PRIMER ON SAVINGS & INVESTMENT INSTRUMENTS IN THE PHILIPPINES

Ateneo-Economic Policy Reform and Advocacy (EPRA) Project

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ATENEO DE MANILA UNIVERSITY
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**Primer on Savings &
Investment in the Philippines**
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why a primer on savings & investment?

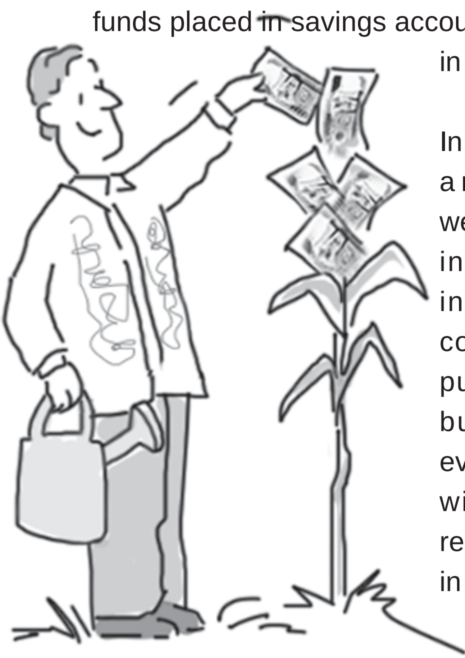
Many Filipinos aim for financial security by setting aside a portion of their disposable income to be placed in better yielding instruments. This primer discusses places to accumulate savings and identifies common invest-ment options. It also list factors to consider when selecting savings and investments. In an attempt to describe the basic features of savings and investment instruments currently available in the market, this primer will hopefully educate the public (particularly the small savers) on the risks and opportunities involved in saving and investing.

WHY SHOULD FILIPINOS SAVE & INVEST?

Saving and investing presents numerous benefits to an average Filipino. First, funds allocated to savings and investments provide *financial security* in times of emergencies and help people cope with unexpected events such as illness, unemployment, and accidents. In addition, saving and investing advances a person's *financial goals* like a new car, education, a trip, or even a down payment for a house. Naturally, a more important benefit of saving and investing is to guarantee a comfortable and financially secure *retirement*. Lastly, saving and investing allows a person to earn more money.

what is the difference between SAVING&INVESTING?

In most cases, saving does not involve any element of significant risk. It simply implies not spending. It is the difference between income and expenses. Almost all Filipinos have savings accounts and ATMs. Placing one's savings in a bank deposit allows Filipinos to access their hard-earned cash to meet short-term expenses and store extra cash in a place safer than a mattress or cabinet at home. The rates of return of funds placed in savings account are lower than those in investment instruments.



In contrast, investing takes a more active approach to wealth accumulation and involves risk. In an investment, a person commits capital for the purchase of securities, business, property, or even art work and jewelry with expectations of realizing profits or returns in the future.

WHAT **DO** YOU **MEAN** BY RISK & RETURN in INVESTMENT?

Risk refers to the uncertainty of receiving profit or return from an investment. The *return* is the compensation to the investor for taking risk and depends on the level of risk involved.

HOW **DO** YOU **KNOW** **WHICH** KINDS **OF** SAVINGS **OR** INVESTMENT **VEHICLES** ARE **THE** BEST**?**

Before making decisions on where to put one's hard-earned cash, a person should look into four (4) major considerations: liquidity, return, tax implications, and risk.

Liquidity: How quickly will this person need the money? When investing or placing funds in a savings or a time deposit, a person must determine how soon he or she will need the money and assess the amount of his or her short-term expenses and emergency money.

Return. Returns may come from earnings or growth. Earning or profits from investments may be in the form of interest, dividends, or rent payments. Growth, in contrast, comes from the appreciation in the value of the investment that is bought and sold.

Tax Implications. How much will a saver or investor pay to place hard-earned cash in savings and investment vehicles? Money may grow faster in a tax-advantaged savings or investment plan because the money that would have been paid in taxes will earn.

Risk: How willing is the person to take risks? Can this person sleep well at night when the value of the investment goes down? As a general rule, the greater the return, the higher is the risk. Risk tolerance is a person's strength to endure the ups and downs of the market without panicking when the value of investments goes down. The list below describes five varieties of risk.

a) *Interest Rate Risk.* This is relevant for fixed-income investments such as bonds or mutual bond funds. Changing interest rates can have a major effect on fixed-income investments. The value of a fixed-income investment decreases when interest rates rise and increases with a decline in interest rates. When a person buys a long-term fixed income investment and interest rates go up, he or she loses the value of higher returns.

b) *Business/Event Risk*. This refers to unforeseen circumstances that may adversely affect the value of a person's investment. This risk can be either company-specific or industry wide.

c) *Credit Risk (or Default Risk*). In the case of a bond, it is the possibility the issuer (e.g. a corporation or a government institution) will fail to meet the terms of the obligations with respect to the timely payment of interest and principal. If the bond is part of a mutual fund or a unit investment trust fund (UITF), the risk will certainly affect the net asset value of that fund. For stocks, credit risk is the likelihood the company issuing the stock may have financial problems that may lead it to cut or suspend its dividend payments.

d) *Market Risk.* This arises from the ups and downs and sentiments of the markets, which may affect the prices or value of bonds and stocks.

e) *Purchasing Power/Inflation Risk.* This happens when the financial return on an investment loses purchasing power due to a general rise in the prices of goods and services. To deal with this risk, a person must ensure that the investment rate of return exceed the rate of inflation.

f) *Political Risk.* Political risk stems from changes to the political and socio-economic conditions of the Philippines that may affect market sentiments, business profits, and investment returns.

