Securities and Exchange Commission PHILIPPINES

BAGONG PILIPINAS

OFFICE OF THE GENERAL COUNSEL

09 October 2024

SEC OGC Opinion No. 24-28
Re: Foreigner in the Board of Off-shore Collective Investment Schemes

BELLO VALDEZ & FERNANDEZ
17F Robinsons Equitable Tower
4 ADB Ave., cor. P. Poveda Drive
Ortigas Center, Pasig City 1605

Attention : **Atty. Emilio Sebastian M. Caedo**
esmcaedo@jglaw.com.ph

Re : **Request for opinion**

Dear Atty. Caedo:

This refers to your letter dated 28 April 2023 requesting, on behalf of your clients, for an opinion on the "setting-up of foreign-owned venture capital, private equity and hedge funds (collectively referred to as "the funds") in the Philippines."

In your letter, you provided the definition of the different kinds of funds in this wise:

> A '**venture capital fund**' is a type of investment fund that provides capital to early-stage or startup companies with high growth potential, in exchange for an ownership stake in the company. A '**private equity fund**' is a type of investment fund that invests in privately held companies or takes private ownership stakes in public companies with the goal of generating high return on investment. A '**hedge fund**' is a type of investment fund that uses various investment strategies to generate high returns on investment for its investors. Hedge funds typically raise capital from wealthy individuals, institutional investors, and pension funds, and use the funds to invest in a wide range of securities, including stocks, bonds, commodities, currencies, and derivatives.[1]

You are now asking for an opinion on whether or not "***foreign nationals will be allowed to have representation in the boards of directors of such funds***, considering that: (i) such funds will be wholly- or partially-owned by foreign stockholders, and (ii) the units of participation in those funds will be exclusively offered offshore (i.e. outside of the Philippine territory)." [2]

Nature of Investment Companies

Section 4 of Republic Act (R.A.) No. 2926 or the Investment Companies Act (ICA) defines "investment companies" as follows:

> **SECTION 4.** ***Definition of investment company.*** —
>
> (a) when used in this Act "investment company" means 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;

Rule 1(19) of the Implementing Rules and Regulations (IRR) of the ICA [3] defines ***investment companies*** as follows:

[1] Lifted from Pages 1 and 2 of your letter-request.
[2] Emphasis supplied.
[3] Rule 1(19), Implementing Rules and Regulations of Republic Act (R.A.) No. 2629 or the Investment Companies Act (ICA-IRR), 19 December 2017.

19. **Investment Company** — shall refer to a stock corporation primarily engaged or holds itself out as being engaged primarily, or proposes to engage, in the business of investing, reinvesting and trading in securities.

Section 15 of the ICA provides a specific rule for board composition, *viz.*:

SECTION 15. Board of directors; election; term vacancies; and salaries. — No person shall serve as a director of a registered investment company unless he is a Filipino citizen and elected to that office by the holders of the outstanding voting securities of such company, at an annual or a special meeting duly called for the purpose; except that vacancies occurring between such meeting may be filled in any otherwise legal manner if immediately after filling any such vacancy at least two-thirds of the directors then holding office shall have been elected to such office by the holders' of the outstanding voting securities of the company at such an annual or special meeting. In the event that at any time less than a majority of the directors of such company holding office at that time were so elected by the holders of the outstanding voting securities, the board of directors or proper officer of such company shall forthwith cause to be held as promptly as possible and in any event within sixty days a meeting of such holders for the purpose of electing directors to fill any existing vacancies in the board of directors unless the Commission shall by order extend such period. The foregoing provisions shall not apply to members of an advisory board.

In relation thereto, Rule 3.4 of the ICA-IRR[4] provides the following minimum requirements:

3.4. ***Minimum Requirements.*** An Investment Company applying for incorporation with this Commission shall comply with the following requirements:

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e. ***All members of the Board of Directors shall be Filipino citizens***;

Notably, the letter does not conclusively show that the management of the funds will be through an investment company. In fact, your claim that the three types of funds described "***may*** fall under this definition of investment companies."[5] Nevertheless, assuming that your proposed activities and business model fall under the definition of investment companies, we provide the following discussion.

