

# **UITF PLANNING CONFERENCE**

## **Securing the Success of UITF Industry: Crafting a Medium-Term Plan**

Evercrest Golf Club Resort  
October 14-15, 2005  
Nasugbu, Batangas

## Acknowledgement:

In behalf of the current Board of Directors of Trust Officers Association of the Philippines, I would like to thank all the speakers and facilitators for taking time to prepare and participate in this valuable endeavor, to the delegates for sharing their vision, issues and concerns, the committee members for their time and effort in making the event possible.

### Speakers:

Mr. Nestor A. Espenilla, Jr.	– Deputy Governor, BSP
Mr. Rafael G. Ayuste	– TOAP President, MBTC
Ms. Pauline Wong	– HSBC Securities Services
Mr. Shiv Taneja	– Cerulli Associates, Inc.
Ms. Juliet S. Dytoc	– MBTC
Mr. James John P. Cezar	– PricewaterhouseCoopers
Mr. Mike Ferrer	– ING
Mr. Roberto S. Vergara	– TOAP Director, Landbank
Mr. Mario T. Miranda	– TOAP Director, BPI
Ms. Ma. Elena S. Sarmiento	– TOAP Director, PNB
Ms. Ma. Lourdes T. De Vera	– TOAP Director, BDO

### Facilitators:

Mr. Noli Inumberable	- TOAP Director, JP Morgan Chase
Mr. Rolando D. Esguerra	- TOAP Director, EPCI Bank
Ms. Ma. Lourdes T. De Vera	- TOAP Director, BDO
Mr. Serafin P. Tongco	- TOAP Director, Banco Filipino

### Delegates:

Atty. Guia Legaspi	– TOAP Consultant
Ms. Dolly Yuvienco	– BSP, Assistant Director
Ms. Remy Torregrosa	- BSP
Ms. Ching Garcia	– BSP
Ms. Judith Sungjai	– BSP
Ms. Joy Cervero	– MBTC
Ms. Maite Toledo	– HSBC
Mr. Ador Abrogena	– BDO
Mr. Adelbert Legasto	– BPI
Mr. Raul C. Diaz	– PBCOM
Mr. Marvin V. Fausto	– EPCI
Ms. Stella Sampayan	– AMEX
Mr. Andrew Chua	– AUB
Ms. Rose Tantoco	– HSBC
Ms. Concepcion Cruz	– ING

**The Committee Members:**

Ms. Christine Y. Ramos	– TOAP Secretariat
Mr. Dennis L. Elayda	– MBTC
Ms. Kay Pagal	– MBTC
Ms. Anna S. Calayan	– MBTC
Ms. Michelle A. Maaño	– Student Trainee DLSU

**Foreword:**

It is expected that the output of this workshop be implemented between 2005 and 2010 with the majority of the planning and activities to be undertaken in the intermediate term. The proposal for the creation of the UITF Council (renamed Council for UITF Development and Promotion) as recommended during the workshop has already been submitted and approved by the TOAP Board of Directors during its monthly meeting held December 5, 2005. One crucial factor in the mandate for the creation of the UITF Council is the term of the Council president which is 'at the pleasure of the TOAP board of Directors'. This will ensure continuity and implementation of the output of the workshop. The approval paves the way for the rationalization of the recommendations arising out of the workshop and further prioritization of the plans.

The board also approved the hiring of an officer to handle Research and Development for TOAP. Though the new TOAP personnel will not be for exclusive use of UITF council, he will definitely be of significant value in the implementation of the Medium Term Plan. The hired personnel will join TOAP by February 15, 2006.

The launch of the UITF advertisement has been set for January 16, 2006 and participated by 10 Trust institutions. The project, though delayed due to logistical issues, is already geared for the launch. The discussion on the UITF website has also been started and targeted for implementation by mid-February of 2006.

Another development is the lease of office space for TOAP located at Cityland 10 at H.V. Dela Costa cor. Valero Sts. Makati City. This is a significant milestone for TOAP since it signifies the serious intention and long term commitment of the association to build the foundation for further development and promotion of the Trust industry.

Original Signed  
Mr. RAFAEL G. AYUSTE, JR.  
President  
Trust Officers Association of the Philippines

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*Speaker: Ms. Ma. Elena S. Sarmiento, TOAP Director*

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**Workshop 1 Facilitator: Ms. Ma. Lourdes T. De Vera, TOAP Director**

What needs to be done to broaden the product line-up of UITF and to support such introduction?

**Workshop 2 Facilitator: Mr. Serafin P. Tongco, TOAP Director**

What is needed to educate, understand needs and protect the interest of the investing public?

**Workshop 3 Facilitator: Mr. Rolando D. Esguerra, TOAP Director**

What is needed in terms of investment and risk management, best practice standards, disclosure, transparency and related activities of the Trust entities to ensure the success of the UITF industry?

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## **Securing the Success of UITF Industry: Crafting a Medium-Term Plan**

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### **I. Opening Remarks**

*By: Mr. Rafael G. Ayuste Jr., TOAP President*

Our theme for this event is Ensuring the Success of the UITF Industry – Crafting a Medium Term Plan. The UITF circular came to fruition after 4 years of intense dialogue and discussion between BSP and TOAP. The UITF was received by the industry with much apprehension but the product holds much promise for the Trust industry and the investing public. The restructured CTF will see to it that the industry stays relevant with the fast changing times amidst evolving financial services, entry of traditional and new competitors, emergence of global standards, changing investor preferences and the challenging operating landscape. As the industry prepares to surge forward, reinventing ourselves and more importantly refocusing our UITF business after nearly 2 decades of existence of CTF, it is crucial for TOAP to chart a growth path for this new product. Ultimately, we need to strategize and energize our combined and collective plans in the right direction to realize the industry’s objective of remaining at the forefront of retail funds.

If we duplicate the success of CTF that would be an enormous achievement, but why stop at the success of CTF when the global market is ours for the taking. When the Asian Bond Fund 2 managed by our esteemed colleagues at BPI, is finally launched, renewed interest in the Philippine market is expected. If the industry measure up to the challenges in terms of global standards, disclosure, best practices, investment and risk management and the likes I’m certain that it is going to happen. We will keep the anecdotal philosophy of one of the most successful Filipino businesses – SM. It seems like if SM builds it they will come ... Maybe “If we build the UITF properly they will come”.

