

PHILIPPINE MUTUAL FUNDS AND COMMON TRUST FUNDS: HOW DIFFERENT ARE THEY?

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This study aims to explore the differences between mutual funds (MF) and common trust funds (CTF) in the Philippines. It is proposed that the differences between these two types of investigations stem principally from differential regulation and taxation. Removal of these "artificial" sources of differences should result in a CTF investment which has the same risk-expected return profile as a MF investment, despite the different nature of the fiduciary relationship between the CTF issuer and its investor on the one hand, and the shareholder relationship between the MF issuer and its investor on the other.

I. INTRODUCTION

The tremendous growth of mutual funds in the U.S. in the decade of the 1990s and the "coincident" bull run of U.S. stock markets during that period can be said to be elements of a virtuous cycle. Regulation and lower returns on debt securities encouraged U.S. investors' foray into equities, and U.S. mutual funds were quick to spot the opportunity to offer products which allow investors to invest more cheaply and efficiently in portfolios of equity securities. The availability of more long-term capital cannot but have positive consequences on investments and growth in the real economy. This in turn, confirmed and further encouraged investors' confidence in equity investments.

Wanting to duplicate the U.S. experience in the Philippines, technical assistance was made available in the late 1990s to study and strengthen our country's mutual fund industry. Several important

reforms were subsequently initiated; in particular, revisions to tax rules which were believed to discourage investments in mutual funds. The study produced by that effort also made reference to the very tough competition mutual funds (MF) have to contend with from common trust funds (CTF).

A recent research¹ on the Philippine mutual funds industry (Valderrama and Bautista, 2005) revealed that many investors, even the more educated among them, are not clear as to the differences between these two types of investments. This is the main impetus for the present study.

The paper proceeds as follows: the first section briefly describes the CTF and MF markets, the second section summarizes key similarities and differences between the two types of investments, and the third and final section concludes the paper.

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II. THE COMMON TRUST FUND MARKET

As of June 30, 2003, 17 expanded commercial (universal) banks, 16 regular commercial banks, 13 thrift banks, and 8 investment houses are authorized to conduct trust businesses in the Philippines (see Appendix A for the list). Of these, however,

only 30 report CTF accountabilities as of September 19, 2003. The universal banks are the dominant supplier of common trust funds in the country, as can be seen in Table 1.

Table 1
Common Trust Fund Market Participants

Type of Financial Institution	Number of institutions with trust license [1]	Number of institutions with CTF [2]	Total CTF Accountabilities (in Php . millions) [2]	Percentage Share in Total CTF Accountabilities
Universal Banks	17	16	228,744	94.57%
Regular Commercial Banks	16	8	9,312	3.85%
Thrift Banks	13	4	3,820	1.58%
Investment Houses [3]	8	1	Na	
Total	54	29	241,876	100.00%

[1] as of June 30, 2003

[2] as of September 19, 2003

[3] Data on the number of investment houses with CTF is based on the database of the Trust Officers Association of the Philippines, which database includes only unitized CTFs.

Source: Bangko Sentral ng Pilipinas

Common trust funds are classified by the industry association (Trust Officers Association of the Philippines) as fixed income, mixed/balanced/equity, and dollar CTFs. The classification depends on the

portfolio mix of the fund. As can be seen in Table 2, fixed income funds dominate the type of CTFs available in the Philippine market.

Table 2
Distribution of Different Types of Common Trust Funds¹
(October 2003)

Name of Institution	Fixed Income Funds	Mixed/Balanced/Equity Funds	Dollar CTFs	Total CTFs
UNIVERSAL BANKS				
Allied Bank	1	2	0	3
Banco de Oro	3	0	2	5
BPI	4	1	4	9
Landbank	2	1	1	4
Metrobank	7	1	1	9
RCBC	3		1	4
Security Bank	1			1
COMMERCIAL BANKS				
Asia United Bank	1		1	2
East West Bank	1		2	3
Export & Industry Bank	1		1	2
Maybank	1			1
Philippine Bank of Communications			1	1
INVESTMENT HOUSE				
PCCI	1			1
Total	26	5	14	45

Source: Trust Officers Association of the Philippines (TOAP)

CTFs dominate the trust portfolios of financial institutions authorized to conduct the trust business. As can be seen in Table 3, total CTF accountabilities of the

Philippine banking system were over P155 billion and comprised 24% of total trust assets of the Philippine banking system in June 2003.

