Securities and Exchange Commission PHILIPPINES

BAGONG PILIPINAS

OFFICE OF THE GENERAL COUNSEL

6 March 2025

SEC OGC Opinion No. 25-06

Re: Allowable activities of a corporate debt vehicle

PUYAT JACINTO AND SANTOS LAW OFFICE
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Rockwell Center, Makati City 1200

Attention: **Atty. Pearl Grace G. Cabali**
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Atty. Kristine Marie Liberato-Cuaresma
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Re: Request for opinion

Dear Attys. Cabali and Liberato-Cuaresma:

This refers to your letter dated 23 November 2022 on behalf of your client, ATRAM Unitized Corporate Debt Vehicle Inc. (ATRAM or the Company), requesting for a confirmatory opinion on whether a corporate debt vehicle (CDV) may engage in direct lending activities.

In your letter, you disclosed the following matters:

a) The primary purpose of ATRAM is as follows:

> to subscribe for, invest and re-invest in, or sell, transfer, trading or otherwise dispose of bonds, notes, commercial papers, debentures and other evidence of indebtedness, and all other types of securities and investment assets under the Investment Company Act and its Rules, whether secured or unsecured, **of other corporations**; and generally, to carry on the business of a closed-end investment company in all the elements and details thereof pursuant to the Rules on Corporate Debt Vehicle (SEC Memorandum Circular No. 23, series of 2020), or any amendments thereto, **with the specific purpose of investing in corporate debt, which shall refer to any bonds, notes, commercial papers, debentures and other evidence of indebtedness**, whether secured or unsecured, which pending the deployment of the Fund in accordance with its investment objectives, may include deposits and money market instruments, of **(1) large and medium-sized corporations operating or deriving income in the Philippines; or (2) any company guaranteed by a large or medium-sized domestic corporation or by the Philippine government and/or its agencies or by multi-lateral agencies involving exempt securities under the Securities Regulation Code Rule 9.1.2.3**[1]; and

b) ATRAM offers various units of participation with a term of two (2) years from issue date.

It is your position that ATRAM may engage in direct lending because:

a) "the [Investment Company Act or the] ICA[2] and its Rules do not expressly prohibit and/or restrict investment companies, including CDVs, except those which are engaged in money market fund or its equivalent fund, to engage in direct lending activities, provided that the

[1] As stated in the Second Article of ATRAM's Articles of Incorporation (AOI) which you have attached as an Annex to your letter.
[2] Republic Act (R.A.) No. 2629, *Investment Company Act (ICA)*, 18 June 1960.

said activities are also included in the corporation's purpose or incidental to its business, which is the case for the Company"; and

b) "the Company's primary purpose allows it to invest in evidence of indebtedness, which is akin to lending."

Nature of a CDV and its Allowable Activities

Per ATRAM's articles of incorporation (AOI) which is attached as an Annex to your letter, it is evident that it is registered as a CDV. Section II of SEC Memorandum Circular No. 23, Series of 2020 (SEC MC No. 23-20) defines a CDV and a corporate debt as follows:

> **Corporate Debt Vehicle (CDV)** — shall mean a Closed-end Investment Company to be offered to any number of Qualified Buyers (QBs) and/or non-Qualified Buyers (non-QBs) not exceeding nineteen (19) persons in the Philippines during any twelve (12)-month period ***with the specific objective of investing in the Corporate Debts of large corporations and medium-sized enterprises.***
>
> **Corporate Debt** — shall mean any bonds, notes, commercial papers, debentures and other evidence of indebtedness, whether secured or unsecured, of (1) large and medium-sized corporations operating or deriving income in the Philippines; or (2) any company guaranteed by a large or medium-sized domestic corporation or by the Philippine government and/or its agencies or by multi-lateral agencies involving exempt securities under SRC Rule 9.1.2.3.[3]

SEC MC No. 23-20 states that it shall be without prejudice to the Implementing Rules and Regulations (IRR) of Republic Act (R.A.) No. 2629 (ICA-IRR).