But alas, the road to success will not be easy, like the roads of Manila filled with potholes, humps and lumps. Building the UITF business into a success will be both demanding and daunting. It will take tons of hard work and cooperation from the industry organization, the industry players and the regulators. The road will be filled with pitfalls, petty issues and self-interests however, we must not lose sight of the big picture a global standard product that will be a success not only in terms of AUM but a product at par with the international market.

## **II. Introduction to the Planning Conference**

*Speaker: Mr. Reeve Vergara, TOAP Director and Vice-President*

### **A. Objectives of the Conference**

1. To chart out a plan to ensure and sustain the success of the new UITF products
2. To align industry and regulatory directions
3. To provide additional inputs to TOAP's total approach to rationalizing TOFA/IMA, including elevation of practices to globally accepted standards

### **B. The Approach – How?**

1. By gathering issues, insights, trends and developments in the local and global markets
2. By coming together in the discussion-workshops and sharing insights, contributing ideas and agreeing on directions / actions
3. By considering in the workshop discussion other outputs useful for the TOFA / IMA project

### **C. The Program**

1. Sharing of observations, overviews, product trends, regulatory developments, and risk management processes
2. Sharing of desired directions and approaches from regulatory representatives
3. Observations and industry issues on the UITF product, competition from retail and underground funds, and Filipino investor considerations

### **D. What do we want to achieve?**

1. The successful exchange of ideas in the workshops resulting in organized presentation of these outputs
2. The application of these outputs to a medium term program for the UITF industry and also to the TOFA/ IMA total approach program

### III. The Malaysian Unit Trust Market – Report on Malaysian Trip

*Speaker: Mr. Rafael G. Ayuste Jr., TOAP President*

#### A. Federation of Malaysian Unit Trust Managers (FMUTM)

The Federation of Malaysian Unit Trust Managers (FMUTM) is a quasi-self regulatory organization, responsible for registration of Persons Dealing in Unit Trusts (PDUTs). It ensures eligible individuals possess the minimum accepted level of product knowledge & understanding of unit trusts before they are registered & licensed to market & distribute UTF as required by the SEC. The conduct of mandatory Unit Trust Examination (UTE) is entrusted to them.

#### B. Brief History

FMUTM's predecessor is the National Unit Trust Association, which is formed in 1990.

1. 1959 → 1<sup>st</sup> unit trust was established by a group of Australian investors
  - Asia Unit Trust Berhad (AUT), now Malayan Unit Trusts Limited
2. 1967 → 2<sup>nd</sup> fund was launched
  - Mara Unit Trust Berhad (MUT), now ASM Mara Unit Trust Management, Berhad
3. 1977 → 3<sup>rd</sup> fund was established
  - Amanah Saham MIC-TPG Berhad, now KL City Unit Trust Berhad

#### C. Regulatory Developments

The approvals from various regulatory authorities took 11 months, which caused delays and much frustration.

3. 1975 → The Introduction of Informal Committee on Unit Trust Funds was formed to coordinate unit trusts. The approval process improved though not significantly and separate approvals are still required.
4. 1991 → The roles and responsibilities of the Informal Committee were shifted to the Capital Issues Committee.
5. 1993 → Securities Commission became the sole authority responsible for regulating the unit trust industry.
6. 2004 (Nov 24) → The Securities Commission issued the “Guidelines on Online Transactions of and Online Activities in Relation to Unit Trusts”, which is based on Securities Commission’s consultation paper on “Framework for the Implementation of Electronic Commerce in the Capital Market”.
7. 2004 (Jan 5) → The Securities Industry Amendment Act of 2003 that created a single licensing body for the fund management industry. It also expanded the definition of “Investment Adviser”, which refers to person who holds out or carries on a business of analyzing the financial circumstances of another person and provides a plan to meet the other person’s financial needs and objectives, including any investment plan in securities whether or not a fee is charged. Any person who represents himself as a financial planner is required to be licensed as an Investment Adviser.

8. 2005 (Mar 23) → The increased investment abroad by UTMC's from 10% to 30% of net asset value was attributed to the residents of Malaysia.

#### D. Industry Developments

3. 1980s → Unit Trust Management Companies (UTMC) faced difficulties in expanding business.
4. 1993 (Aug 7) → The Federation of Malaysian Unit Trust Managers (FMUTM) was formally incorporated when SC realized the important role of the federation in implementing and enforcing unit trust funds marketing and distribution guidelines. SC made it mandatory for Unit Trust Management Companies (UTMCs) to become members of FMUTM. The membership fee is based on aggregate net asset value of all unit trust funds individually managed by members. SC also required the agents of UTMCs to be registered with the federation. Lastly, minimum standards for registration of Persons Dealing in Unit Trusts (PDUTs) were required by SC.
5. 1996 → The registration of PDUTs was implemented. The Unit Trust Pre-Registration Examination (UTPRE) was outsourced to third party to develop, conduct and coordinate the said examination. But UTPRE did not get off the ground until 1999 and was changed to UTE. In the same year, the Performance Statistics on Malaysian Unit Trust Funds as provided by Standard and Poor's was introduced. It provides the public with independent evaluation and helps monitor returns on investments. The Malaysian Unit Trust Funds Performance Table was launched. But there were complaints about inefficient registration of PDUTs and issuance of authorization cards.
6. 1999 (Jan 30) → The first UTE was conducted with 1,004 agents who registered and 717 participants who took the exam. FMUTM took over from the third party the registration of agents and running of UTE. Thirteen UTEs were conducted, provisional registration and examination of PDUTs with 7,422 registered participants.
7. 2000 (Feb) → Developed Guidelines for Registration of Institutional Agents for the Marketing and Distribution of Unit Trusts (IUTA) was approved. It enforced guidelines and by-laws relating to the Procedures for Disciplinary Proceedings Guidelines developed by FMUTM. It also implemented new distribution channel that contributed significantly to promoting greater growth for the unit trust industry. In the same year, the registration requirements of PDUTs were fully enforced. The participating PDUTs are required to sit and pass UTE before being authorized by FMUTM to market and distribute unit trusts.
8. 2001 (Sept 1) → With SC's blessings, "The Code of Ethics and Standards of Professional Conduct for the Unit Trust Industry" was revamped extending the scope to ordinary members, PDUTs and IUTAs.
9. 2002 (Aug), from the proposal of FMUTM, all UTMCs were required by SC to additionally disclose their charges and annual management fees in major newspapers. This demonstrated the industry's responsibility towards the investing public. It also issues legal developments, distribution of investment funds, selling and marketing of

offshore funds and development of pension systems. In the same year, FMUTM became a regular participant in the Asia-Oceania Regional Meetings of International Investment Fund Associations (IIFAs). FMUTM became a Steering Committee member of IIFA in 2000.