Table 3
Trust and Fund Management Operations of the Philippine Banking System
(June 2003)

	Php Millions	%
Trust and Other Fiduciary Assets (TOFA)	279,533	43%
Common Trust Funds	155,095	24%
Investment Management Accounts	88,352	14%
FCDU/EFCDU Trust Accountabilities	109,010	17%
Others	11,817	2%
Total Trust Accountabilities	643,807	100%
Breakdown of TOFA		
Employee Benefits Under Trust	66,375	
Personal Trust	56,270	
Pre-Need Plans	56,446	
Escrow	47,078	
Administratorship	22,571	
Others	30,793	
Total – TOFA	279,533	

Source: Bangko Sentral ng Pilipinas

There is significant concentration in the CTF sector. The commercial banks account for over 98% of CTF accountabilities. 64%

of the CTF market is held by the 3 largest Philippine commercial banks (see Table 4).

Table 4
Major Players of the Philippine CTF Industry
(September 19, 2003)

	Rank in Banking Industry Based on Total Assets	CTF Accountabilities in Php millions	Market Share
Metropolitan Bank and Trust Company	1	64,270	26.57%
Bank of the Philippine Islands	2	45,876	18.97%
Equitable PCI Bank	3	43,218	17.87%
Banco de Oro Universal Bank	9	38,438	15.89%
Rizal Commercial and Banking Corporation	8	17,171	7.10%
Rest of Universal Banks		19,771	8.17%
All Regular Commercial Banks		9,312	3.85%
All Thrift Banks		3,820	1.58%
Total		241,876	100.00%

Source of data: Banks' Statements of Financial Condition

As “bank” products, CTFs are distributed or sold primarily to retail investors by bank employees via their respective branch networks. CTFs may also be availed of directly from the trust departments of the banks. CTF placements

can be made for as short a period as less than a month. Expenses that may be charged to the fund, including the trust or management fee, pretermination consequences, and the method of fund valuation are prescribed in the CTF plan.

III. THE MUTUAL FUND INDUSTRY²

As of September 2003, there are 25 mutual funds and 14 investment advisers registered with the Securities and Exchange Commission (see Table 5). Very similar to CTFs, Philippine mutual funds are also classified by the industry association (Investment Company Association of the Philippines or ICAP) as stock funds, balanced funds, bond funds, and money

market funds. None of the 25 funds existed prior to 1990, and a majority of the funds were incorporated after 1996.

Only 16 of the registered funds are still actively selling shares in the fund. Nine (9) funds are not selling shares anymore and are either inactive (dormant) or in redemption mode.

Table 5
Mutual Funds/Investment Management Companies and Managers/Advisers
(September 30, 2003)

Investment Company (launch date)	Investment Manager/Adviser	
Stock Funds (6)		
Philippine Index Fund (2003)	BPI Investment Management Inc.	
Philam Strategic Growth Fund (1998)	Philam Asset Management Inc.	
Philequity PSE Index Fund (na)	Philequity Management Inc.	inactive/ dormant
Philequity Fund (1994)	Philequity Management Inc.	
Sun Life Phil. Equity (2000)	Sunlife Asset Management Co., Inc.	
United Fund (1994)	UCPB Trust Banking Division	
Balanced Funds (10)		
All Asia Fund (1997)	All Asia Asset Management Inc.	inactive/ dormant
Citisec Growth and Income Fund (1994)	Citisec Management Inc.	
ECC Growth and Income Fund (1997)	ECC Asset Management Inc.	redemption
Emergent Fund [1] (2002)	First Abacus Investment Management Inc.	redemption
First Galleon Family Fund (1991)	First Galleon Fund Management Inc.	
GSIS Kinabukasan Fund (1997)	Philam Asset Management Inc.	
MFCP Kabuhayan Fund (1995)	Mutual Fund Mgt. Co. of the Phils. Inc.	
Philam Fund (1993)	Philam Asset Management Inc.	
Sun Life Prosperity Balanced (2000)	Sunlife Asset Management Co., Inc.	
Sun Life Prosperity Dollar Advantage (2002)	Sunlife Asset Management Co., Inc.	