Section 6.1, Rule 6 of the ICA-IRR provides an enumeration of the eligible investment assets in which investment companies may invest, to wit:

> **6.1. Investment Assets.** The Fund Manager, based on the Investment Company's investment objective, policy and focus, may only invest in the following eligible investment assets:
>
> a) Transferrable securities;
> b) Money market instruments;
> c) Deposits;
> d) Financial derivatives;
> e) Tradable securities;
> f) Units or participation in other CIS; and
> g) Securities issued by or guaranteed by the Philippine government or the Bangko Sentral ng Pilipinas.[4]

In relation thereto, Section 5.1.3 of the ICA-IRR[5] provides the following prohibited acts of the Fund Manager of all types of investment companies:

> **5.1.3. Prohibited Acts of the Fund Manager.** The Fund Manager shall not:
>
> xxxx
>
> b). Engage in a business other than the business of managing, administering, marketing and distributing funds and securities, and other related activities;
>
> xxxx
>
> h). ***Engage the Investment Company in non-permissible activities such as direct lending of monies***; and
>
> i). Engage in any other prohibited acts that the Commission by rule or order shall prescribe. (Emphasis and underscoring supplied)

Subsequently, ***SEC MC No. 33, Series of 2020 (SEC MC No. 33-20)***[6] was issued to introduce amendments to the ICA-IRR, aligning the said rules with global standards and practices particularly the ASEAN Standards of Qualifying Collective Investment Schemes (ASEAN Standards).

Thus, ***SEC MC No. 33-20***[7] adopted the rules and guidelines under the ASEAN Standards. Section 1, Part II of the ASEAN Standards[8] provides the following enumeration of eligible assets:

> **SECTION 1**
>
> **Types of eligible assets**
>
> 1. The Qualifying CIS's underlying investments may only consist of the following assets (collectively, the —eligible assets):

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[3] Section II, SEC Memorandum Circular (MC) No. 23, Series of 2020, or the *Rules on Corporate Debt Vehicles (CDV)*, 24 August 2020.
[4] Section 6.1, Rule 6 of the *Implementing Rules and Regulations of R.A. No. 2629 or the Investment Company Act* (ICA-IRR), 19 December 2017.
[5] Section 5.1.3., *ibid.*
[6] SEC MC No. 33, Series of 2020. *Amendments to the ICA-IRR.* 27 November 2020.
[7] *Ibid.*
[8] Section 1, Part II, *ASEAN Standards of Qualifying Collective Investment Schemes* (ASEAN Standards). Retrieved from: https://www.theacmf.org/images/downloads/pdf/standards_of_qualifying_cis.pdf

(a) transferable securities;
(b) money market instruments;
(c) deposits;
(d) units in other CIS; and
(e) financial derivatives.

For the avoidance of doubt, a ***Qualifying CIS must not engage in non-permissible activities such as*** securities lending, repurchase transactions, and ***direct lending of monies***. (Emphasis and underscoring supplied)

It is worthy to note that the ASEAN Standards makes no distinction as to the classes of funds to which the prohibition on direct lending applies.

It is clear from the foregoing that ***loan contracts are not among the eligible assets, and direct lending is in fact one of the prohibited acts, of investment companies, regardless of the classification of the investment company, as provided under ICA-IRR, as amended, SEC MCs No. 23-20 and 33-20, and the ASEAN Standards.***

Investing in evidence of indebtedness is not equivalent to direct lending

A possible confusion may have arisen from the fact that an investment company is referred to as a "lender" when it purchases evidence of indebtedness from a corporate issuer, with the latter referred to as the "borrower," similar to a lender-borrower relationship created in an ordinary loan transaction. However, please note that a loan and an evidence of indebtedness are two different things.

An evidence of indebtedness is classified as securities under the IRR of R.A. No. 8799 or the Securities Regulation Code (SRC),[9] to wit:

3.1.20. Securities shall include:

(a) Shares of stock, bonds, government securities, commercial papers, 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;
(c) Fractional undivided interests in oil, gas or other mineral rights;
(d) Derivatives like options and warrants;
(e) Certificates of assignments, certificates of participation, trust certificates, voting trust certificates or similar instruments;
(f) Proprietary or nonproprietary membership certificates in corporations; and
(g) Other instruments as may in the future be determined by the Commission.