HOW CAN I ASSESS MY **RISK** TOLERANCE**?**

You can take the short survey to assess your risk tolerance and level of comfort with the way money is invested. This short five-question survey is a modified version of the Risk Tolerance Survey of Wells Fargo.[1]

1. With which types of savings or investments are you most comfortable?
   a. Savings Accounts
   b. Money Market instruments and Government savings bonds
   c. Corporate bonds or bond funds
   d. Stocks or stock funds

2. After you make a savings or investment decision, you feel:
   a. Worried
   b. Satisfied
   c. Hopeful
   d. Invigorated

[1] http://www.wellsfargo.com/investing/basics/goals_risk

3. Say you invest $20,000. Each of the following answers shows the range of returns that your investment may experience after just one year, based on the underlying holdings. Which investment would you be most comfortable holding?
   a. PhP 10,000 –PhP50,000
   b. PhP 60,000-PhP 100,000
   c. PhP 100,000-PhP 200,000
   d. PhP 200,000-PhP 500,000

4. For the last five years, your investment has returned an average 10% per year — in line with other similar investments. However, it loses 20% over the next year. What do you do?
   a. Sell all of the investment.
   b. Sell a portion of the investment.
   c. Nothing.
   d. Buy more of the same investment.

5. Which phrase best describes your take on life?
   a. Proceed with caution — take no unnecessary risks.
   b. Take small, measurable risks and patiently pursue your dreams.
   c. Prepare well, but follow your goals without fear.
   d. No hesitation — go for it!

Results of Risk Tolerance Survey (Source: http://www.wellsfargo.com/investing/basics/goals_risk)

If you selected mostly (a)'s:
You are highly risk-averse. You're also a strong candidate to learn as much as you can about investing because the more you know about risk-and-reward potential, the better you can manage your portfolio to take advantage of growth opportunities.

If you selected mostly (b)'s:
You are somewhat risk-averse, but you understand the importance of investing and do so with a measure of caution and calculated risk. You would probably benefit from a diversified portfolio. It's important to remember to build in some component of growth in your portfolio in order to mitigate the impact of taxes and inflation.

If you selected mostly (c)'s:
You understand the concept of risk and are prepared to deal with the consequences in an effort to attain greater growth opportunities. You seem comfortable with your investment selections, which generally are the product of research and a balanced strategy that combines conservative-, medium-, and high-growth oriented investments.

If you selected mostly (d)'s:
You like taking risks and probably have an aggresive growth-oriented portfolio. If you are quite young (in your 20s or 30s) with sufficient income so that you're not dependent on your investments, taking the hig-risk road may reward you over time. However, make sure that your equity holdings are diversified and always maintain a long-term perspective.

Do you have summary of the risk, liquidity, return, and tax consequence of the instruments covered in this primer?

Savings/Investment Instrument	Risk	Return	Liquidity/Time frame	Tax Consequence to Investor
Savings Deposits	Low Risk, but PDIC guarantees only up to PhP 250,000	Below 1%	High Liquidity	Interest income subject to withholding tax, but amount is negligible
Checking Deposits	Low Risk, but PDIC guarantees only up to PhP 250,000	0%	High Liquidity	Interest income subject to withholding tax if it's an interesting-bearing account
Time Deposits (Dollar and Peso Accounts)	Low Risk, but PDIC guarantees only up to PhP 250,000	Generally 2-3% points below 91-day Treasury bill, but banks may also use 180-day treasury bill as baseline	Relatively liquid, but investor pays penalty if withdrawn during the placement period	Interest income subject to 20% withholding tax for peso account and 7.5% for dollar account, but some banks absorb the tax if the amount of placement is very high
Dollar Savings Account	Low Risk, but PDIC guarantees only up to PhP 250,000	0.5% to 0.75%	High Liquidity	Interest income subject to withholding tax, but amount is negligible
Dollar Checking Account	Low Risk, but PDIC guarantees only up to PhP 250,000	Around 0.5%	High Liquidity	Interest income subject to withholding tax if it's an interesting-bearing account
Government Securities (Treasury Bills, Treasury Notes, Retail Treasury Bonds, Dollar-linked Peso Notes)	Backed by National Govt	Interest rate vary with maturity of the issue, with shorter term issues having lower interest rates than longer term issues	Highly Liquid and can be sold through brokers or banks	Interest income subject to 20% withholding tax
Unit Investment Trust Funds (UITF)	Risk varies widely depending on objectives and policies of the fund	Good for longer-term investment-- 5 years or more	Can be sold anytime subject to "Plan Rules", but value changes daily.	Tax already imputed in the NAV per unit
Long-term Negotiable Certificates of Deposits (LTNCD)	Low Risk, but PDIC guarantees only up to PhP 250,000	Premium over the 3-month Treasury bill rate	Relatively low liquidity. Investor pays tax penalty if money is withdrawn before the 5-year maturity date	Interest income subject to withholding tax if investment is held for less than 5 years, but becomes tax-free of held for 5 years or more
Mutual Funds	Risk varies widely depending on objectives and policies of the fund	Good for longer-term investment-- 5 years or more	Very Liquid, but value changes daily and may be subject to redemption fees.	Tax already imputed in the NAV per share.
Corporate Bonds	Not guaranteed by National Government, and, therefore, riskier than government securities	Short-term bonds are good for time periods of 1-3 years, and all other bonds should be considered long-term investments.	Highly Liquid, but can only be sold through a broker when markets are open or when buyers make offers. Proceeds of sale may come after 3-5 days.	Interest income subject to withholding tax
Stocks	Prices fluctuate daily.	Must be considered a long-term investment.	Most stocks can be sold on almost any day, but proceeds of sale may come after 3-5 days.	Subject to stock transaction tax if stocks are sold though the exchange and capital gains tax for transactions not traded through the exchange. Purchases of stocks are subject to documentary stamp tax (DST)
Pre-Need Plans	Depends on the liquidity position and management of funds the pre-need company		Payment of contract is usually five years	Stamp tax on pre-need is PhP 0.20 on each PhP 500 or fraction thereof of the plan value.
Insurance Products	Depends on the liquidity position and management of premium income of the company		Payment of premiums depends on amount of coverage	Annuities are subject to DST of PhP 0.50 on each PhP 200 or fraction thereof of annuity capital. Life insurance policies are subject to DST of PhP 0.50 on each PhP 200 or fraction thereof of amount insured.
Pension Plans	Depends on the liquidity position and management of contributions of the institution		Contributions last until retirement age	Contributions to government pension plans not subject to tax.