Investment Company (launch date)	Investment Manager/Adviser	
Bond Funds (7)		
All Asia Fixed Income Fund (1997)	All Asia Asset Management Inc.	inactive/ dormant
Ayala Life Fixed Income Fund (1997)	BPI Asset Management and Trust Group	
Far East Dollar Bond Fund [2] (2002)	FEB Management Inc.	inactive/ dormant
Philam Bond Fund (1997)	Philam Asset Management Inc.	
Philam Dollar Bond Fund (2001)	Philam Asset Management Inc.	
Philequity Dollar Income Fund (na)	Philequity Management Inc.	inactive/ dormant
Sun Life Bond Fund (2000)	Sunlife Asset Management Co., Inc.	
Money Market Funds (2)		
ECC Money Market Fund (2001)	ECC Asset Management Inc.	redemption inactive/ dormant
Philequity Money Market Fund (na)	Philequity Management Inc.	dormant

Source: Securities and Exchange Commission; launch dates based on ICAP statistical report.

na – not available

[1] formerly Abacus Growth Fund (1996)

[2] formerly Far East Fund (1999)

While Philippine mutual funds have grown significantly in the last six (6) years, the sector's share in the total investible funds of Filipino savers remains small. As shown in Table 6 below, only P25 billion are invested in mutual funds as of December 2002. This is only 20% of the investment in CTFs and a little over 2% of funds in quasi-money deposits on that same date.

Table 6 also shows that bond funds (which did not join the market until 1997) account for all the growth in the mutual

funds industry (stock and balanced funds have been shrinking since 1999). As of December 2002, the 6 bond funds account for over 92% of the industry's net assets.

As with the CTFs, there is significant concentration in the mutual funds sector. If the funds with the same investment adviser are combined, the sector can be said to have only 3 major industry players – the BPI Group, Philam Asset Management Inc., and Sunlife Asset Management Co. Inc.

Table 6
Selected Financial Asset Holdings of Philippine Investors
(in Million Pesos)

	1997	1998	1999	2000	2001	Dec-02	97-02*
Common trust funds	77,745	88,435	82,409	67,598	81,964	122,562	9.53%
Investment management accounts	54,820	58,352	66,475	67,261	81,183	94,874	11.59%
FCDU/EFCDU Trust accounts	23,990	27,763	36,614	49,986	62,412	114,053	36.59%
Quasi money deposits (savings and time)	795,631	856,294	963,778	1,036,210	1,133,068	1,184,758	8.29%
Mutual Funds (net assets)	1,352	2,543	4,703	5,443	10,859	25,392	79.78%
Net assets by type of fund							
Stock	400	506	952	830	864	725	12.63%
Balanced	871	1,622	2,000	1,704	1,510	1,158	5.86%
Bond	81	415	1,751	2,909	8,423	23,500	210.83%
Money market					61	9	

Source of trust data: Bangko Sentral ng Pilipinas

Source of mutual funds data: Investment Company Association of the Philippines.

* Compound Annual Growth Rate

Table 7 below shows that one fund managed by the BPI Asset Management and Trust Group accounts for over 44% of the industry's net assets. Four (4) funds

managed by PAMI corner 40% of market share based on net assets, and the Sunlife funds (all of which started operations only in 2000 or later) have an 11% share.³

Table 7
Industry Concentration in Terms of Net Asset
(September 30, 2003)

Fund/Family of Funds	Net Assets	% Share
Ayala Life Fund (1 fund) [1]	17,517	44.17%
All Philam Funds (4 funds)	15,995	40.34%
All Sunlife Funds (4 funds)	4,389	11.07%
GSIS Kinabukasan Fund (1 fund) [2]	618	1.56%
All Others (12 funds)	1,136	2.86%
Total - all mutual funds	39,655	100.00%

[1] Far East Dollar Fund and the Philippine Index Fund Corporation are also managed by the BPI Group. Because of their small sizes, however, their inclusion would have only increased the figures reported in this table for the BPI-managed funds by less than 1 percent.

[2] Management of the GSIS Kinabukasan Fund was transferred to Philam Asset Management Inc. beginning 2nd quarter of 2003

Source: Investment Company Association of the Philippines.

Based on number of accounts, however, the PAMI Funds have the largest share at over 45%. The GSIS Kinabukasan Fund, which was initially marketed to GSIS members, has the second largest number of accounts. Given the size of their net assets,

the PAMI and GSIS Funds appear to be invested in by "smaller" investors. This is contrasted with the Ayala Life and Sunlife Funds, wherein net assets per account average P1 million and over (see Table 8).