E. Industry Development Plans

Some industry development plans of FMUTM is to ensure Unit Trust Management Companies (UTMCs) are restructured into investment companies, to expand the scope of business beyond unit trust products and services, and lastly, for FMUTM to evolve to represent all organizations involved in managed funds.

F. Five Priority Areas for the Unit Trust Industry

1. Sufficient and sustained product and service innovations breadth and depth
2. Capture bigger share of financial services sector
3. Solicit SC's support for tax incentives to nurture unit trusts as source for long term savings, higher education and retirement funds
4. Look into the possibility of allowing Investment Advisers as additional distribution intermediary
5. For FMUTM to invest in technology through enhancing and upgrading our infrastructure for processes and communication with members to be more efficient and effective.

G. The Malaysian Unit Trust Industry

1. Industry AUM 2004	USD 23B (87.39B)
2. Total number of funds	312
3. Number of Unit Trust Management Companies	36
4. Total number of Funds Launched in 2005	61
5. UTMC with new UIF in 2004	16
6. Number of PDUTs	32,027 (20% active 6,405)
7. Types of PDUTs	Tied Agents (73.84%), UTMC Staff (3.65%), Corporate Representatives – Related Party (13.01%), Corporate Representatives – 3rd Party (9.50%)
8. Currency	Malaysian Ringgit
9. Currency Risk Exposure to Foreign Markets	30% of fund size attributed to Malaysian residents
10. Valuation	MTM (15 years ago – 1990)
11. Investment Industry	Direct Investment in securities, stocks, properties, REIT (only 1 listed), Unit Linked Insurance

	*UIT cannot invest in properties but can invest in REIT																		
12. Distribution Channel	Banks, 3 <sup>rd</sup> party Banks, Stock Brokers, Unit Trust Consultants; Individual Agents																		
13. Commission	5 to 6% (Sales Charge)																		
14. % Market Capitalization to Bursa Malaysia Market Capital	12.1%																		
15. Awards	Edge-Lipper Malaysian Unit Trust Fund Awards																		
16. Award Categories	Best Fund Group over 3 years; 5 and 10 years across asset classes (i.e., Bond, Mix, etc.)																		
17. Fund Types	<table> <tr> <td>Stock</td> <td>44.60%</td> <td></td> </tr> <tr> <td>Bond</td> <td>17.75%</td> <td></td> </tr> <tr> <td>Islamic</td> <td>15.81%</td> <td></td> </tr> <tr> <td>Asset Allocation</td> <td>10.89%</td> <td></td> </tr> <tr> <td>Money Market</td> <td></td> <td>8.73%</td> </tr> <tr> <td>Guaranteed/Protected</td> <td>2.22%</td> <td></td> </tr> </table>	Stock	44.60%		Bond	17.75%		Islamic	15.81%		Asset Allocation	10.89%		Money Market		8.73%	Guaranteed/Protected	2.22%	
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H. Federation of Malaysian Unit Trust Managers (FMUTM)

1. Staff Count	24
2. Licensing Mode	MUTE/CUTE (Manual/Computerized Unit Trust Examination)
3. Number of CUTE from Jul (22) to Dec 2004	2,208 sessions
4. Number of MUTE in 2004	10 sessions
5. Language	Bahasa Melayu (6.1%), English (89.1%) and Chinese (4.8%)
6. Licensing of the following:	Approval to market & distribute unit trusts <ul style="list-style-type: none"> <li>• Person Dealing in Unit Trust (PDTUs)</li> <li>• Institutional Unit Trust Agents (IUTAs)</li> </ul>

7. Departments	Registration – for examination IT – for on-line examination Legal & Compliance – for public complaints Marketing & Communications – for promotion of unit trust, education of public (i.e. road shows) & members' communication Accounts – for finance administration Research & Development – for technical & products
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In 1996, the Bursa Malaysia Market Capitalization is highest with the amount of RM 806.77 billion, while the Net Asset Value reached its peak in 2004 with RM 70.06 billion. The percentage of Net Asset Value over the Bursa Malaysia Market Capitalization is highest in 2004, 12.10%, and lowest in 1993, 4.54%. The total net asset value of the different types of funds (Guaranteed/Protected, Islamic, Asset Allocation, Money Market, Bond, and Stock) gradually increased from 1999 to 2004.

#### IV. Asia's Mutual Fund Marketplace: An Overview

*Speaker: Mr. Shiv Taneja, Director for Asia and Australia, Singapore, Cerruli & Associates, Inc.*

##### A. Introduction

1. Five years of covering Asia-Pacific markets
  - o Includes China, India, Hong Kong, Singapore, Korea and Taiwan
  - o Japan and Australia have separate coverage within the firm
2. Bank distribution has emerged at core of data-gathering activities
  - o Propriety bank surveys in region for past four years
  - o First ever survey of Indian asset management firms; continued tracking of Chinese asset managers, in addition to asset managers and banks in Hong Kong, Singapore and Taiwan
3. Other channels emerging, though banks continue to dominate
  - o Insurance and IFA; first-ever survey of financial advisors in Singapore
4. CA's research methodology applied to the region
  - o Continuous interaction with asset managers, distributors and regulators