what are the most basic SAVING&INVESTMENT instruments offered by banks?

Savings Accounts

The most basic of savings instruments housed in banks is the savings account. However, interest here is almost nil; hence, the only use of savings account to many is for safekeeping purposes. In addition to safekeeping, some people find keeping money in a savings account a good way to prevent mindless spending or an effective tool to prudent savings.

Current/ Checking Accounts

Another simple deposit instrument offered by banks is the checking account. The best way to settle payments/ obligations is by way of issuing checks because one is able to issue large sums of money safely without risk of theft. However, checking accounts do not earn interest. Hence it is advisable not to keep a large maintaining balance in your current account. Some banks have packaged a two-in-one savings and checking account to facilitate

easy transfer from checking account to savings and allow the depositor to still enjoy the interest that regular savings accounts offer while maintaining a checkbook.

A person who holds a checking account should always ensure that there are sufficient funds to back up any check that he issues. A check that is drawn against insufficient funds (DAIF) or drawn against an uncleared deposit (DAUD) will be charged by the bank at least P2, 200. If an account holder issues bouncing check for more than three times, his or her name is reported to the Bangko Sentral ng Pilipinas (BSP). The name becomes part of a list that banks usually refer to before granting loans and credit cards and is a negative point to one's "credit-worthiness".

Time Deposits

If one wants to keep excess funds (defined as that over and above your daily requirements), time deposits can offer a depositor slightly higher interest than savings accounts. Moreover, the bank assures the depositor of a fixed rate, often based on the 30-day, 90-day or 180-day Treasury bill rates, but sets a fixed duration where no withdrawals should be made. Hence, the depositor is advised to ensure that the amount placed in the time deposits will not be used during the placement period or else pay penalties.

Dollar Savings Accounts

Dollar Savings accounts allow a depositor to keep his dollars in a savings account and earn an interest rate of 0.5% to 0.75 %. Attached to this is the bank service that allows remittances from relatives abroad via telegraphic transfers. It can come with an international ATM for easier access when out of the country.

Dollar Checking Account

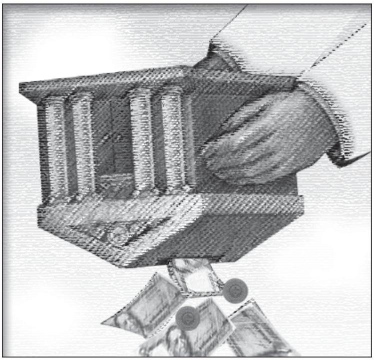
Similar to the peso checking account, the dollar checking account earns no interest. When packaged as a checking cum savings account, it is able to earn minimal interest (0.5%) as a regular dollar savings account. The real selling point is the ease it offers when one needs to settle major obligations abroad such as paying tuition fees or purchasing real estate overseas. For businessmen, import transactions can also be facilitated.

WHICH **GOVERNMENT** AGENCY IS RESPONSIBLE FOR MONITORING **BANKS**?

is there an insurance for my deposits?

The banks are governed by Bangko Sentral ng Pilipinas (BSP) under the General Banking Law of 2000, the New Central Bank Act of 1993, and the Thrift Bank Act of 1994. Today, the Philippine Deposit Insurance Corporation (PDIC) insures deposits to up to PhP 250,000.

CAN YOU GIVE ME SOME TIPS ON HOW TO PROTECT MYSELF FROM LOSS OF DEPOSITS?

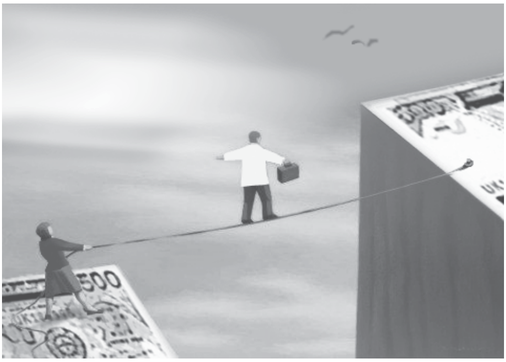


Depositors can help impose market discipline on banks by observing the following smart savings tips from PDIC in safeguarding their deposits:

1) **Know the bank's reputation.** Depositors should read newspapers and surf websites of BSP and the bank to know about the bank's capitalization increases, ranking among peers, financial statements, income projection, and products and services.