Table 8
Industry Concentration in Terms of Number of Accounts
(September 30, 2003)

Fund/Family of Funds	Number of Accounts	Percentage of Total	Net assets per account (million pesos)
Ayala Life Fund (1 fund)	4,237	8.85%	4.13
All Philam Funds (4 funds)	21,903	45.73%	0.73
All Sunlife Funds (4 funds)	4,196	8.76%	1.05
GSIS Kinabukasan Fund (1 fund)	7,902	16.50%	0.08
All other funds (12 funds)	9,663	20.17%	0.12
Total - all mutual funds	47,901	100.00%	0.83

Source: Investment Company Association of the Philippines.

Mutual funds are sold by SEC-registered investment company sales agents. The sales agents are required to register as distributors of a specific investment company adviser. They are also required to pass an examination before being granted authority

to distribute the product. A redemption fee of 1-3% is charged if an investor redeems his shares before a prescribed period, which is two years for most funds. A front-end sales commission or load of at most 5.5% is also a common feature of many funds.

IV. ELEMENTS OF A TRUST

The distinguishing feature of a trust is that the legal title (and thus the legal rights of ownership and control) of the property is transferred from the original owner (trustor) to one person (trustee), while the beneficial interest is in another (beneficiary). The trustee has the duty to use and apply the property as directed by the trustor. The instructions of the trustor are contained in a trust agreement or terms of the trust.

Thus, ownership of the portfolio of assets in a CTF resides in the trustee institution⁴. For trust in general, the trustor sets the terms of the trust. For CTFs, it is the trustee institution which develops the

terms, documents this in a CTF plan submitted to the Bangko Sentral ng Pilipinas, and presents the terms for acceptance by any willing trustor. The investor/trustor receives units of participation in the CTF as evidence of his transfer of funds to the trustee, and benefits from the CTF in proportion to his share in the total participation in the fund. The trustee is obliged to comply with the terms of the trust and to "administer the funds or property under its custody with the diligence that a prudent man would exercise in the conduct of an enterprise of a like character

and with similar aims.⁵” As elaborated in the Manual of Regulations for Banks:

“The cardinal principle common to all trust and other fiduciary relationships is fidelity. Policies predicated upon this principle are directed towards confidentiality, scrupulous care, safety and prudent management of property including

reasonable probability of income with proper accounting and appropriate reporting thereon. Practices are designed to promote efficiency in administration and operation; to adhere and conform with the terms of the instrument or contract; and to maintain absolute separation of property free from any intrusion of conflict of interest.⁶”

V. TRUST VERSUS EQUITY

The fiduciary nature of the relationship between the CTF issuer and trustor/investor appears, on the surface, to be different from that which exists in a mutual fund arrangement. In the latter, the investor purchases equity shares from the investment company or mutual fund. Ownership of the portfolio of assets resides in the mutual fund, with the investor a claimant to the net assets of the fund, in proportion to his equity holdings. Management of an investment company is undertaken by SEC-registered investment advisers. As the incorporation of an investment company is initiated by an investment adviser, the “identity” of the mutual fund is inseparable from that of the investment company adviser.

As far as the investor is concerned, however, there appears to be no difference in the risk he faces whether he invested in a

common trust fund or a mutual fund. In both cases, there is no guarantee on the principal or on the return. While a trustor should normally be able to directly influence the terms of the trust agreement, the fact that he is only one of numerous trustors in a common trust fund virtually makes it impossible for him to do so. There is no reason to expect that the level of diligence, prudence and care in the management of a fund would differ between a trust entity and an investment company adviser. The quote above from the Manual of Regulations for Banks on governing policies for the conduct of a trust business should apply as well to the management of an investment company, except in one respect – confidentiality. This cannot be expected of a mutual fund, given that mutual funds are not governed by the bank secrecy law (R.A. No. 1509).