##### B. Regional Overview

1. Asia ex-Japan continues to represent one of the fastest growth regions for mutual funds
  - o CA forecasts 11% CAGR growth to 2009; mutual fund assets expected in the region of US\$ 750 billion
  - o China had a banner year, while Taiwan had a very bad one – while the rest of the region fell somewhere in between
2. Bank distribution continues to dominate
  - o Regional strategies are dominated by Citibank, Standard Chartered and to some extent HSBC
  - o Local distributors are growing in strength in markets like Singapore, Taiwan and HK

- IFA channel continues to flatter to deceive, though Singapore may prove to be the exception
- 3. Product Innovation: Groundhog Day for Capital Guaranteed Funds
  - 2004 was a quiet year for capital guaranteed funds, but the early signs in 2005 suggest that interest is back
  - Select markets like Hong Kong, and to some extent Singapore, saw interest in more traditional asset classes like equities and equity income funds
  - REITs and real estate funds saw strong growth in 2004

### C. Regional Quantitative Overview

2. Despite all its problems over the past few years, Asian mutual fund assets have steadily risen to just under US\$ 450 billion at the end of 2004
3. While the overall size of the industry is still small from a global standpoint, one hopes the steady growth of the past few years is building a foundation for the next phase of growth, which is most likely going to have to come from the retirement marketplace
4. It is a telling statistic that of the meaningful distribution channels for mutual funds in Asia, the only one that CA believes will grow its share of assets during the next five years belongs to the banks
5. Neither the direct nor the brokerage channel will disappear together, but it is clear to CA that these channels will continue to see their sphere of influence diminish in the longer term
6. Pan-regional banks continue to be the mainstay for international asset management firms looking to sell their funds in multiple markets across the region. However, don't confuse a regional footprint with market penetration in individual markets, and therefore managers need to look to establish strong links with local managers as well
7. Banks have started to realize that if they do not start providing an acceptable level of service and advice to their clients – as it appears some are beginning to do – they run the risks of having regulators step with a far heavier hand
8. “Free Advice” is here to stay; there is little appetite to introduce unbundled advisory fees by the banks, and one suspects even less appetite to pay for advice on the part of most investors across Asia
9. CA expects mutual fund growth to reach US\$ 750 billion by the end of 2009, a 5-year CAGR of about 11%
10. While Asia remains the fastest growing mutual fund region in the world, our forecasts for future growth are lower than they have been in the past

### D. Country Snapshots

1. Taiwan
  - Onshore assets: US\$ 108 billion by 2009E; CAGR of 7.5%
  - Offshore assets: over US\$ 64 billion by 2009E; CAGR of 20%
  - Key Trends
    - Potential impact of bond fund crisis has led to a decline in assets; CA's forecast for asset growth sharply lower
    - More positive news is that offshore funds are no longer being treated as a poor relative to onshore funds
    - Structured Notes continue to exhibit strong sales

2. Korea
  - Onshore assets: US\$ 236 billion by 2009E; CAGR of 6.7%
  - Offshore assets: over US\$ 15 billion by 2009E; CAGR of 29.3%
  - Key Trends
    1. Strong stock market performance, coupled by strong won has pushed overall AUM to over W200 trillion in mid-2005; however, expect volatility to persist
    2. Greater regulatory effort to boost transparency is meeting with some success
    3. Foreign ownership will benefit Korean industry in long run
  
3. Hong Kong
  - MF assets actually held by Hong Kong residents stood expected to cross US\$ 50 billion by 2009
  - Net flows have been steadily declining but that may not be all bad
  - Key Trends
    - Total assets have been steadily rising, but a lot of this has to do with market appreciation
    - Banks are aggressively competing for wealth management business, and already control a massive 82% of assets under management
    - Future growth in market share for the banks will come because there appear to be no viable alternatives
  
4. Singapore
  - Virtually flat growth in assets in 2004, has led to small downward revision in CA's projections in 2009
  - The investment segment of CPF hangs in a balance – a radical solution is needed
  - Key Trends
    - Singapore's fully funded retirement system, the Central Provident Fund, makes the Lion City's asset management marketplace larger than its population would suggest
    - However, the most effective use of these savings has not quite gone to plan
    - Despite a good showing from Singapore's FAs, banks will continue to dominate the distribution
  
5. China
  - 5-year CAGR: 18%
  - Despite a shambolic stock market, 2004 was a banner year for the mutual fund industry in China
  - Key Trends
    - Banks and insurers are both looking to expand into the mutual fund business in China, with potentially big implications for the future shape of the industry

- Despite brokers trying to drum up mutual fund sales in 2004, banks will dominate the distribution of funds in China for the foreseeable future

## 6. India

- Forward 5-year CAGR: 8%
- It wasn't a great year for the Indian asset management industry; assets only grew 7%
- Key Trends
  - Structurally the Indian asset management industry is still very heavily skewed towards the institutional marketplace, which has a very short term view
  - A strong stock market in 2004 raised the overall, share of equities, but this segment of the market is still very heavily momentum driven
  - Industry consolidation is very much on the cards

## E. Conclusions

1. It is quite remarkable that despite all the problems with which Asia has grappled with the past few years (notably, SARS in the latter part of 2003), mutual fund assets have steadily raised to just short of US\$ 450 billion at the end of 2004.
2. Growth has come partly from market appreciation, as several markets (notably, Korea, India, Hong Kong and Singapore) saw strong growth in equity markets. China's A-share market has a shambolic year, but the poor showing was more than made up by huge flows of fresh capital in to Chinese mutual funds.
3. Of our six moan countries in the region, CA believes only two will see their market share rise between 2004 and 2009. These are the two Chinas: Taiwan and the mainland. The rest will either maintain their market share (Singapore), or see a decline in their market share (Korea, Hong Kong, and India). Overall mutual fund assets will rise to US\$ 750 billion by 2009.
4. The bank channel already accounts for a majority of mutual fund assets under management in Asia ex-Japan, and is expected to represent almost two-thirds of AUM before the end of 2009. Our estimates suggest that of all the meaningful distribution channels for mutual funds in Asia – direct, brokerage and banks – the only that will gain influence during the next five years will be the bank channel.
5. 2004 was a relatively slow year for capital guaranteed and protected funds across the region, with some markets like Hong Kong and Singapore actually seeing a return to more traditional asset classes. However, early data from 2005 suggests a return to capital guaranteed funds. Structured products continue to see high demand.