2) **Know the bank's products.** Depositors should also determine whether a particular bank product is a deposit or not. They may confuse deposit products with investment schemes not covered by PDIC.

3) **Know the current market interest rates**. Depositors should be cautious with overwhelmingly high interest rates. Unusually high interest rates compared to market interest rates may mean liquidity problems and higher risks.



4) **Read the fine prints**. Depositors should also be careful not to miss out the fine prints—tiny words, phrases, or sentences in the passbook, certificate of time deposit, or any documents that need to be signed.

5) **Secure and update bank records**. Depositors must secure passbook, ATM card, certificate of time deposit, checkbook and other bank records. These records serve as proof of the deposit accounts.

6) **Check for signs that the bank may be in trouble**. Depositors should be wary when they cannot withdraw their money on demand or if they can only withdraw money at a schedule given by bank officers. Further, they should be cautious of aggressive solicitation by bank marketing personnel. Finally, depositors should also take note of their bank's past due loan ratios. High levels of unpaid debt may lead to a bank's difficulty in servicing withdrawals.

do banks **offer** other investment instruments in **addition** to basic savings, dollar & time deposit accounts?

Yes. Aside from deposit products, another broad category of bank-based products is the money and capital market instruments. The money market is a market for low risk, highly liquid short-term evidences of indebtedness. When someone borrows money, the “promise” of the borrower to pay back the amount borrowed (principal) with interest, which is evidenced or documented by either a certificate, a promissory note, can be bought by an investor, and resold easily to another interested investor. These promises, or debt securities, are usually housed in banks or investment houses. Capital market instruments, on the other hand, have long-term maturities, better yields, but higher risks.

WHAT **KINDS** OF MONEY & CAPITAL **MARKET** INSTRUMENTS **do** bank **offer**?

Banks may offer government securities in the form of treasury bills, treasury notes, retail treasury bonds (RTBs), or dollar-linked peso notes. Or they may also offer long-term negotiable certificates of deposits (LNCDs) or unit investment trust funds (UITFs).

what are government securities?

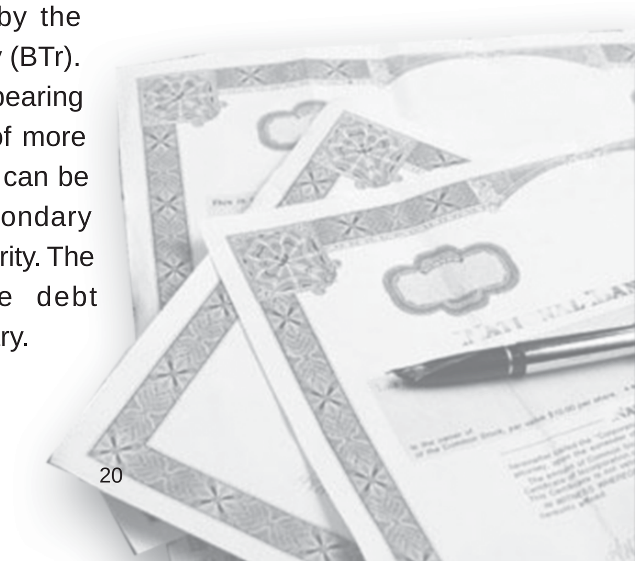
On many occasions, the Philippine National Government or its agencies issue debt securities to finance deficits and development projects. These debt securities, commonly referred to as GS, can be alternative forms of investments. Further, they are either directly or indirectly backed by the full faith of the Philippine Government. Hence, they carry lower interest rates than those issued by the corporate sector. In addition, GS may be used to track market interest rate movements and as benchmarks in setting the return rates of corporate issues.

Treasury Bills

Treasury Bills (T-bills) are direct and unconditional obligations of the national government. They are issued by the Bureau of Treasury (BTr). They carry maturity of one year or less and can be traded in the secondary market before maturity. Various tenors of Tbills exist: 91,182 or 364 days. Banks that comprise majority of the Government Security Eligible Dealers (GSED) bid for T-bills in the weekly auctions held by the Bureau of Treasury. Then, the banks resell the T-bills to investors. Treasury Bills do not bear interest. They are issued and sold at a discount from face value and are redeemed at maturity for the full face value of the instrument

Treasury Notes

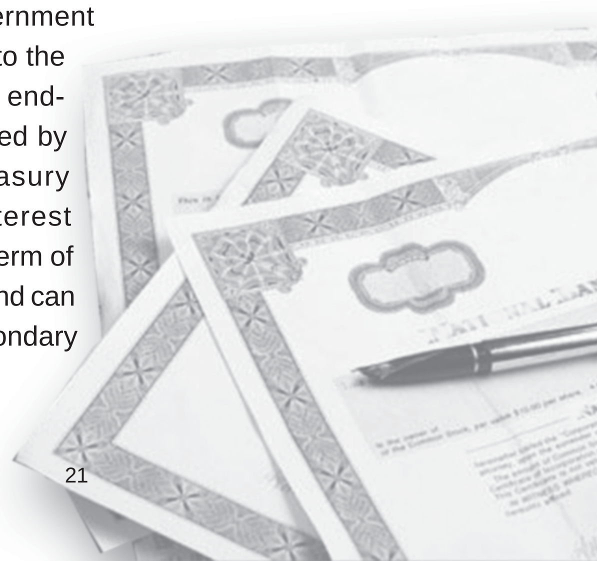
Fixed Rate Treasury Notes (FXTNs) are direct and unconditional obligations of the national government. They are issued by the Bureau of Treasury (BTr). They are interest bearing and carry a term of more than one year and can be traded in the secondary market before maturity. The tenors for these debt instruments can vary.