VI. DIFFERENTIAL REGULATION AND TAXATION

CTFs and mutual funds differ significantly, however, in regulatory and taxation aspects. CTFs are regulated by the Bangko Sentral ng Pilipinas while the main regulator of mutual funds is the Securities and Exchange Commission. A comparison of the rules and regulations as regards capitalization, investments, management, disclosures and taxation reveals that the 2 forms of investment differ in the following respects (see Table 9)⁷:

a. Entry standards – the capitalization requirement for entities interested in establishing a common trust fund is higher than that for a mutual fund. In addition, the BSP requires an entity to have a track record of profitability, solvency and compliance with BSP regulations on capital, governance structures, and loan activities prior to the grant of authority to conduct trust business.

b. Liquidity requirements – CTFs’ liquidity requirements are higher than

mutual funds. CTFs are subject to legal and liquidity reserves of 21%; mutual funds are required to have 10% of their net assets in liquid funds.⁸

c. Investments – Investment restrictions appear to be more stringent for mutual funds than they are for CTFs. Mutual funds by law are prohibited from investing in certain assets (e.g., futures, precious metals, unlimited liability investments). Mutual funds are also subject to a lower ceiling on investments in a single entity or issuer.

d. Management – CTF management regulations appear to be stricter than that for the mutual funds. The emphasis of the former is on eliminating sources of conflicts of interest and on ensuring the independence of trust operations and management from the rest of the bank's operations and management.

e. Disclosure – Disclosure requirements for each type of investment differ. It may be argued that CTFs have more stringent requirements, given that trust entities are required to submit financial statements and detailed quarterly reports of investments and income to their trustors. On the other hand, mutual funds are required to publish their daily NAV in newspapers of general circulation. Prospectuses and

financial statements of the mutual funds are also freely available to present and potential investors – either from the investment companies, the investment company agents, or the SEC. The same cannot be said of CTF plans and financial statements of the trust funds.

f. Taxation – CTFs are not subject to income tax whereas mutual funds are charged a corporate income tax of 32%.⁹ Nevertheless, both funds are subject to the same final taxes on investment income. The two also differ in that mutual funds are subject to documentary stamp taxes for share issuances. Mutual fund investors are also subject to a 10% tax on dividend income received from their investments. As CTF holders do not receive “dividends”, they are not subject to the same tax.

g. Others – The BSP requires banks to deposit with it cash and securities worth P500,000 or 1% of the book value of its trust assets, whichever is higher “as security for the faithful performance of trust duties”¹⁰. Banks are also required to build up a surplus, from the income of its trust business, an amount equal to 20% of its authorized capital stock. Such surplus shall not be available for dividends but used to absorb losses from the bank's trust business.¹¹

Table 9
Regulatory and Taxation Differences: Common Trust Funds and Mutual Funds

	Mutual Funds	Common Trust Funds
Basis of Regulation	Investment Company Act (RA 2629 - 1960) and Implementing Rules and Regulations contained in ICA Rule 35.1 (1998)	General Banking Act (RA 8791 - 2000) Chapter IX – Trust Operations and Part IV – Manual of Regulations for Banks
Regulator	Securities and Exchange Commission	Bangko Sentral ng Pilipinas (Central Bank)
Form of Organization	Stock corporation	Stock corporation or authorized person
Capital Requirements	Paid in capital of P50 million per investment company	Minimum capital of P4.95B, P2.4B, and P650M for universal, regular commercial, and thrift banks, respectively, and track record of profitability and compliance with BSP rules on capital, governance structures, and loan activities. For non-bank financial institutions (e.g., investment houses), minimum capital requirement is P250 million.
Investment Conditions/ Restrictions	<p>Investment objectives and initial investment plans clearly stated in prospectus</p> <p>Change in investment objective requires approval of majority of shareholders.</p> <p>Maximum investment in any single enterprise not to exceed 10% of the investment company's net assets, except in ROP¹², or 10% of outstanding securities of any one investee company</p> <p>Liquidity requirement: 10% of fund in short-term t-notes or bills or savings/time deposits</p>	<p>According to CTF plan. The CTF plan is made available at the principal office of the trustee during regular office hours for inspection. Information in CTF plan are in Sec X410.2 of Manual of Bank Regulations.</p> <p>Loans funded by trust accounts are subject to SBL and DOSRI ceilings. For determining compliance, loans granted by trust department and bank are combined.</p> <p>Maximum investment in any person, firm or corporation, excluding the ROP, shall be 15% of the market value of the CTF.</p>
Prohibited Investments	<p>Margin purchases of securities</p> <p>Commodity futures contracts</p> <p>Precious metals</p> <p>Unlimited liability investments</p>	

Table 9 (cont'd)

