

ASIA-PACIFIC REGULATORS' AND INDUSTRY DIALOGUE

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The Role of Regulators

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SUMMARY PAPER

Private Pension Plan System: The Philippine Experience

I. Introduction

The pension fund industry in the Philippines has been essentially founded on a tax law when, in 1967, the Philippine Congress enacted Republic Act (RA) 4917 which provides tax exempt treatment of the retirement benefits voluntarily granted and designed by private firms for their officer and employees. This was later supplemented by Presidential Decree 442 issued in 1974. The latter law embodies the labor code of the Philippines, one section of which, made mandatory the provision of a minimum retirement pay to employees of private business entities. These pension plans for the private sector cover defined benefit plans.

The aforementioned provision of retirement benefit plans are further complemented by the mandatory social pension fund maintained by the Social Security System, a government entity tasked to manage the contributions made by private entities to pay the retirement benefits of their employees.

Since the late 1980s, there has been a proliferation of pre-need companies which offer hybrid pension plans to investors who are made to pay the agreed contributions in order to enjoy the promised pre-defined benefits.

In all of the above, the local pension fund industry has not been spared by the intensified challenge of managing the funds' assets to meet their future liabilities. The same has been put on the spotlight because of the changing demographic profiles as well as the increased volatility in the prices of assets experienced in the local markets brought about by outside forces. Consequently, the challenge to us regulators of coming up with the appropriate regulatory approaches becomes imperative.

We are presenting here the regulatory environment enveloping the private pension fund industry in the Philippines with the expectation that through this dialogue, we will be able to pick up from the experiences of our more developed neighbors a better way, if there is any, of regulating of the private pension fund industry.

II. Voluntary Private Retirement Benefit Plans

Tax Exemption and Free From Attachments

RA 4917 extends twin preferential treatments to retirement benefits accruing from a *reasonable* retirement plan, namely: (1) exemption from imposition of all taxes and (2) not subject to attachment, garnishment, levy or seizure by or under any legal or equitable process whatsoever except to pay a debt of the official or employee concerned to the private benefit plan or that arising from liability imposed in a criminal action.

In order to enjoy said treatments, at the time of his retirement, the retiring official or employee shall have been employed by the same employer for at least ten (10) years and is not less than fifty (50) years of age. An exception is when a person is *involuntarily* terminated earlier due to death, sickness or disability or other valid cause beyond his control. These special considerations accorded retirement benefits can be enjoyed only once by retiree.

Requisites for a Reasonable Retirement Plan

In implementing the said law, the Bureau of Internal Revenue prescribes the following requisites to tag a retirement benefit plan as *reasonable*:

- (a) There must be a definite **written** program setting forth all provisions essential for qualification;
- (b) It must be a **permanent** and **continuing** program unless sooner terminated by virtue of a valid business reason;
- (c) It must **cover at least 70%** of all officials and employees.
- (d) The employer, or officials and employees, or both, shall **contribute to a trust fund** for the purpose of distributing the corpus and income of the fund **in accordance with the plan**.
- (e) The corpus or income of the trust fund must **not be diverted** and shall be **used exclusively for the benefit** of the said officials and employees.
- (f) The contributions or benefits in the plan shall be **non-discriminatory** to favor of officials and employees who are officers, shareholders, supervisors, or highly compensated.
- (g) It must provide for **non-forfeitable rights** to benefits accrued and to the amounts credited to an account of an official and employee at the time of discontinuance or termination of plan.

(h) Any **forfeited amounts** must not be applied to increase the benefits any employee would otherwise receive under the plan but must be used as soon as possible to reduce the employer's contributions under the plan.

Allowable Form of Retirement Benefit Plans

Initially, the BIR required that the retirement fund shall be **administered by a trust**. However subsequent amendments to the regulations allowed retirement benefit plans to be either (1) **trusteed plans** covered by trust agreement, (2) **non-trusteed/insured plans** covered by Deposit Administration Contract Deferred Annuity Contract, or (3) **multi-employer plans** covered by corresponding agreements.

An amendment may be introduced later provided that amendment does not affect the qualification of the Plan as earlier approved by BIR and it is beneficial to the employee-members of the Plan.

Limitations of Investments

There are no specific limitations with respect to investments of the fund provided they are permitted by the trust agreement. However, under BIR Regulation Regulations No. 01-68, the exemption of the trust income under may be denied if the trust:

“(a) lends any part of its income or corpus without adequate security and a reasonable rate of interest;

(b) pays any compensation in excess of a reasonable allowance for salaries or other compensation for personal services actually rendered;

(c) makes any part of its services available on a preferential basis;

(d) makes any substantial purchase of securities or any other property for more than adequate consideration in money or money's worth;

(e) sells any substantial part of its securities or other property, for less than an adequate consideration in money or money's worth;

(f) engages in any other transaction which results in a substantial diversion of its income or corpus.”