Fixed Rate Treasury Notes are considered one of the prime investment instruments in the market. They are safe, liquid and offer attractive returns to investors. Tenor can be 2, 5, 7 and 10, years. The interest rate is fixed for the life of the FXTN based on the lowest accepted yield to maturity on auction date. The coupon payment period (or the periodic payment of interest) can be payable semi-annually. Fixed Rate Treasury notes are issued and sold at a price equal to be face value and are redeemed at maturity for the full face value of the instrument plus interest/coupon of the last period.

Retail Treasury Bonds

Retail Treasury Bonds (RTBs) are like treasury notes but are usually longer in maturity (10 years and above). They are direct and unconditional obligations of the national government that primarily caters to the retail market or the end-users. They are issued by the Bureau of Treasury (BTr). They are interest bearing and carry a term of more than one year and can be traded in the secondary

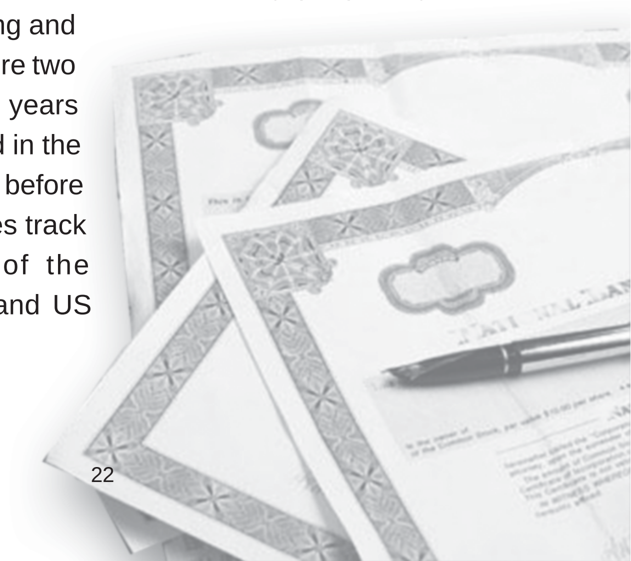


market before maturity. Retail Treasury Bonds (RTBs) are safe, liquid and offer attractive returns to investors. The interest coupons of treasury bonds are paid to the investor quarterly.

Further, Retail Treasury Bonds (RTBs) serve as a critical part of the government's program to make government securities available to small investors. They are issued to mobilize savings and encourage retail investors to purchase long-term papers. In contrast to PhP 500,000 in the wholesale market, the minimum placement of RTBs is PhP 5,000.

Dollar Linked Peso Notes (DLPN)

Dollar Linked Peso Notes (DLPNs) are direct and unconditional obligations of the national government and are issued by the Bureau of Treasury (BTr). They are interest bearing and carry a term of more two (2) and three (3) years and can be traded in the secondary market before maturity. The notes track the movement of the Philippine Peso and US



Dollar exchange rate. Payments of interest and principal are linked to the movement of the exchange rate and computed based on the foreign exchange factor.

HOW **CAN** I PURCHASE **GOVERNMENT** SECURITIES?

Institutions that buy these government securities include mutual funds, pension funds, insurance companies, commercial banks, corporations, state and local governments, central bank, and international investors.

Individual clients buy or hold government bonds through common trust funds/unit investment trust funds, mutual funds, or pension plans. Those who opt to purchase government securities through these channels tend to look for dependable income, relative safety, and diversification (BusinessWorld, 2005). Retail investors may also purchase government securities (GS) through eligible/qualified dealers or commercial banks.

Although government bonds are the safest and are relatively “risk-free”, it does not mean they are immune from credit/default risk, credit spread risk, or downgrade risk. Credit or default risk is the possibility the issuer will fail to meet the terms of the obligations with respect to the timely payment of interest and principal. Credit spread risks refer to the probability of an increase in the spread of the bond over a default-free security (i.e., US Treasury security) and a decline in the price of that bond. Downgrade risks pertain to the chance a credit rating firm (e.g., Fitchratings, Moody’s, or Standard and Poor’s) will lower the rating of a bond. In this regard, downgrade risks are closely associated with credit spreads risks.

The table below summarizes the product features of the government's four (4) main issues.