## V. Introduction to Retail Funds Product Trends

Speaker: Mr. Mike Ferrer, Regional Manager, ING IM Asia-Pacific, HongKong

### A. What drives the Asset Management Industry?

1. Regulatory Environment
  - Prudential standards, investor protection
  - Degree of openness to new ideas
  - Pension reforms and regulations
2. Economics
  - GDP, interest rates, inflation
  - Per capita income
  - Savings rates, productivity
3. Demographic Trends
  - Population, growth rate
  - Age distribution
  - Working population

### B. Summary of Regulatory Bodies in Asia

Country	Product	Regulator	Scope
Hong Kong	Unit Trust, Mutual Funds	Securities and Futures Commission (SFC)	Regulate all matters relating to securities
PRC	Investment Funds	China Securities Regulatory Commission (CSRC)	Regulates the investment fund management companies and the establishment of investment funds
		People's Bank of China (PBC)	Examination and approval of a trustee or custodian to conduct custody business
Taiwan	Unit Trust, Mutual Funds	Securities and Exchange Law (SEL)	Governs securities related activity
		Securities and Futures Commission (SFC)	Regulate securities related activity
Korea	Unit Trust, Mutual Funds	The Securities and Exchange Act (SEA)	Regulates the securities companies
		Securities Investment Trust Business Act (SITBA)	Regulates the investment trusts companies
		Financial Supervisory Commission (FSC)	Regulates the assets of investment securities
Japan	Contractual Type	Japanese Securities Dealer's Association (JSDA)	Regulates foreign investment trust securities and open-ended foreign investment securities
Australia	Unit Trust, Mutual Funds	Australian Securities and Investments Commission (ASCI)	Companies and Securities
	Superannuation products	Australian Prudential Regulation Authority (APRA)	Superannuation Industry, Investment offered by Insurance Companies

New Zealand	Unit Trust, Mutual Funds	New Zealand Securities Commission	Regulate all matters relating to securities
India	Unit Trust	Securities and Exchange Board of India (SEBI)	All the schemes operated by mutual funds except for money market scheme
Singapore	Unit Trust, Mutual Funds	Monetary Authority of Singapore (MAS)	Banking, Insurance, Securities, and Futures Industries
Thailand	Unit Trust, Mutual Funds	Securities and Exchange Commission (SEC) Bank of Thailand (BOT)	Regulates business relating to securities including mutual funds BOT regulates offshore investing
Philippines	Unit Trust, Mutual Funds	Securities and Exchange Commission (SEC) Bangko Sentral ng Pilipinas (BSP)	Regulate all matters relating to mutual funds BSP regulates Unit Trusts
Malaysia	Unit Trust	The Securities Commission	Regulate all matters relating to unit trust schemes
Indonesia	Mutual Funds	Capital Market Supervisory Agency (Bapepam)	Oversees the market, Securities Industry
Pakistan	Unit Trust	Securities and Exchange Commission of Pakistan (SECP) State Bank of Pakistan (SBP)	Regulate all matters relating to securities Central Bank and exchange control authority

### C. Product Trends

#### 1. Episode I: The Attack of Correlations (The move towards off-shore diversification)

- The Asian crisis provides impetus for offshore diversification
- Highlights high correlations among domestic asset classes
- International Asset Classes can:
  - Reduce risk through low correlations with domestic assets
  - Introduce currency risk which can increase return and reduce risk
- However, many Asian governments are slow to open up markets due to weak foreign reserve position
- Modes of Offshoring
  - Registration of Offshore Funds in local markets (HK, Taiwan, Singapore)
  - Feeder Funds, Fund of Funds (Thailand, Malaysia)
  - Domestic overseas funds (Taiwan, Philippines)
- Diversification benefits Asian USD Bonds

Philippine investors would improve the risk-return profile of their fixed income portfolios by adding Asian Investment Grade USD Bonds to their ROP portfolios, due to the low correlation between the two.

- Regulatory Framework for Offshore Investing

Country	Remarks
Hong Kong	<ul style="list-style-type: none"> <li>Absence of capital control</li> <li>Retail sales of offshore funds allowed subject to prior registration</li> </ul>
Australia	<ul style="list-style-type: none"> <li>Absence of capital control</li> <li>Retail sales of offshore funds allowed subject to prior registration</li> </ul>
Japan	<ul style="list-style-type: none"> <li>Retail sales of offshore funds allowed subject to prior registration</li> </ul>
Singapore	<ul style="list-style-type: none"> <li>Recently relaxed registration requirement to offshore funds sales to public</li> </ul>
Taiwan	<ul style="list-style-type: none"> <li>Local mutual funds allowed to invest offshore subject to approval by Regulator</li> <li>Offshore funds allowed upon registration</li> </ul>
Korea	<ul style="list-style-type: none"> <li>Local mutual funds allowed to invest offshore subject to approval by Regulator</li> <li>Offshore funds allowed upon registration</li> </ul>
Thailand	<ul style="list-style-type: none"> <li>Offshore investments allowed subject to quota availability and permission by BoT</li> </ul>
Malaysia	<ul style="list-style-type: none"> <li>Locally domiciled funds allowed to invest up to 10% in offshore investments, prior to approval required by Central Bank</li> </ul>
Philippines	<ul style="list-style-type: none"> <li>Offshore investments allowed under UITF guidelines but prior approval required</li> <li>Offshore funds are not allowed to be promoted, no clear registration guidelines</li> </ul>
India	<ul style="list-style-type: none"> <li>Private individuals allowed to remit USD25,000 free of regulatory restrictions</li> <li>Capital Control by SEBI for institutional offshore investments</li> </ul>
Indonesia	<ul style="list-style-type: none"> <li>Capital Control – offshore investing restricted</li> <li>Offshore Funds are not allowed for public sale in Indonesia</li> </ul>
Pakistan	<ul style="list-style-type: none"> <li>Asset management industry restricted to domestic equities and fixed income</li> <li>Capital control prevalent</li> </ul>
PRC	<ul style="list-style-type: none"> <li>Asset management industry restricted to domestic equities and fixed income</li> <li>Capital control prevalent (institutions not allowed)</li> </ul>