	Mutual Funds	Common Trust Funds
Reportorial Requirements	<p>Monthly report to the SEC showing the following information: (1) total amount received from sale of shares, (2) total amount of redemptions, (3) number of shares at beginning of month, (4) number of shares sold during the month, (5) number of shares redeemed during the month, (6) number of shares outstanding at the end of the month, and (7) percentage of outstanding shares owned by Filipinos</p> <p>Subject to reporting requirements of Securities Regulation Code (SRC) Rule 68 and 68.1</p>	<p>To trustor, at least quarterly: (1) balance sheet, (2) income statement, (3) schedule of earning assets of the account, and (4) investment activity report. Items (3) and (4) shall include at least the following: (a) name of issuer or borrower, (b) type of instrument, (c) collateral, if any, (d) amount invested, (e) earning rate or yield, (f) amount of earnings, (g) transaction date, and (h) maturity date. [Sec X425.1 Manual of Bank Regulations]</p> <p>To BSP: Audited Financial Statements of Trust and Other Fiduciary Business and Fund Management Activities and the auditor's letter of comments on trust/investment management accounts' internal control</p>
Other Disclosure Requirements	Post NAV per share on a daily basis published in at least 2 newspapers of general circulation and posted in conspicuous place at principal office and branches	
Management	<p>Incorporators and directors must be Filipino citizens.</p> <p>SEC sets compensation levels of Board of Directors and executives.</p> <p>Investment manager or adviser of an investment company applies with the SEC and is required the following: P10M minimum unimpaired net worth, curriculum vitae of directors, audited financial statements for last 3 yrs, compliance with governance requirements.</p>	Trust committee, trust officer, and other subordinate officers of the trust department. The trust department shall be organizationally, operationally, administratively and functionally separate and distinct from the other departments and/or businesses of the institution. Trust department reports to trust committee, which reports to bank's Board of Directors. Trust committee must have at least 5 members who are not bank officers.
Minimum size of investment	P5,000 (by law)	None
Operating expenses	Not to exceed 10% of total investment fund or total net worth	
Capital structure	Requirement of 300% asset coverage for all borrowings	No specific requirement for trust funds. Banks have required capital to risk assets ratio.

Table 9 (cont'd)

	Mutual Funds	Common Trust Funds
Others	<p>Amount of paid-in capital at incorporation as well as investment securities are required to be deposited with a custodian (i.e., commercial bank authorized to engage in trust operations)</p> <p>Cannot underwrite securities except its own</p>	<p>Required to have investment securities in the custody of a BSP-accredited third-party provider effective October 2004¹³</p> <p>Subject to legal (10%) and liquidity reserves (11%) [BSP Circular 491 s.2005]. The required liquidity reserves may be maintained in the form of short-term market yielding government securities purchased directly from the Bangko Sentral ng Pilipinas (BSP) Treasury Department, pursuant to Circular 10 dated December 29, 1993.</p> <p>Requirement of BSP deposit of cash or securities worth P500,000 minimum or 1% of the book value of the total volume of trust, other fiduciary and investment management assets.</p> <p>Banks are required to build up, from trust business income, a surplus equivalent to 20% of authorized capital stock. This is not available for dividends but to absorb losses from the bank's trust business.</p>
Fund Taxation	<p>Final tax of 20%, 12%, 5% on interest income from peso bank deposits, deposit substitutes, etc., with tenors of less than 3 years, 3-4 years, 4-5 years, respectively</p> <p>Final tax of 7.5% on interest income from foreign currency deposit units</p> <p>Corporate income tax rate of 32%</p> <p>Capital gains tax from sale of shares of stock (5-10% if not listed, ½ of 1% if listed)</p> <p>Documentary stamp tax – Fund pays P2 per P200 on original issuance of shares</p>	<p>Final tax of 20%, 12%, 5% on interest income from peso bank deposits, deposit substitutes, etc., with tenors of less than 3 years, 3-4 years, 4-5 years, respectively</p> <p>Final tax of 7.5% on interest income from foreign currency deposit units</p> <p>Capital gains tax from sale of shares of stock (5-10% if not listed, ½ of 1% if listed)</p>
Shareholder Taxation	<p>Tax on cash or property dividends – 10%</p> <p>Documentary stamp tax of P1.50 per P200 of par on subsequent sale or transfer of shares</p>	

VII. CONCLUSIONS AND AREAS FOR FURTHER RESEARCH

Based solely on finance principles (i.e., eliminating the effects of differential regulation and taxation), there should be no difference in the risk-return profile of a CTF investment vis-à-vis a mutual fund investment. For both, the risk and returns depend on the portfolio mix of the fund. Investors benefit from diversification and "professional" management in both types of funds. Both investments are liquid, in that the issuers, whether a trust entity or an investment company, stand ready to redeem or payout one's shares or participation in a fund. Both do not assure any rate of return, nor guarantee the safety of the principal investment.

