



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

29 June 2012

SEC Opinion No. 12-10
Independent Directors; SRC
Rule 38(2)

ATTY. MARISSA B. ESPINO

Vice-President/
Chief Compliance and Corporate Governance Officer
UnionBank of the Philippines
UnionBank Plaza
Meralco Avenue cor. Onyx and
Saphire Road, Ortigas Center,
Pasig City

Dear Atty. Espino:

This refers to your letter dated 09 March 2012, endorsed to this Office by our Corporation Finance Department on 20 March 2012, requesting for confirmation of your opinion that the nominee-directors of the Social Security System (SSS), which is one of the stockholders of UnionBank of the Philippines (UnionBank), may qualify as independent directors of UnionBank.

In your letter, you disclosed that currently, SSS owns more than 10% shareholdings of UnionBank. Based on the foregoing, you are asking this Office to confirm your opinion that the nominee-directors of SSS may qualify as independent directors of UnionBank.

Section 38 of the Securities Regulation Code (SRC)¹ provides that any corporation (1) with a class of equity securities listed for trading on an Exchange; or (2) with assets in excess of fifty million pesos (Php50,000,000.00) and having two hundred (200) or more holders, at least of, two hundred (200) of which are holding at least one hundred (100) shares of a class of its equity securities or (3) which has sold a class of equity securities to the public pursuant to an effective registration statement in compliance with Section 12 of the SRC, "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." For this purpose, an independent director shall mean "a person other than an officer or employee of the corporation, its parent or subsidiaries, or any other individual having a relationship with the corporation, which would interfere with the exercise of independent judgment in carrying out the responsibilities of a director."

¹ Republic Act No. 8799 (8 August 2000).

The above provision is amplified by Rule 38 of the Amended Implementing Rules and Regulations (IRR) of the SRC which applies to the "covered companies", *i.e.*, to (1) companies mentioned in Section 38 of the SRC and (2) "companies with secondary licenses that adopted in their Manuals on Corporate Governance the practice of nominating and electing independent director/s in their Boards."²

Notably, Rule 38 of the IRR of the SRC enumerates those who are disqualified to be an independent director. Thus, an independent director is one who:

- A. Is not a director or officer of the covered company or of its related companies or any of its substantial shareholders except when the same shall be an independent director of any of the foregoing;
- B. Does not own more than two percent (2%) of the shares of the covered company and/or its related companies or any of its substantial shareholders;
- C. Is not related to any director, officer or substantial shareholder of the covered company, any of its related companies or any of its substantial shareholders. For this purpose, relatives include spouse, parent, child, brother, sister, and the spouse of such child, brother or sister;
- D. Is not acting as a nominee or representative of any director or substantial shareholder of the covered company, and/or any of its related companies and/or any of its substantial shareholders, pursuant to a Deed of Trust or under any contract or arrangement;
- E. Has not been employed in any executive capacity by the covered company, any of its related companies and/or by any of its substantial shareholders within the last two (2) years;
- F. Is not retained, either personally or through his firm or any similar entity, as professional adviser, by that covered company, any of its related companies and/or any of its substantial shareholders, within the last two (2) 2 years; or
- G. Has not engaged and does not engage in any transaction with the covered company and/or with any of its related companies and/or with any of its substantial shareholders, whether by himself and/or with other persons and/or through a firm of which he is a partner and/or a company of which he is a director or substantial shareholder, other than transactions which are conducted at arms length and are immaterial. (underscoring supplied)

² Rule 38(1), Amended Implementing Rules and Regulations (IRR) of the Securities Regulation Code (SRC).