2. Episode II: The Market Strikes Back  
(Investors return to Capital Preservation)

- Crash in equity markets make Investors risk averse
- Proliferation of Guaranteed Funds or Capital Preservation Funds
- Longer tenors (5-7 years) moving to shorter tenors (2-3 years)
- Linked to a variety of indices (index, equity, currency, interest rates)
- Structured notes later dominate due to lower costs

3. Episode III: The Performance Menace  
(Index strategies and low cost funds)

- Continued underperformance of Active Managers; Investors less willing to pay high fees for beta (market returns)
- Growth of passive or low tracking error funds (Index, Enhanced index, ETFs)

4. Episode IV: The Return of Alpha  
(Hedge Funds and Absolute Return products)

- Shift in Demand from relative return (benchmark) products to absolute return products
- Investors willing to pay high fees for high alpha strategies (2/20)

The Range of Fees in Asia

	Front-End Fees		Annual Management Fees		Custody and Administration Fees	
	Singapore	Hong Kong	Singapore	Hong Kong	Singapore	Hong Kong
Equity	3% - 5%	5% - 5.25%	1% - 2.4%	1.25% - 1.75%	0.075% - 0.45%	0.25%
Bond/Fixed Income	2% - 3%	5% - 5.25%	0.5% - 1.2%	0.75% - 1.25%	0.075% - 0.15%	0.25%
Balanced	3% - 5%	5% - 5.25%	1% - 1.5%	1%	0.075% - 0.2%	0.25%
Money Market	0% - 0.2%	5%	0.2% - 0.5%	0.3% - 0.75%	0.075% - 0.1%	0.25%
Capital Guaranteed	0% - 3.5%	NA	0.75% - 1.5%	2% - 2.25%	0.2% - 0.68%	0.25%

Hedge Funds Strategies

- Long / Short Equities
- Fixed Income
- Event Driven
- Distressed Debt
- CTA / Managed Futures
- Convertible Arbitrage
- Relative Value
- Multi-strategy
- Macro

5. Episode V: The Revenge of the Yield

- With low interest rate environment, investors search for higher yields
- Increased demand for high yield products (e.g. Emerging Market Debt)
- High Dividend equity funds become popular
  - Dividend is real cash
  - Dividends proved important signals
  - Dividends are an important tool against misuse of capital
  - Dividends provide a stable flow of income
  - Dividend yield is a stable valuation tool

## Real Estate Investment Trusts (REITs)

- Real Estate Investment Trusts (REITs) are currently the flavor
- REIT features:
  - Invests in properties
  - Closed-end (due to illiquidity of assets)
  - Listed on an exchange (to provide liquidity); traded like stock
  - Pays out income as dividends (like a bond)
  - Opportunity for capital appreciation
- Fund of REITs
  - Fund that invests in REITs
- Real Estate Securitization Spreading  
Proliferation of tax-exempt REIT-like structures is driving growth of public equity sector and may increase dividend payouts.

## Countries with REIT-like structures

- U.S. (1960 REIT)
- Netherlands (1969 FBI)
- Australia (1971 FBT)
- Malaysia (1980s REIT)
- New Zealand (1993 LPT)
- Canada (1994 REIT)
- Belgium (1995 SICAFI)
- Japan (2000 J-REIT)
- Korea (2001 K-REIT)
- Singapore (2002 S-REIT)
- Taiwan (2003 REIT)
- France (2003 SIIC)
- Hong Kong (2003 REIT)

## Countries considering REIT-like Structures

- United Kingdom
- Germany
- Finland
- Italy
- Spain

## Income Benefits

- Dividend yields vary by region and are affected by the prevalent real estate company structure. The proliferation of “REIT-like” structures in Europe and Asia is likely to boost average dividend yields.

## Dividend Yield Relationship to Bonds

- Real estate stocks’ dividend yield spreads versus the 10-year bond yield are generally higher than normal around the globe.

## Strong Relative Performance

- Global real estate securities have delivered good relative performance compared to stocks and bonds over the last 3, 5 and 10 years.

6. Episode VI: A New Hope  
(For returns)

- Commodities Bull Market: Commodity Funds, Commodity-Linked Structured Notes / Funds
- Multi-Manager Products are gaining popularity
  - Seeks to achieve diversified risk and consistent out-performance
  - Multi-manager encompasses “Manage the Managers” (MTM) and Fund of Funds (FoF) structures
- Private Equity goes retail
  - Invest in direct equity
  - Unlisted, illiquid

Trends in Asia: MTM

- Growth correlated to advice demand
- MTM eventually outpace FoF: Separate accounts reduce manufacturing costs

D. Some Considerations for the Philippines

1. Potential for continued growth of AM industry through product innovation
2. Regulatory environment needs to be supportive
3. Challenges remain:
  - Adapting best practices; move to UITF in the right direction
  - Educating the investor is key
  - Upgrading sales and advise processes for proper representation
  - Higher compliance standards

E. Product Platform

<b>Unit Trust or Mutual Funds</b>	<b>Fund of Fund Master Trust</b>	<b>Discretionary Master Trust</b>	<b>Wrap Administration or Service</b>	<b>Separately Managed Account</b>
Retail pool  Single manager  May include sector or diversification options	Retail fund invests in a portfolio of wholesale funds from different managers  Weighted towards internal funds  Manager selects funds to maximize return and diversify exposure	Umbrella fund enabling a client to select investment options from a menu  Menu can range from a handful of hundreds of funds from different managers  Provides consolidated reporting  In some jurisdictions, can provide tax and fee benefits when switching	Expands Master Trust concept to include direct equities and other investment options  Often includes a cash account providing the client with access to the funds  Range of investment options means fees must be explicit and deducted from the cash account	Portfolio of direct equities investments held in the clients’ name  Portfolios of a number of clients are managed en masse and aligned  Large transactions executed on the market are booked against the individual portfolios
Performance	Diversification	Choice	Flexibility	Ownership

F. Distribution Business Models for Banks

1. *Strategic Imperatives* for banks develop funds distribution capabilities:
  - *Retention Strategy* to keep customers to switch out of bank deposits into investment products
  - *Relationship enhancement* strategy for client retention
  - *Additional Revenue Stream* from mutual funds commission
  