Foreign Equity Restrictions

To support your position that Section 15 of the ICA was repealed, you claim that Executive Order (E.O.) No. 175, Series of 2022 or the Twelfth (12th) Foreign Investments Negative List (FINL) "does not provide a foreign equity limitation in investment companies" such that "foreign nationals may set-up these types of funds in the Philippines without ownership restrictions."[6]

You also cited the doctrine of *lex posteriori derogate legipriori* to support your position that "Section 2-A of the Anti-Dummy Law supersedes Section 15 of the ICA, since the former was passed after the latter."[7]

As such, we must examine the nature of the FINL and the Anti-Dummy Law.

As to the FINL, under R.A. No. 7042, also known as the Foreign Investments Act of 1991 (FIA), foreigners are allowed to invest in up to 100% of the **equity** of a domestic enterprise ***unless otherwise restricted by the Constitution and other pertinent laws.***

The 12th Regular FINL provides a specific list of activities, businesses, and enterprise in which foreign ownership is limited by mandate of the Constitution and specified laws (List A), and those in which foreign ownership is limited for reasons of security, defense, risk to health and morals and protection of small and medium scale enterprises (List B).[8] It is updated from time to time by the National Economic and Development Authority (NEDA).[9]

As to the Anti-Dummy Law, SEC-OGC Opinion No. 24-18[10] is instructive, *viz.*:

In all cases in which a constitutional or legal provision requires that, in order that a corporation or association may exercise or enjoy a right, franchise or privilege, ***not less than a certain per centum of its capital*** must be owned by citizens of the Philippines or of any other specific country, it shall be unlawful to falsely simulate the existence of such minimum of stock or capital as owned by such citizens, for the purpose of evading said provision.

It is clear that for the Anti-Dummy Law to apply, the corporation ***must be engaged in a nationalized or partly-nationalized activity.*** A list of activities which are deemed "nationalized" or "partly-nationalized" is provided under the 12th [FINL]. ***Only the investment areas and/or activities listed in the 12th FINL shall be reserved for***

[4] Rule 3.4, *supra* Note 3.
[5] Lifted from Page 2 of your letter-request. Emphasis and underscoring supplied.
[6] As stated in page 2 of your letter.
[7] As stated in page 5 of your letter.
[8] SEC-OGC Opinion No. 24-19 addressed to Siguion Reyna Montecillo & Ongsiako dated 02 July 2024.
[9] SEC-OGC Opinion No. 24-01 addressed to Estrada & Aquino dated 02 January 2024.
[10] SEC-OGC Opinion No. 24-18 addressed to Community Economic Ventures (A Microfinance NGO) Inc. dated 25 June 2024.

> ***Philippine Nationals, subject to the exceptions and conditions indicated therein.*** (Emphasis and underscoring supplied)

Under the Anti-Dummy Law, a corporation with foreign equity restriction of 40% or less as a result of engaging in a certain industry/activity is a nationalized or partly-nationalized corporation. The Anti-Dummy Law **does not prescribe foreign equity restrictions**, what it does is to prescribe the ***effects*** of having one.

One effect of having a foreign equity restriction or being a nationalized or partly-nationalized corporation under Section 2-A of the Anti-Dummy Law is that "the election of aliens as members of the board of directors or governing body of [such corporation] shall be allowed in proportion to their allowable participation or share in the capital of [the corporation]."[11]

Considering the foregoing, it is established that while the FINL provides the **enumeration** of nationalized or partly-nationalized corporations, the Anti-Dummy Law complements the same by providing the **consequences** thereof.

No Repeal of ICA

It is worthy to note that there is no ***express*** repeal of the ICA. The question then is whether or not there was an implied repeal of ICA. As early as ***Antonio Mecano vs. Commission on Audit,***[12] the Court laid down the rule on implied repeal:

> Repeal by implication proceeds on the premise that where a statute of later date clearly reveals an intention on the part of the legislature to abrogate a prior act on the subject, that intention must be given effect. Hence, before there can be a repeal, ***there must be a clear showing on the part of the lawmaker that the intent in enacting the new law was to abrogate the old one.*** The intention to repeal must be clear and manifest; otherwise, at least, as a general rule, the later act is to be construed as a continuation of, and not a substitute for, the first act and will continue so far as the two acts are the same from the time of the first enactment.
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> There are two categories of repeal by implication. The first is where provisions in the two acts ***on the same subject matter*** are in an ***irreconcilable conflict,*** the later act to the extent of the conflict constitutes an implied repeal of the earlier one. The second is if the later act ***covers the whole subject of the earlier one and is clearly intended as a substitute,*** it will operate to repeal the earlier law.
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> ***Implied repeal by irreconcilable inconsistency takes place when the two statutes cover the same subject matter; they are so clearly inconsistent and incompatible with each other that they cannot be reconciled or harmonized; and both cannot be given effect, that is, that one law cannot be enforced without nullifying the other.***
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> xxx
>
> The fact that a later enactment may relate to the same subject matter as that of an earlier statute is not of itself sufficient to cause an implied repeal of the prior act, since the new statute may merely be cumulative or a continuation of the old one. ***What is necessary is a manifest indication of legislative purpose to repeal.*** (Emphasis and underscoring supplied, citations omitted)