Summary of Philippine Government Issues	
Treasury Bills	
Issuer	National government
Term	91, 182, 364 days
Tax feature	Interest income subject to 20% final withholding tax
Type of income	Tax paid income
Interest computation	True discount formula
Manner of purchase	Auction or through secondary market
Fixed Rate Treasury Notes	
Issuer	National government
Term	2, 5, 7, 10, 15, 25 years
Tax feature	Interest income subject to 20% final withholding tax
Type of income	Tax paid income
Rate	Fixed for the life of the FXTN; based on lowest accepted yield to maturity on auction date
Coupon payment period	Payable semi-annually in arrears
Interest computation	Simple interest/add-on
Manner of purchase	Auction or through secondary market
Retail Treasury Bond	
Issuer	National government
Term	3 and 5 years
Tax feature	Interest income subject to 20% final withholding tax
Type of income	Tax paid income
Rate	Fixed for the life of the RTBs
Coupon payment period	Payable quarterly in arrears
Interest computation	Simple interest/add-on
Manner of purchase	Auction or through secondary market
Dollar Linked Peso Notes	
Issuer	National government
Term	2 and 3 years
Tax feature	Interest income subject to 20% final withholding tax
Type of income	Tax paid income
Rate	Fixed for the life of the FXTN; based on lowest accepted yield to maturity on auction date
Coupon rate and computation	Base Rate * Foreign Exchange Factor * 180 / 360
	Base rate is the coupon designated by the Issuer divided by 0.80 plus a spread of 50 basis points
	Foreign exchange factor = Php B Val/Php A Val
	Php B Val = spot Php/USD exchange rate one business date prior to coupon date
	Php A Val = spot Php/USD exchange rate one business date prior to issue date
Coupon payment period	Payable semi-annually in arrears
Redemption computation	[Face Value / PHP_A_Val] * PHP_C_Val
	Php A Val = spot Php/USD exchange rate one business day prior to issue date
	Php C Val = sport Php/USD exchange rate one business date prior to maturity date
Manner of purchase	Auction or through secondary market

Source: Money Market Association of the Philippines (www.mart.com.ph)

what are long-term negotiable certificates of deposit?

Negotiable certificates of deposit refer to a debt instrument sold by a bank to the public that pays annual interest and gives back the original purchase price at maturity. They can be liquidated anytime at the current market price, but the investor has to pay withholding taxes if held less for less than five years. Investments in NCDs are not subject to withholding tax if held for more than five (5) years. Long- term NCDs are competitively priced and usually carry a premium over the 3-month Treasury bill benchmark.

In the Philippines, only a few banks issue and sell negotiable certificates of deposits. This year, only Citibank and Banco de Oro have issued LTNCDs.

WHAT **IS** A UNIT INVESTMENT TRUST FUND (UITF)?

The Unit Investment Trust Fund (UITF) serves as an addition to the country's investment channels created under the central bank's Circular No. 447 in 2004. The UITF is actually an improved version of the existing Common Trust Fund (CTF), which is a collective investment scheme similar to a mutual fund that pools the investments of small investors into a larger fund under professional management that is able to access more superior investment opportunities that are not normally available to individual retail players (Bangko Sentral ng Pilipinas, 2004).

Purchase of a UITF. A prospective investor may buy in a UITF by purchasing "units of participation" in the fund. The units of participation correspond to the investor's proportionate share in the total value of the fund. Units of participation are based on the "net asset value per unit" (NAVPU) of the fund for the day. The NAVPU is calculated by dividing the fund's "net asset value" (NAV) by the number of outstanding units in the fund. The NAV of the fund is the sum of the market value of the investments of the fund less expenses. (BusinessWorld, 2005)

Further, the UITF is open-ended pooled trust fund such that it gives clients the option to invest or redeem their investments at any time subject to guidelines set forth in the UITF Declaration of Trust (or Plan Rules). The Plan Rules contain the mechanics of for investing, operating, and administering the fund.

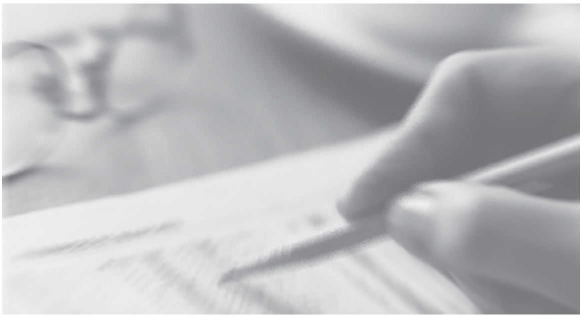
Valuation Method. The main difference of UITF from that of a CTF lies in the valuation methodology. CTFs are valued using the **accrual method**, whereby the NAV of the fund takes into account principal and interest accruing from various investments in the fund. This allows the fund to grow over time regardless of market price movements and hides paper losses. UITFs, on the other hand, are valued based on **marked-to-market method**, wherein investments are valued at market prices, allowing them to move with market fluctuations. In particular, with the marked-to-market method, the investors share in the gains and losses after expenses of the fund, proportionate to their respective participations in the pool. Thus, unrealized gains and losses are included in earnings. The change in valuation method aligns UITF with best practices in trust industry worldwide.

what are non-bank financial institutions?

Non-bank financial institutions (NBFIs) refer to non-monetary institutions outside the traditional banking sector which are primarily engaged in long-term financing of productive ventures. Moreover, NBFIs provide alternative avenues to savings but typically do not take deposits. They consist of mutual funds (or investment companies), investment houses, finance companies, securities dealers/brokers, pension funds, and insurance companies.

WHAT **ARE** MUTUAL FUNDS OR INVESTMENT COMPANIES?

Mutual funds (or investment companies) pool money from individual investors with small capital to purchase bonds and stocks, and create a diversified portfolio. The funds are then run separately by professional managers. Like any other companies, mutual funds issue shares of stock and sell these shares to public investors in exchange for cash. Mutual funds (or investment companies) allow savers to become long-term investors and make it possible to open the public to the securities markets.



what are the different kinds of mutual funds?