2. Bank distributors have a number of options for *implementing advice*:
  - Limited advice **sales – only** model
  - Limited advice **sales & service – retail product** model
  - Limited advice **sales & service – wrap account** model
  - **Full advice** model

Spectrum of Complexity

<b>Sales only</b>	<b>Sales &amp; service – retail product</b>	<b>Sales &amp; service – wrap account</b>	<b>Full advice</b>
20 minutes with customer Limited written advice Just a distribution point for offer documents No “portfolio servicing”	Two meetings with customer Advisor gives an Investment Proposal Online customer access After sales service is based on record of purchases, not other cash flows	Two meetings with customer and ongoing relationship Advisor gives an Investment Proposal Online customer access Full portfolio servicing based on all cash flows	Two meetings with customer and ongoing relationship Advisor gives a Full Financial Plan covering investments, borrowings and risk products Online customer access If a wrap account is used, portfolio servicing is based on all cash flows

## VI. Regulatory Developments in the Asset Management Industry in Asia

*Speaker: Ms. Pauline Wong, Head of Regional Sales, Institutional Fund Services, HSBC, HongKong*

### A. Collective Investment Scheme

Collective Investment Scheme is a vehicle that takes money from a number of investors and pools it together. A professional fund manager will then use his/her skill to make investments, in order to achieve the investment objectives as disclosed to investors, which invariably include an increase of value of the funds under management. Several types of Collective Investment Schemes:

- Unit trusts
- Mutual funds
- SICAVs – Sociétés d'Investissement à Capitale Variable
- UCITs – Undertaking for Collective Investment in Transferable Securities
- OEICs – Open Ended Investment Companies, and Partnerships.

### C. Regulatory Framework of Collective Investment Scheme

There are three Regulatory Frameworks of Collective Investment Schemes located in:

- Hong Kong (Securities and Futures Commission)
- Singapore (Monetary Authority of Singapore)
- Korea (Financial Supervisory Service)

They regulate all financial institutions including banks, asset management, insurance, investment advisory and securities futures, all listed companies, and in Hong Kong, including Hong Kong Exchanges and Clearing Limited (HKEx).

#### 1. Regulatory Objectives

- ❖ Hong Kong (Securities and Futures Commission)
  - To promote fairness, efficiency, competitiveness, transparency and orderliness of the industry
  - To promote understanding by the public of the operation and functioning of the industry
  - To protect investors
  - To minimize crime and misconduct in industry
  - To reduce systematic risks in the industry
  - To assist in maintaining the financial stability of Hong Kong
- ❖ Singapore (Monetary Authority of Singapore)
  - To conduct monetary policy and issue currency, and to manage the official foreign reserves and the issuance of government securities
  - To supervise the banking, insurance, securities and futures industries
  - To develop strategies in partnership with the private sector to promote Singapore as an international financial center
  - To build a cohesive and integrated organization of excellence
- ❖ Korea (Financial Supervisory Service)
  - To maintain the integrity of Korea's financial market
  - To ensure fairness of financial transactions
  - To protect the rights and interests of the general public

## 2. Relevant Regulations

- ❖ In Hong Kong (Securities and Futures Commission), their relevant regulation is based on the Code on Unit Trusts and Mutual Funds that they apply on unit trusts, mutual funds and unit-linked.
  - Defines the role of Manager and Trustee/Custodian
  - Describe in details Operational Requirements of each scheme and Authorization Procedures
  - Set out core investment restrictions
  - State requirements of Specialized Schemes (e.g. Money Market Funds, Warrant Funds, Guaranteed Funds, Hedge Funds, ETFs etc. Separate Code on REITs)
  - Describes required disclosures in the Offering Document, required contents of the Constitutive Documents, and contents of Financial Reports
  
- ❖ In Singapore (Monetary Authority of Singapore), their relevant regulation is based on the Securities and Futures (Offers of Investments) Regulations 2002 and Code on Collective Investment Scheme that they apply on unit trusts.
  - Set out the following:
    - Approval criteria and operational requirements for Approval Trustee
    - Requirements of Trust Deed
    - Disclosure requirements of Offering Document
    - Core investment restrictions
  - State requirements of Special Schemes (e.g. Property Funds, Hedge Funds, Money Market Funds, etc.)
  - Describe Authorization Procedures
  
- ❖ In Korea (Financial Supervisory Service), their relevant regulation is based on Asset Management Business Act 2003 that they apply on investment trust or Investment Company.
  - Details the disclosure requirements of Offering Documents
  - Set out operational issues of the investment trust and Investment Company, and general investment restrictions
  - States the circumstances under which reporting to FSC/FSS is required, and the Roles and Responsibilities of the manager and the trustee/custodian
  - Describes Authorization Procedures
  - Provides for the establishment of the Asset Management Association

## 3. Roles of Trustee / Custodian

- ❖ Hong Kong (Securities and Futures Commission)
  - Must be independently audited
  - Independence of the Trustee / Custodian from the Manager

- Hold fund assets “in trust” for the investors
  - Take reasonable care to ensure all aspects of operations of the fund are in accordance with the constitutive documents
  - Issue annual report to the investors to advise if the Manager has in all material aspects managed the scheme in accordance with constitutive documents
- ❖ Singapore (Monetary Authority of Singapore)
    - Trustee independent of the Manager
    - Handle all transactions at arm’s length
    - Inform the Authority where the approved trustee is aware that the Manager has contravened any legal or regulatory requirement
    - Hold all property for the participants
    - Keep and maintain or cause to be kept and maintained a register of the participants
- ❖ Korea (Financial Supervisory Service)
    - Independent from manager
    - Trustee is subject to Trustee Act
    - Perform its duties for the benefits of the investors in good faith
    - Report to FSS if Manager in breach did not rectify within 3 days
    - Confirm:
      - If the manager is in violation of any regulations, trust deed or Offering Document
      - If valuation is fair
      - If performance of the manager is notified of breach

#### D. Common Market Practices

##### 1. Dealing

- ❖ Frequency dealing should be disclosed in the Offering Document
- ❖ For open-ended funds, at least once a month