Debt securities/instruments include any evidence of indebtedness such as bonds, notes, debentures, commercial papers, treasury bills, treasury bonds and other similar instruments as may be determined by the Commission.

Equity securities include shares of stock in a corporation.

An evidence of indebtedness held as an asset by the investment company falls under the category of transferable securities under Item 39, Rule I of the ICA-IRR, to wit:

39. Transferable securities — shall refer to shares and other securities equivalent to shares, and bonds and other forms of securitized debt ***excluding*** money market instruments or ***any security title to which can be transferred only with the consent of a third party***. (Emphasis and underscoring supplied)

An evidence of indebtedness is transacted not as an ordinary loan but as a kind of a money market transaction.

Meanwhile, Article 1933 of R.A. No. 386 or the Civil Code[10] defines a loan as follows:

By the contract of loan, one of the parties delivers to another, either something not consumable so that the latter may use the same for a certain time and return it, in which case the contract is called a commodatum; or money or other consumable thing, upon the condition that the ***same amount of the same kind and quality shall be paid***, in which case the contract is simply called a ***loan or mutuum***. (Emphasis and underscoring supplied)

The crucial element differentiating an ordinary loan transaction from investment in debt securities or instruments like evidence of indebtedness is the ***impersonal character*** of the latter.

Thus, they may be differentiated as follows:

a) ***As to the parties.*** Investment in debt securities or instruments involves an investor and an issuer of debt securities or instruments. In CDV's context, the parties involved in the investment

[9] Rule 3.1.20, R.A. No. 8799 or the 2015 *Implementing Rules and Regulations of the Securities Regulation Code* (SRC-IRR), 04 August 2015.
[10] Article 1933, R.A. No. 386, *Civil Code of the Philippines*, 30 August 1950.

transaction are the investor, i.e., CDV, and the issuer of the corporate debt securities, i.e. large corporations and/or medium-sized enterprises.[11]

In a loan transaction, the active parties involved are the creditor/lender and the debtor/borrower.

b) ***As to nature of transaction.*** Investing in debt securities or instruments involves purchasing ***existing*** debt securities in the capital market. This is a passive and impersonal investment, i.e. purchasing and holding securities usually held until maturity, generally, for the purpose of earning profit or rate of return.

In this relation, a CDV's investment in a corporate debt, i.e., bonds, notes, commercial papers, debentures and other evidence of indebtedness, whether secured or unsecured,[12] has the specific objective of investing in portfolios of corporate debt papers[13] of large corporations and medium-sized enterprises.[14] The corporate debt portfolio is therefore held by the CDV as an investor and not as a creditor/lender contemplated under the Civil Code.

In contrast, direct lending, as a business activity, pertains to the grant of loans in such amounts and reasonable interest rates and charges as may be agreed upon between the creditor/lender and the debtor/borrower. In short, direct lending involves originating a loan, i.e. there is a direct and personal relationship in the form of a debtor-creditor relationship with the following prestation: (1) for the creditor/lender, to deliver money, the object of the loan; and (2) for the debtor/borrower, to pay the loan along with the corresponding interest, as agreed upon.

The general objective of the creditor/lender is to gain profit or income through interest payments, while the debtor/borrower's objective is to obtain the loan object, e.g. cash. The loan instrument is held not as an investment nor as a capital asset but as an evidence of the debtor/borrower's obligation to repay the creditor/lender.

c) ***As to expectation of profits.*** In investments in debt securities or instruments, the issuers are required to pay an interest rate (coupon rate), which may be fixed throughout the life of the security ***or which may vary with inflation, economic situations, interest rates, or asset prices***. If the debt security or instrument is held to maturity, Yield-to-maturity (YTM) is one of the important considerations in measuring the annual rate of return that an investor is expected to earn.