Depending on the investment objectives, professional managers buy, hold and sell assets in equities, fixed-interest instruments like bonds, and money-market deposits. In the Philippines, mutual funds fall under the following:

a) *Equity fund*. This fund is largely placed in stock market and has wide fluctuations. Nonetheless, in the long run, equity funds tend to perform better than fixed income funds.
b) *Index fund*. This fund consists of several stocks in the same proportion as that of the index the fund tracks (e.g., PSE Composite index), and has less risk than the equity fund.
c) *Balanced fund*. This makes investment in a balanced portfolio of stocks and fixed income securities. It both has the earning power of stocks and the stability and income of bonds.

d) *Bond fund*. This describes a type of investment company that primarily invests in long-term bonds and other types of debt securities. Earnings do not fluctuate as much as the other types of funds.

e) *Money market fund*. This refers to fund that makes investment in short-term fixed income instruments (i.e., those securities with less than one year of maturity). This portfolio has the lowest risk.

In the Philippines, banks are not allowed to sell mutual funds for the announced reason that it gives "impression that the investor is dealing with the parent bank" (USAID-AGILE, 1999). Unlike CTFs or UITFs, mutual funds are distributed and sold by insurance companies and asset management companies and regulated by the Securities and Exchange Commission (SEC) under the Investment Company Act. In February 2001, the SEC allowed Philippine-registered mutual funds to invest 20% of their portfolio in foreign funds or securities in response to weakness in the local equities market. (EIU, 2004)

Since mutual funds are professionally managed, investors need to pay specific fees called sales fee/ load. Like CTFs/UITFs, the actual price of each share is calculated defined by what is called net asset value per (NAVPS), which is the value of all assets held by the fund (less any liabilities) divided by the number of shares sold. To realize earnings on a mutual fund, an investor should compare the current NAVPS of the fund with its NAVPS at the time he/she bought it, and also take account of cost of sales and redemption fees. The NAVPS of mutual funds is regularly published in *BusinessWorld, Philippine Daily Inquirer,* and *Philippine Star*. The table below shows the top mutual funds based on assets at end-2003.

Top Ten Mutual Funds

Ranked by reported assets at end-2004, in millions of Pesos

Company	Assets	Market Share (%)
Philam Dollar Bond Fund (AIG)	12,490.4	42.5
Philam Bond Fund (AIG)	7,866.4	26.7
Sun Life of Canada Prosperity Bond Fund	4,652.8	15.8
GSIS Mutual Fund	1,169.5	4.0
Philippine Index Fund	413.8	1.4
Philequity Fund	393.8	1.3
Mutual Fund Company of the Philippines	370.5	1.3
Philam Strategic Growth Fund (AIG)	266.6	0.9
Sun Life of Canada Dollar Advantage Fund	260.9	0.9
Grepalife Fixed-Income fund	189.4	0.6
Total	29,400.7	100.0

Source: Economist Intelligence Unit (2004)

comparing mutual funds

COMPARING MUTUAL FUNDS

		1.	2.	3.
NAME OF MUTUAL FUND		1.________	2.________	3.________
MUTUAL FUND TYPE	(Stock, bond, money market, balanced, indexed, sector)	1.________	2.________	3.________
MUTUAL FUND OBJECTIVE	(Aggressive growth, moderate growth, income and safety, and income)	1.________	2.________	3.________
CURRENT RATE OF RETURN		1.________	2.________	3.________
YIELD RANGE IN LAST THREE TO FIVE YEARS		1.________	2.________	3.________
LOAD FEES	(Sales and redemption charges)	1.________	2.________	3.________
TOTAL OPERATING EXPENSES	(Management fees, advertising, and marketing costs expressed as a percentage of average net assets)	1.________	2.________	3.________
LEVEL OF RISK	(High, medium, low)	1.________	2.________	3.________

WHAT **ARE** CORPORATE BONDS?

A company with strong credit rating may issue bonds to fund working capital or expansion requirements. Most corporate bonds are fixed-rate bonds such that the interest rate the company pays (**coupon payment**) remains constant until maturity. Corporate bonds may either take the form of debentures, asset-backed bonds, or convertibles. Debentures have no collateral and are simply backed by the company's credit standing and its capacity to repay interest and principal. Asset-backed bonds come with specific assets that serve as collateral in case of default by the issuer (i.e., company), while convertibles have the additional feature of allowing the holder to convert them into shares of stock under certain provisions.

how can **i** purchase **corporate** bonds?

Investors who want to purchase corporate bonds must contact the lead manager/underwriter of the issuer and submit an application and other documents for purchase and verification. The lead underwriter guarantees the sale/distribution the bond issued by the company, negotiates the pricing with the issuer, secures rating from credit rating agencies, and handles registration requirements from the SEC. Alternatively, investors may contact a bank or broker who participated in the sale of the corporate bond, or simply participate in a bond fund.

Corporate bonds involve higher risks than government bonds, but higher risks may also mean better returns. They involve more risk because companies are vulnerable to economic shocks, mismanagement, and competition. (BusinessWorld, 2005) Returns on corporate bonds hinge on the issuing company's performance and outlook.

WHAT **IS** A STOCK?