III. Mandatory Private Retirement Benefit Plans

In 1974, Presidential Decree No. 442 makes **mandatory** the provision by private companies to their employees of a retirement benefit plan upon retirement. The same however recognized the existence of voluntary retirement plans arising from existing laws or any agreements which may be used as substitute provided they shall not be less than those under the mandatory plan. This was later amended by RA 7641 in 1992.

PD 442, as amended, set the compulsory and mandatory retirement age (60 and 65 years old, respectively) provided the person has been employed for five (5) years. In the absence of a retirement plan or agreement providing for retirement benefits of employees in the establishment, a retiring employee shall be entitled to retirement pay equivalent to at least one-half (1/2) month salary for every year of service, a fraction of at least six (6) months being considered as one whole year.

Any mandatory retirement plan may be accorded the same tax exemptions under RA 4917 if (1) it has been approved by the BIR; (2) the retiring official or employee must have been in the service of the same employer for at least ten (10) years and is not less than fifty (50) years of age at time of retirement; and (3) the retiring official or employee has not availed of any retirement plan.

IV. Third Party Issued Pension Plans

Section 16 of RA 8799 or otherwise known as the Securities Regulation Code (SRC) prohibits a person from selling or offering for sale to the public any pre-need plan except in accordance with rules and regulations which the Commission shall prescribe. Consequently, it provides authority to the Securities and Exchange Commission (SEC) to prescribe rules governing the sale of pre-need plans by, among other things, (1) requiring the registration of pre-need plans, (2) licensing persons involved in the sale of pre-need plans, (3) requiring disclosures to prospective plan holders, (4) prescribing advertising guidelines, (5) providing for uniform accounting system, (5) reports and record keeping with respect to such plans, (6) imposing capital, bonding and other financial responsibility, and (7) establishing trust funds for the payment of benefits under such plans.

A pre-need plan is a form of a collective investment product designed by the issuer company such that investors pay regular contributions to the issuer company with the expectation that that they will receive a promised return amount or service sometime in the future. The payment period usually covers a four (4) or five (5) year period and the payback period of the promised return amount or service takes place typically within five (5) years from end of payment period.

There are three (3) types of pre-need plans: educational plan, life plan and **pension plan**.

The focal points of the SEC's regulation on this investment product may be summarized as follows:

- Pre-need Reserves shall be set up for all pre-need benefits guaranteed and payable by the pre-need company as defined in the pre-need plan contracts.
- Part of the contributions by investors shall be entrusted in a trust fund managed by a trustee accredited by the SEC for the exclusive benefit of the

planholders, the amount of which contributions shall be determined based on actuarial study made by a qualified actuary.

- The net asset value of the trust fund shall be at least equal to the required Pre-need Reserve as determined by a qualified actuary using a method prescribed under SEC Rules.

The above regulations are meant to ensure that the Pre-need Reserve covers the liabilities for any pre-need plan at anytime since the said reserve represents the present value of future pre-need benefits less the present value of future trust fund contributions.

Under the rules, the Pre-need Reserve of the three (3) plan types should be maintained separately as they differ in the treatment of assumptions. Moreover, a pre-need company is required to compute the Pre-need Reserve using the Sec-approved hurdle rate per product model. The company may however also compute the present value of its liabilities using discount rate lower than the SEC-approved hurdle rate and the difference between the two computations shall be booked under the account "Other Reserves" in the Audited Financial Statement. Last but not the least, the SEC has prescribed the manner on how the hurdle rates and other assumptions shall be disclosed in the Audited Financial Statements and the Actuarial Valuation/Validation Report.

V. Additional Notes on the Trust Entity

In the Philippines, a trust entity can either be a bank, investment house, or a corporation that expressly seeks authorization from the Bangko Sentral ng Pilipinas (or Central Bank of the Philippines) to perform the acts of a trustee. Under RA 8791 or otherwise known as the General Banking Law of the 2000, a trust entity shall act as a trustee or administer any trust or hold property in trust or on deposit for the use, benefit or behoof of others.

The relevant provisions of the said law require the separation of the trust business from the general business as well as exempting the assets held by the entity as trustee to any claims other than those of the parties interested in the specific trusts. There are provisions too that requires a trust entity to maintain minimum paid-in capital, file a bond for the faithful performance of his duties. The main players in trust business are mostly banks.