BSP Gives Green Light to Unit Investment Trust Funds

The Monetary Board approved the Guidelines in its regular meetings held on July 22, 2004 and August 26, 2004 that pave the way for the creation of Unit Investment Trust Funds (UITF) by authorized trust entities.

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. The investors share in the gains and losses after expenses of the fund, proportionate to their respective participations in the pool.

The BSP expects the UITFs to completely replace the CTFs over time. Unlike CTFs, UITFs are not subject to reserve requirements and are not considered in single borrowers limit calculations. The BSP agreed to this more favorable treatment because UITFs feature clearer safeguards that effectively distinguish these from deposit substitutes. A key enhancement is the unitization of investor participation expressed in terms of net asset value (NAV) per unit. Under the scheme, investors may buy as many units as they like. On the other hand, NAV will be strictly market-determined based on the daily mark-to-market of the asset pool divided by the number of units outstanding. Investors can freely join or exit based on the quoted NAV per unit.

To ensure proper market valuation of the asset pool at all times, UITFs may only invest in securities which have an active market with transparent pricing. They are prohibited from directly extending traditional loans although they may invest in tradable loans in the future once a market for these is established. They are also prohibited from investing in real estate and other illiquid investments.

In the interest of proper disclosure, all UITFs managers are required to fully inform their prospective investors of their investment strategy including what kind of investments they plan to put money into. Investors must also understand that their principal is not guaranteed by the trustee and it is not covered by deposit insurance. Investment in UITFs are therefore inherently riskier than deposits but may be rewarded with potentially higher returns compared to a deposit.

As part of safeguards, the guidelines require proper training of marketing personnel to better ensure that investors are properly informed of the risks of their investments in UITFs and to make sure no promises are made that would in any way tend to guarantee financial performance by the bank under which the trust entity belongs.

The guidelines also require UITF assets to be under third party custody by BSP accredited custodians to protect investors from fund manager misconduct and to have independent valuation of the asset pool.

To allow greater investor flexibility, UITFs are allowed to be offered in dollar-denominated forms for investors with independent dollar sources.

"The entry of UITFs is a major development that will not only provide more investment outlets for retail customers, it will also help jump start the domestic capital market. CTFs today total about P260 billion. We expect this figure to grow significantly in the future as CTFs are replaced by UITFs. This resource pool can then serve as a major institutional player in the domestic capital market.

However, we don't expect UITFs to replace deposits. Each has its own place. Deposits are still among the most liquid of investments while UITFs offer higher yield. They are complementary and investors would probably want to have money invested in both," BSP Deputy Governor Alberto V. Reyes said.