Differential regulation as discussed above, however, have made (or at least have aimed to make) CTF investments safer than mutual fund investments. In particular, trust entities have higher capitalization and liquidity requirements. Trust entities are also subject to greater disclosure and supervision requirements than are mutual funds. These obviously impose additional costs on CTFs and reduce expected returns from these types of funds, all else being equal.

In the process of conducting this research, however, it is also revealed that there is much more information available as regards the mutual funds than the common trust funds. Despite the requirement of detailed quarterly financial reporting to CTF investors, it is not evident that this is being complied with. At least one instance of anomalous transactions involving a bank's trust operations, which led to the closure of Urban Bank, also raises some doubt

regarding the effectiveness of present regulation aimed at ensuring the independence of the trust business of a bank from the rest of its operations. Nonetheless, the lack of transparency can be argued to be offset by the extent and strictness of regulations governing the CTFs.

The foregoing considered, market completeness is promoted by the availability of both types of investments to investors. The local dominance of common trust funds may also now be explained, not only by its ready accessibility to investors, but also by the fact that Filipino investors may generally be risk-averse and not sophisticated enough to analyze the merits and demerits of mutual fund investing. Mutual funds have to exert greater effort in educating investors, improving their accessibility, and advocating against unnecessary controls on their investment activities. The main mutual fund regulator, the SEC, should focus on greater transparency and information dissemination regarding the funds, rather than on restrictions on mutual fund activities.

An interesting area for future research is to determine whether indeed comparable (in terms of portfolio mix) CTFs underperform mutual funds. It will also be very interesting to determine how different the profile of a CTF investor is from a mutual fund investor. These may confirm (or disconfirm) this study's suggested reasons for the dominance of CTFs in the local investment market and provide additional evidence on the efficiency (or inefficiency) of Philippine financial markets.

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Appendix A
List of Institutions Authorized to Conduct Trust Business in the Philippines
(March 2005)

Universal & Commercial Banks

1. Allied Banking Corporation
2. Banco de Oro Universal Bank
3. Bank of Philippine Islands
4. China Banking Corporation
5. Development Bank of the Philippines
6. Equitable PCI Bank
7. ING Bank N.V. – Manila Branch
8. Land Bank of the Philippines
9. Metropolitan Bank and Trust Company
10. Philippine National Bank
11. Prudential Bank
12. Rizal Commercial and Banking Corporation
13. Security Bank Corporation
14. Standard Chartered Bank
15. The Hongkong & Shanghai Banking Corp. Ltd.
16. Union Bank of the Philippines
17. United Coconut Planters Bank

Thrift Banks

1. American Express Bank
2. Asiatrust Development Bank
3. Banco Filipino Savings and Mortgage Bank
4. BPI Family Savings Bank
5. Equitable Savings Bank
6. Insular Life Savings and Trust Company
7. Keppel Bank Phils. (A Thrift Bank)
8. Optimum Development Bank
9. Philam Savings Bank
10. Philippine Business Bank
11. Philippine Savings Bank
12. Planters Development Bank
13. Premiere Development Bank
14. RCBC Savings Bank
15. Robinsons Savings Bank
16. The Manila Banking Corporation

Commercial Banks

1. ABN-AMRO Bank, Inc.
2. Asia United Bank Corporation
3. BDO Private Bank, Inc.
4. Bank of Commerce
5. Citibank, N.A. (Phils.)
6. Chinatrust (Phils.) Commercial Bank Corp.
7. Deutsche Bank
8. East-West Banking Corporation
9. Export and Industry Bank
10. International Exchange Bank
11. JP Morgan Chase Bank
12. Maybank Philippines, Inc.
13. Philippine Bank of Communication
14. Philippine Trust Company
15. Philippine Veterans Bank
16. United Overseas Bank Philippines

Investment Houses

With Quasi-Banking Function

1. AB Capital and Investment Corporation
2. Multinational Investment Bancorporation
3. State Investment Trust, Inc.

Without Quasi-Banking Function

1. Advent Capital and Finance Corporation
2. ATR-Kim Eng Capital Partners, Inc. - (Trust only)
3. Insular Investment and Trust Corporation
4. Philippine Commercial Capital, Inc.
5. Wise Capital Investment and Trust Co., Inc. - (Trust & IMA)
6. Pentacapital and Investment