The Rule 38 of the IRR of the SRC also defines a substantial shareholder as **"any person who is directly or indirectly the beneficial owner of more than ten percent (10%) of any class of its equity security."**³

UnionBank argues that although SSS holds more than 10% of the stocks of UnionBank, its nominee-directors may not be considered as nominees or representatives of a substantial shareholder, since SSS only holds legal title to the shares, the SSS members who are employees in the private sector being the beneficial owners of the SSS shares at UnionBank. In the words of UnionBank:

"At present, SSS holds more than 10% shareholding of the Bank. However, it must be noted that it only holds legal title to said SSS shares as it only acts as custodian thereof. Beneficial ownership of these SSS shares rests on SSS members, who are composed of workers and employees in the private sector. This being the case, SSS, not being the beneficial owner of SSS shares of the Bank may not be considered as "substantial" under SRC Rule 38 (*supra*).

The nominee-directors of SSS may not therefore be considered as directors of a substantial shareholder and may hence qualify as "independent directors" provided they do not fall under any of the list under SRC Rule 38 on who cannot be independent directors."⁴

We cannot agree.

At first blush, UnionBank's argument seems logical and valid. However, the definition of "substantial shareholder" in Rule 38 5(B) of the IRR of the SRC should be correlated with Rule 3(1)(A) of the same IRR.

Rule 3(1)(A) of the IRR of the SRC defines **"beneficial owner"** or **"beneficial ownership"** as **"any person who, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise, has or shares voting power, which includes the power to vote, or to direct the voting of such security; and/or investment returns or power, which includes the power to dispose of, or to direct the disposition of such security."** (Emphasis supplied)

The same Rule 3(1)(A) of the IRR of the SRC also states that a person shall be deemed to have an indirect beneficial ownership interest in any security which is:

- i. held by members of his immediate family sharing the same household;
- ii. held by a partnership in which he is a general partner;
- iii. held by a corporation of which he is a controlling shareholder; or
- iv. subject to any contract, arrangement or understanding which gives him voting

³ Rule 38 5(1)B, *id.* Emphasis supplied.

⁴ Letter dated 9 March 2012, at 3-4.

power or investment power with respect to such securities; provided however, that the following persons or institutions shall not be deemed to be beneficial owners of securities held by them for the benefit of third parties or in customer or fiduciary accounts in the ordinary course of business, so long as such shares were acquired by such persons or institutions without the purpose or effect of changing or influencing control of the issuer:

- a. a broker dealer;
- b. an investment house registered under the Investment Houses Law;
- c. a bank authorized to operate as such by the *Bangko Sentral ng Pilipinas*;
- d. an insurance company subject to the supervision of the Office of the Insurance Commission;
- e. an investment company registered under the Investment Company Act;
- f. a pension plan subject to regulation and supervision by the Bureau of Internal Revenue and/or the Office of the Insurance Commission or relevant authority; and
- g. a group in which all of the members are persons specified above.⁵
(underscoring supplied)

In this case, the facts are bereft of indication for us to be able to determine whether SSS is indeed the beneficial owner of the UnionBank shares, using the definition under SRC Rule 3(1)(A), so as to make it a substantial shareholder of UnionBank. However, the answer to the dilemma is found in Section 26 of the Social Security Law⁶ which provides:

"SEC. 26. *Investment of Reserve Funds.* - All revenues of the SSS that are not needed to meet the current administrative and operational expenses incidental to the carrying out of this Act shall be accumulated in a fund to be known as the "Reserve Fund." **Such portions of the Reserve Fund as are not needed to meet the current benefit obligations thereof shall be known as the "Investment Reserve Fund" which the Commission shall manage and invest with the skill, care, prudence and diligence necessary under the circumstances then prevailing that a prudent man acting in like capacity and familiar with such matters would exercise in the conduct of an enterprise of a like character and with similar aims.** Pursuant thereto, and in line with the basic principles of safety, good yield and liquidity, the Commission shall invest the funds to earn an annual income not less than the average rates of treasury bills or any other acceptable market yield indicator in any or in all of the following:

- (a) In bonds, securities, promissory notes or other evidence of indebtedness of the Government of the Philippines, or in bonds, securities, promissory notes or other evidence of indebtedness to which the full faith, credit and unconditional guarantee of the Government of the Philippines is pledged;

⁵ 3(1)(A), IRR of the SRC.