Stocks represent ownership of a company as well as claims on the net income and assets of a corporation. Stocks are either common (voting) or preferred shares. Prices of stocks are determined by market valuation based on the performance of the company or market perception, and fluctuate daily. The prices of most stocks are listed in major newspapers.

how can **i** **invest** in the stock market?

Individuals, pension funds, mutual funds, banks, and insurance companies may hold stocks. A person or an institution makes money on the stock market either through the dividends declared by the listed company or when the stock is sold at a higher price than the purchase price. Investors may purchase stocks from investment/brokerage houses, banks, or investment companies (mutual funds). Stocks are usually considered long-term investments. Most stockbrokerage firms are located in the buildings of the Philippine Stock Exchange in Ortigas and Makati.

WHAT **ARE** CONTRACTUAL SAVINGS INSTITUTION?

Contractual savings institutions insure against a future event by taking in premiums or payments today in exchange for payment upon the happening of an event. Their products may come in the form of education plans, insurance plans, or pension plans.

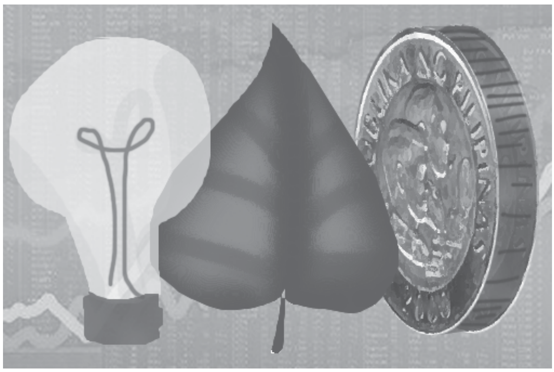
what are pre-need plans?

Pre-need companies offer education, pension, and memorial plans. Based on the Rules on Pre-Need of the Securities and Exchange Commission (SEC), "pre-need plans are contracts that provide for the performance of the future service(s) or payment of future monetary consideration at the time of actual need, payable either in cash or installment by the plan holders at prices stated in the contract with or without interest or insurance coverage and includes life, pension, education, internment and other plans which the commission from time to time approve."

Pre-need plans come in two forms: open-ended and fixed value plans. Open-ended, actual cost, or traditional plans are acquired through fixed costs and delivered to the beneficiary based on actual costs upon the period of availment. They, however, expose pre-need firms to risks of not being able to service maturing obligations. Fixed-value plans are plans in which the amount of the benefit fixed at the time of purchase. These plans may yield returns below inflation rates but have features to compensate for it. (Padojinog, 2005)

In the Philippines, pre-need pension plans usually have the following features (Aquino, 2002):

a.) Payment of contract price averages five years, which can be made in monthly, quarterly or yearly installments.
b.) Maturities of pre-need pension plans are either upon reaching a certain age of the plan-holder or over a period of years after full payment.
c.) Pension benefits may be paid out in lump sum or installments or both at the option of the plan-holder.



d.) In case of death of the plan-holder before the maturity date, pay-out will still be at maturity date.

e.) To ensure payment of benefits, pre-need companies are required to contribute to a Trust Fund which are funded from their collection

A number of pre-need companies are subsidiaries of banks or insurance companies. Pre-need firms are regulated by the SEC and not subject to liquidity requirements imposed by the central bank. Recently, however, a few of the big pre-need companies have experienced financial difficulties and failed in fulfilling their contractual obligations to their clients.

WHAT **IS** AN INSURANCE PRODUCT?

On the whole, the Philippine market has two types of insurance companies: life insurers and general (non-life) insurers. Life insurance companies cover people against financial hazards following death and sell annuities (annual income payments upon retirement). The other type of insurance covers fire, casualty, and accidents. Like other contractual savings institutions, insurance companies acquire funds at periodic intervals ("**premiums**") on a contractual basis to keep their policies in force and to use them to purchase investments.

The Insurance Commission, currently under the Department of Finance (DoF), regulates insurance companies in the Philippines. Some commercial banks with universal licenses also offer insurance products.

what are pension plans?

Pension funds provide retirement income through annuities to employees covered by a pension plan. Funds are obtained through contributions from employees or employers. Pension funds differ in method of payment although the purpose remains the same. The first method of payment— known as defined benefit plan— guarantees payments of benefits that are not tied to contributions but based on a prescribed formula. Under this type of plan, the sponsor shoulders risk of shortfall in investment returns. The other type of plan—defined contribution plan—both the employee and the employer contribute specific amounts to the plan periodically. Under the defined contribution plan, the employee bears the risk of accumulated funds not meeting replacement income goal.

The Government Service Insurance System (GSIS) and the Social Security System serve as the largest pension funds in the Philippines. These two government-administered funds invest in government securities, the stock market, commercial paper, and property development. Their income usually comes from salary and housing loans, interest income in investments,

dividends, and foreign exchange gains. (EIU, 2004) Apart from GSIS and SSS, there is another smaller government administered fund: the Armed Forces of the Philippines Retirement Separation and Benefits System (AFP-RSBS). These three public pension funds all fall under, mandatory defined benefit plan.

At present, GSIS and SSS experience difficulty in meeting their redistribution goal. Specifically, benefits paid to member have outpaced the amount of contributions of members. Meager returns on investments, poor compliance and enforcement in payment of premiums, low collection rate on loans, huge losses from housing programs, and the lack of regulatory institution threaten the viability of the two government-administered pension funds.

Nonetheless, there have been initiatives to reform the country's pension system and enhance its role in capital market development.

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