In the context of CDVs, the CDV will purchase the existing debt securities of large corporations and medium-sized enterprises. In return, the CDV would receive a series of interest payments or dividends as the yield of its investment. When the corporate debt reaches its maturity, the principal amount is then returned to the CDV as the investor. ***However, the investor or holder of debt securities may sell prior to maturity of the securities allowing them to realize a capital gain or loss on their initial investment.***

In direct lending, however, the expectation of profit is usually fixed and direct, i.e. the creditor/lender gains profit through the payment of the interest generally made over a period of time and paid in accordance with the stipulated loan repayment schedule, e.g. even principal payments or even total payments.

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[11] Proceeds from the issuance of CDV securities shall be invested in corporate debts of large corporations and medium-sized enterprises, however, pending the deployment of the CDV in accordance with its investment objectives, the CDV can invest in deposits and money market instruments under Section V(5), *Rules on CDV.*

[12] Section II of the Rules on CDV defines Corporate Debt as any bonds, notes, commercial papers, debentures and other evidence of indebtedness, whether secured or unsecured, of (1) large and medium-sized corporations operating or deriving income in the Philippines; or (2) any company guaranteed by a large or medium-sized domestic corporation or by the Philippine government and/or its agencies or by multi-lateral agencies involving exempt securities under SRC Rule 9.1.2.3.

[13] Section III(1) in relation to Section V(5), *Rules on CDV.*

[14] Section III(1) in relation to Section III(2)(e) of the Rules on CDV provides that a CDV may offer different share or unit classes with similar investment objective but managed as separate asset pools. Each class corresponds to a distinct part of the assets and liabilities of the CDV. In case of a CDV that will offer share/unit classes, the AOI shall clearly indicate its structure as such, as well as the nature, type of classes, rights, privileges and restrictions of their holders.

d) ***As to governing law/s.*** Investment in debt securities or instruments is governed by the relevant securities and investment laws like the ICA, ICA-IRR, SRC, and SRC-IRR. Meanwhile, direct lending is governed by lending laws and regulations like the R.A. No. 9474 or the Lending Company Regulation Act (LCRA),[15] LCRA-IRR,[16] R.A. No. 8556 or the Financing Company Act (FCA),[17] FCA-IRR,[18] and the general law on obligations and contracts under R.A. No. 386 or the Civil Code.[19]

In short, investment in debt securities or instruments like evidence of indebtedness pertains to an investment in transferable securities through the money market with an expectation of profit which may be based on variable prevailing market forces while direct lending contemplates a direct contractual relationship between the creditor/lender and the debtor/borrower involving loan of money with expectation to be repaid plus interest, based on the terms of the contract.

Thus, as direct lending is different from investing in debt securities, the authority to invest does not necessarily include the authority to lend.

Conclusion

From the foregoing, we answer your query in the negative.

It shall be understood that the foregoing opinion is rendered solely on the basis of the facts, circumstances and documents disclosed/submitted, and should be considered relevant solely to the particular issue raised therein. It shall not be used in the nature of a standing rule binding upon the Commission in other cases or upon the courts whether of similar or dissimilar circumstances.[20] If upon investigation, it will be disclosed that the facts relied upon are different, this opinion shall be rendered null and void.

Please be guided accordingly.

Very truly yours,

ROMUALD C. PADILLA
General Counsel

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[15] R.A. No. 9474, *Lending Company Regulation Act (LCRA)*, 22 May 2007.
[16] *Implementing Rules and Regulations of R.A. No. 9474 or the Lending Company Regulation Act* (LCRA-IRR), 23 August 2007.
[17] R.A. No. 8556, *Financing Company Act (FCA), as amended*, 26 February 1998.
[18] *Rules and Regulations to Implement the Provisions of R.A. No. 8556 or the Financing Company Act* (FCA-IRR), 20 May 1999.
[19] Book IV, Obligations and Contracts, *Civil Code of the Philippines*.
[20] Section 7, SEC MC No. 15, Series of 2003, 16 December 2003.