Further, repeals by implication are frowned upon. This is based on the presumption that a law was enacted by the legislature ***with full knowledge of "existing laws on the subject and not to have enacted conflicting statutes,"*** to wit:

> Well settled is the rule that repeals of laws by implication are not favored, and that courts must generally assume their congruent application. The two laws must be ***absolutely incompatible***, and a clear finding thereof must surface, before the inference of implied repeal may be drawn. The rule is expressed in the maxim, *interpretare et concordare legibus est optimus interpretendi*, i.e., every statute must be so interpreted and brought into accord with other laws as to form a uniform system of jurisprudence. The fundament is that the legislature should be presumed to have known the existing laws on the subject and not to have enacted conflicting statutes. Hence, all doubts must be resolved against any implied repeal, and all efforts should be exerted in order to harmonize and give effect to all laws on the subject.[13]

It is clear that implied repeal only applies if (1) there is ***irreconcilable conflict*** between the older and the newer law; or (2) the later law covers the ***whole subject*** of the earlier one and is ***clearly intended*** as a substitute. This is because of the well-established rule of statutory construction that endeavor should be made to harmonize the provisions of a law or two laws so that each shall be effective.

We now examine whether or not there was an implied repeal of the ICA.

As to the FINL, it is worthy to emphasize that it is not a law but merely an issuance that deals with **foreign equity restrictions** or those which impose a limit on a corporation's capital structure itself.

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[11] Section 2-A, Commonwealth Act No. 108 or the Anti-Dummy Law, as amended, 30 October 1936.

[12] *Antonio Mecano vs. Commission on Audit (COA)*, G.R. No. 103982, 11 December 1992. [Per J. Campos Jr., En Banc]

[13] *Department of Public Works and Highways (DPWH) vs. Philippine Institute of Civil Engineers Inc. and Leo Gamolo*, G.R. No. 200015, 15 March 2023. [Per J. Leonen, Second Division]

Section 15 of the ICA is different as the restriction imposed is not on equity or capital structure but on the composition of the board itself.

Considering that these are two different subject-matters, there is neither an irreconcilable conflict between the FINL and Section 15 of the ICA, nor is there a showing that the former was intended as a substitute for the latter as the former is not even a law and does not even cover the same subject-matter.

As to the Anti-Dummy Law, Section 2-A thereof can be reconciled or harmonized with Section 15 of the ICA. The former applies as a restriction on the board composition of all corporations which are made nationalized or partly-nationalized by the Constitution or by laws which prescribe foreign equity restrictions but which do not prescribe a specific rule on board composition. This is how, to reiterate, the Anti-Dummy Law complements these laws and the FINL, by providing the effects of such equity restriction on board representation. The latter, on the other hand, applies to all investment companies, regardless of the presence or absence of foreign equity restriction, as the board composition is specifically provided.

Indeed, the law can prescribe a specific board composition that is not necessarily correlated to and/or dependent on the equity structure of the corporation. An example is no less than the Constitution which provides that, in general, educational institutions are limited to 40% foreign equity but the board composition is required to be 100% composed of Filipinos. Article XIV, Section 4(2) of the Constitution[14] provides the following:

> Educational institutions, other than those established by religious groups and mission boards, shall be ***owned solely by citizens of the Philippines or corporations or associations <u>at least sixty per centum</u> of the capital of which is owned by such citizens.*** The Congress may, however, require increased Filipino equity participation in all educational institutions. ***<u>The control and administration of educational institutions shall be vested in citizens of the Philippines</u>***. (Emphasis supplied)

Section 15 of the ICA is another example of a law prescribing a specific rule on board composition of a specific type of corporation that is, unlike the rule under the Anti-Dummy Law, not correlated to and/or dependent on the equity structure.