⁶ Republic Act No. 8282 (Approved on 1 May 1997).

xxx

"(d) In bonds, securities, promissory notes or other evidence of indebtedness of any bank doing business in the Philippines and in good standing with the Bangko Sentral ng Pilipinas to finance loans to private corporations doing business in the Philippines, including schools, hospitals, small-and-medium scale industries, cooperatives and non-governmental organizations, in which case the collaterals or securities shall be assigned to the SSS under such terms and conditions as the Commission may prescribe: *Provided*, That in the case of bank deposits, they shall not exceed at any time the unimpaired capital and surplus or total private deposits of the depository bank, whichever is smaller: *Provided, further*, That said bank shall first have been designated as a depository for this purpose by the Monetary Board of the Bangko Sentral ng Pilipinas: *Provided, finally*, That such investments shall not exceed forty percent (40%) of the Investment Reserve Fund;

xxx

"(i) In preferred or common shares of stocks listed or about to be listed in the stock exchange or options or warrants to such stocks or, subject to prior approval of the *Bangko Sentral ng Pilipinas*, such other risk management instruments of any prime or solvent corporation or financial institution created or existing under the laws of the Philippines with proven track record of profitability over the last three (3) years and payment of dividends at least once over the same period: *Provided*, That such investments shall not exceed thirty percent (30%) of the Investment Reserve Fund;" (underscoring supplied)

From the above provision, it may safely be concluded that whenever SSS invests from the investment reserve fund in securities such as shares of stocks of a company, it is actually SSS, and not its members, which directly or indirectly has or share voting power, (which includes the power to vote or to direct the voting of its shareholdings in such company) and/or investment returns or power, (which includes the power to dispose of, or to direct the disposition of its shares) in such company, in this case, UnionBank. We emphasize that under Section 26 of the Social Security Law it is the SSS which "shall manage and invest with the skill, care, prudence and diligence necessary under the circumstances then prevailing that a prudent man acting in like capacity and familiar with such matters would exercise in the conduct of an enterprise of a like character and with similar aims," which gives the idea that it is the SSS and not its members which controls the management of its investments from the investment reserve fund.

Moreover, it is the Social Security Commission, and not its members, that has the power and duty to compromise or release, in whole or in part, any interest, penalty or any civil liability to SSS in connection with the investments authorized under Section 26, under such terms and conditions as it may prescribe and approved

by the President of the Philippines;⁷ while it is the SSS, and not its members, that has the power and duty to acquire and dispose of property, real or personal, which may be necessary or expedient for the attainment of the purposes of the Social Security Law.⁸

It does not matter then if, as what UnionBank would want us to believe, it is the SSS members who are the ultimate beneficiaries of the investments of SSS because SSS very well fits the definition of a beneficial owner in Rule 3(1)(A) of the IRR of the SRC which would disqualify the nominee-directors of SSS from becoming independent directors in UnionBank.

We are not unaware that Rule 3(1)(A)(iv) of the IRR of the SRC as shown above enumerates persons or institutions who shall not be deemed to be beneficial owners of securities held by them for the benefit of third parties or in customer or fiduciary accounts in the ordinary course of business. However, SSS does not fall in any of them. *Inclusio unius est exclusio alterius*. The inclusion of one is the exclusion of others.⁹

The foregoing opinion is rendered based solely on the facts disclosed in the query and relevant solely to the particular issues raised therein and shall not be used in the nature of a standing rule binding upon the Commission whether of similar or dissimilar circumstances.¹⁰ If, upon investigation, it is disclosed that the facts relied upon are different, this opinion shall be rendered void.

By Authority of the Commission *En Banc*.


CAMILO B. CORREA
General Counsel

⁷ *Id.*, Section 4(a)(6).

⁸ *Id.*, Section 4(b)(8).

⁹ *Vargas v. Rilloraza*, G.R. No. L-1612, 26 February 1948, 80 Phil. 297.

¹⁰ SEC Memorandum Circular No. 15, series of 2003.