economic Community. There is already an initiative called the ASEAN CIS Framework to launch cross-border offering of CIS. Malaysia, Singapore and Thailand are the initial participating countries. Under the framework, fund managers operating in a participating country are allowed to offer CIS constituted and authorized in that country, considered as "ASEAN CIS", to retail investors in other member countries under a streamlined authorization process. A common set of standards have been agreed to be adopted to govern the cross-border offering of ASEAN CIS to ensure that participating fund managers have the necessary expertise and experience, and schemes offered under the framework are managed based on industry best practices.[23]

The opportunities and risks for greater regional and global integration are important considerations for strengthening the regulatory framework of the mutual fund industry. This will prepare local investment companies to compete with their regional counterparts. In return, the exposure of local mutual funds to ASEAN markets will help develop the industry and will provide Filipino investors with wider investment opportunities in foreign markets.[24]

Lastly, it must be pointed out that the Commission is aware and mindful of the queries by mutual fund companies, particularly SLAMC, concerning the issuance of securities of mutual fund companies apart from its shares of stock. While there is a pending bill in Congress relative to CIS,[25] these companies interposed their arguments and contention with the Commission that mutual funds may issue securities other than its own shares of stock, as the ICA will show that mutual funds could sell not just stocks but securities. These mutual fund companies also question the standing policy of the

---

[22] Congressional Policy and Budget Research Department (CPBRD) of the House of Representatives Policy Brief No. 2014 -- 04 "Promoting the Development of Mutual Funds" http://www.congress.gov.ph/cpbo/images/PDF%20Attachments/CPBRD%20Policy%20Brief/PB2014-04%20Mutual%20Funds.pdf, last accessed on 23 March 2015.

[23] *Id.*

[24] *Id.*

[25] House Bill No. 4036, 16th Congress, authored by Rep. Henry Cojuangco.

Commission in treating mutual funds strictly, that they are not allowed to sell other securities other than their shares.

Thus, in view of the foregoing, the Commission deems it necessary to relax its stringent policy of restricting mutual funds to only sell its own shares, and it is now the policy of the Commission to allow mutual funds to sell securities other than shares of its own authorized capital stock. The corresponding guidelines to put this into effect will subsequently be issued.

By the authority of the Commission *En Banc*:

TERESITA J. HERBOSA
Chairperson