Appendix B Terminology¹⁴

- a. Trust business – any activity resulting from a trustor-trustee relationship (trusteeship) involving the appointment of a trustee by a trustor for the administration, holding, management of funds and/or properties of the trustor by the trustee for the use, benefit or advantage of the trustor or of others called beneficiaries.
- b. Trust – a relationship or an arrangement whereby a person called a trustee is appointed by a person called the trustor to administer, hold and manage funds and/or property of the trustor for the benefit of any beneficiary.
- c. Common trust fund – a fund maintained by a bank authorized to perform trust operations under a written and formally established plan, exclusively for the collective investment and reinvestment of certain money representing participation in the plan received by it in its capacity as the trustee.
- d. Investment Company – any issuer which is or holds itself out as being engaged primarily, or proposes to engage primarily in the business of investing, reinvesting and trading in securities.
- e. Open-end Company – shall refer to an investment company which is offering for sale, or has outstanding, any redeemable security of which it is the issuer¹⁵

Appendix C Significant Differences Between Common Trust Funds and Unit Investment Trust Funds

	Common Trust Funds	Unit Investment Trust Funds
Valuation	Beneficial interest of CTF participant is determined using the accrual method (i.e., principal and earned interest from the fund's various investments).	Beneficial interest of a UITF participants is determined under a net asset value per unit (NAVpu) valuation methodology. The value of the total net assets of the fund is based on the market values of the fund investments.
Investment Conditions/Restrictions	Subject to statutory and liquidity reserve requirements, single-borrower's limit (SBL), and DOSRI restrictions (see Table 9)	Exempt from reserve requirements, SBL, and DOSRI restrictions Required to be invested in bank deposits, securities issued or guaranteed by the ROP or the BSP, and/or tradable securities.
Publication Requirement	None	Net asset value per unit of a UITF is required to be published weekly in a newspaper of national circulation.

Source: Manual of Regulations for Banks Section X410.

NOTES

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- ¹ The TOAP database includes only trust funds that are “unitized”; i.e., report net asset value per unit of participation in the fund.
- ² A more comprehensive industry study of the mutual funds sector can be found in Valderrama and Bautista (2005).
- ³ Because of its entry in the mutual funds sector only in the second half of 2003, the Philippine Index Fund Corp. was not included in this tabulation.
- ⁴ A trustee institution is named trust entity in R.A. No. 8791 (General Banking Law of 2000). It is a stock corporation or person authorized by the Monetary Board to engage in trust business (Chapter IX Sec. 79).
- ⁵ R.A. No. 8791 Chapter IX Sec. 80.
- ⁶ Bangko Sentral ng Pilipinas, Manual of Regulations for Banks, Section X401.
- ⁷ Common trust funds are required by the BSP to be gradually converted to unit investment trust funds (UITF) beginning September 2004 (BSP Circular No. 447 series of 2004). To ‘encourage’ the conversion, the BSP hiked the reserve requirements on CTFs from the pre-UITF level of 14% to 19% then subsequently to its present level of 21%. While the BSP defines common trust funds as ‘synonymous’ with unit investment trust funds (Manual of Operations for Banks Section X410.1), a number of significant differences exist between these two types of investments. A summary of these differences is shown in Appendix C.
- ⁸ Effective July 15, 2005 per BSP Circular No. 491 series of 2005. On top of the reserve requirements, FCDU/EFCDU CTFs have a liquidity requirement of 10% of the book value of the fund, which requirement may be met by investing in readily marketable foreign securities or foreign currency deposits with foreign banks (Manual of Regulations for Banks Sec. X412.4).
- ⁹ Corporate income tax was increased from 32% to 35% in the recently passed VAT reform law.
- ¹⁰ Manual of Regulations for Banks Sec. X412.3
- ¹¹ Manual of Bank Regulations Sec. X413
- ¹² ROP-Republic of the Philippines.
- ¹³ BSP Circular No. 452 series of 2004
- ¹⁴ For a, b, and c – Bangko Sentral ng Pilipinas. Manual of Regulations for Banks section X403; for d and e – ICA Rule 35-1 The Investment Company Rule section a.
- ¹⁵ Open-end funds go by the more popular name of “mutual funds”