To sum, the Anti-Dummy Law provides for the general rule on board composition, (i.e. election of aliens as members of the board of directors or governing body of corporations or associations engaging in partially nationalized activities shall be allowed ***in proportion to their allowable participation or share in the capital of such entities***), the exception being when the specific law provides for a different specific requirement on board composition.

As such, there is no irreconcilable difference between the Anti-Dummy Law and the ICA provision on the composition of the Board of Directors, neither is there a showing that the former was clearly intended as a substitute of the later since the former does not cover the whole subject of the latter. It follows then that there is no implied repeal and that the requirement on the composition of the Board of Directors under the ICA still stands.

Effect of off-shore offer and sale of securities

You assert that R.A. No. 8799 or the Securities Regulation Code (SRC) is territorial in scope, citing Sections 8 and 10 thereof, and that since the units of participation of the Funds to be established will be ***offered purely offshore***, the provisions of the SRC are inapplicable. As such, the investors being purely foreigners, it is not necessary to have an all-Filipino board.

a) Registration Requirement under the SRC

The materiality of the *situs* of the offer and sale of securities vis-à-vis the registration requirement under Section 8 of the SRC was discussed in ***SEC-OGC Opinion No. 24-04,***[15] to wit:

> Thus, for the registration requirement to bind the issuer, the following elements must be present:
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> a) the subject matter must be ***securities***;
> b) the securities must either be ***sold or offered for sale or distribution***; and
> c) the sale or offer to sell/distribute securities must be ***within the Philippines***.

That said, it is worthy to stress that Section 8 governs the requirements of securities registration. However, as to the establishment and operation of investment companies, the ICA and its IRR prevail. Hence, notwithstanding the intention to offer units of participation purely offshore, a corporation seeking

[14] Article XIV, Section 4(2), 1987 Constitution, 02 February 1987.
[15] SEC-OGC Opinion No. 24-04 addressed to Puyat Jacinto & Santos dated 26 March 2024.

to obtain and maintain a license as an investment company must comply with the ICA, including Section 15 thereof.

b) ASEAN CIS Framework

The Commission issued SEC Memorandum Circular (MC) No. 09, Series of 2021[16] to operationalize the ASEAN Collective Investment Scheme (CIS) Framework.

The Philippine's adoption of the ASEAN CIS Framework ***does not dispense with domestic laws*** like the ICA and the SRC and their respective IRRs. In fact, Article IV of the same MC provides the following guidelines:

> **IV. Additional Requirements for Investment Companies offering cross-border**
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> 1. An investment company that seeks to offer its shares under the Framework must demonstrate ***compliance with both domestic regulations and Standards of Qualifying CIS, but where the two sets of requirements differ on a particular provision, the stricter requirement/s would govern and such fact must be highlighted in the Prospectus of the Fund.*** (Emphasis and underscoring supplied)

Thus, a company seeking to obtain a license to undertake activities of an investment company under Philippine laws must satisfy the requirements under the domestic laws, i.e. the director of a registered investment company should be a Filipino citizen and elected to that office by the holders of the outstanding voting securities of such company[17] and pursuant thereto, all members of the board must be Filipino citizens, ***notwithstanding the intention to offer units of participation purely offshore.***[18]

Accordingly, foreign nationals will **not be allowed to have representation** in the Board of Directors of funds constituted as investment companies notwithstanding the representation that (i) such funds will be wholly-or partially-owned by foreign stockholders, and (ii) the units of participation in those funds will be exclusively offered offshore (i.e. outside of the Philippine territory).

Indeed, it is doctrinal that when the law is clear, there is no other recourse but to apply it regardless of its perceived harshness. ***Dura lex sed lex***. The proper remedy is not a request for an opinion but an express amendment or repeal of the law – matters which are within the office of the Legislature and not with this Commission.

It shall be understood that the foregoing opinion is rendered based solely on the facts, circumstances and documents disclosed/submitted and 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.[19] If, upon further inquiry or investigation, it will be disclosed that the facts relied upon are different, this opinion shall be rendered void.

Please be guided accordingly.

Yours most respectfully,

ROMUALDO C. PADILLA, LLM, CESO III
General Counsel

[16] Article IV, SEC Memorandum Circular (MC) No. 09, Series of 2021, 16 August 2021.
[17] Section 15, R.A. No. 2926, Investment Companies Act (ICA), 18 June 1960.
[18] Section 3.4, ICA-IRR, *supra* Note 3.
[19] Section 7, SEC MC No. 15, Series of 2003, 16 December 2003.