##### 2. Settlement Cycle

- ❖ Subscription can be in cleared funds basis, or on a T + X days basis, as long as it is disclosed in the Offering Document and all investors are treated in the same way
- ❖ Regulator requires that redemption proceeds have to be paid within one month
- ❖ In view of market competition, it is usually paid as soon as possible, usually within T+5

##### 3. Switching

- ❖ It is usually preferred to happen using NAVs on the same Dealing Day, so that investors do not suffer from market fluctuation
- ❖ Transfer of funds is made as soon as possible between funds
- ❖ Funds are usually allowed to apply for overdraft facilities for the purpose of meeting redemption / switching requests, as it may prove more costly to sell underlying assets
- ❖ Front-end and back-end fees are usually waived, so that investors are not charged twice

#### 4. Valuation

- ❖ Valuation frequency is to be disclosed in the Offering
- ❖ Valuation methods of different type of investments are disclosed in details
- ❖ Trustee/custodian and Manager have to agree on pre-determined valuation approach and be able to adhere to the approach, or monitor if the Manager follows the approach
- ❖ Any pricing error resulting in a difference of 0.5% NAV of the fund needs to be reported to the SFC and appropriate compensation should be made to affected investors
- ❖ Proposal to SFC to rectify the position should be submitted and advice measures to prevent the error from happening again

#### 5. Auditing the Fund

- ❖ In most jurisdictions, auditors must be appointed at the launch of the fund
- ❖ In some jurisdictions, only “approved” auditors can be appointed. Field Audit is to be carried out in the office of the Trustee/Custodian
- ❖ Annual Audited accounts must be delivered to investors within 4 months after the financial year-end of each fund
- ❖ The semi-annual un-audited financial statements are to be sent to investors within 1 month.

#### 6. Internal Auditing of the Trustee / Custodian and Manager

- ❖ Internal Control and Operations of the Trustee and Manager needs to be audited by external auditor on annual basis and a Report is to be sent to the regulator.

### E. Fiduciary Duties to Investors (Roles of Trustee / Custodian)

#### 1. Control of Assets

- ❖ To receive cash from investors
- ❖ To hold cash from investors
- ❖ To settle purchase of assets
- ❖ To safekeep all investment
- ❖ To collect income and cash proceeds following sales
- ❖ To ensure payment are only made to the right party

#### 2. Monitor the Activities of the Manager

- ❖ Investment in asset classes according to constitution
  - By market
  - By % of net asset value
  - By industry sector
  - By issuer
- ❖ Gearing ratio (if any)
- ❖ Compliance with regulations
- ❖ Any unusual transaction (e.g. market manipulation)

#### 3. A Wider Role of Trustee/Custodian

- ❖ NAV calculation
  - Calculate of NAV of the CIS
  - Arrange for publications of prices

- ❖ Registrar services
  - Maintain Register of Investors Unit / Holders or Shareholders
  - Process subscriptions / redemption / transfers
  - Process distributions
  - Issue statements of investors

#### F. Roles of Trustee / Custodian

1. In most jurisdiction, trustee/custodian acts as “Check and Balance” to the manager to protect investors
2. “Trust” is a concept from Common Laws of the English legal system
3. A trustee should exercise the diligence and care that a prudent man would show in the management of *his own affairs*
4. Custodian may not have the same level of responsibilities as trustee, esp. in non-common law jurisdiction
5. The fiduciary duty of both manager and trustee/custodian does not limit what is written in the rules and regulations
6. It requires the manger and trustee/custodian to have in mind the “interest” of ALL investors
7. Trustee/custodian is usually appointed by the Manager
8. Trustee/custodian is expected to monitor activities of the Manager
9. Potential Conflict between manager and trustee/custodian
  
10. Trustee/custodian’s liability is limited to the size of the funds, unless it is proved to be their willful default and gross negligence, etc.

#### G. Typical Market Development in Asia

1. Phase I
  - ❖ Driven by demand for professional asset management, local managers (or JVs) start to manage CIS
  - ❖ Initially invest in local fixed income instruments or in local equity markets
  - ❖ Regulators lay down rules and regulations to regulate activities
  
2. Phase II
  - ❖ For the purpose of diversification, investment in overseas assets is allowed
  - ❖ Draw the interest of more international managers
  - ❖ Introduce overseas best practices, which is a result of lessons from overseas

#### H. Recent Market Development

1. Spitzer Review
  - ❖ Late Deals Accepted
    - This refers to preferential dealing terms to certain investors where deals are accepted after the dealing deadline. This is unfair to other investors.
  - ❖ Stale Pricing
    - A time gap between valuation point and time orders are accepted. When a fund invests in more than one market in different time zones,

it creates arbitrage opportunity for investors. Fair pricing adjustments are necessary.

- ❖ Unequal disclosure of information to different clients
- ❖ Staffs exploiting stale prices
  - Staff dealing rules needs to be implemented and carefully monitored.
- ❖ Inducements are accepted to allow preferential treatment

## 2. How to Prevent Malpractice

- ❖ Independence of trustee/custodian from manager
- ❖ All players subject to regulatory compliance and reporting to achieve “check and balance”
- ❖ Establish internal compliance policy and procedures by each market player, which includes compliance training of all staff members
- ❖ Instill the importance of compliance-awareness in daily operations
- ❖ Create Risk Management department to review operations from time to time to identify potential risk areas

## 3. Bond Funds Crisis in Asia

- ❖ Fixed income instruments are often valued at yield to maturity or at cost
- ❖ This is fine if the instruments are held to maturity by the fund and investors remain in the fund until maturity
- ❖ But problem arises if the investors can go in and out of the fund
- ❖ Fixed income instruments held by funds should be valued “mark-to-market”
- ❖ Difficulty is, for many Asian markets, there is no “market” in view of the lack of liquidity
- ❖ Korea, Taiwan and Indonesia suffer at different degree in the last 2 years

## 4. Emergence of Different Fund Types

- ❖ Classified by Type of Underlying Investments
  - Equity Funds
  - Fixed Income Funds
  - Money Market Funds
  - Hedge Funds
  - Private Equity Funds
- ❖ Classified by Structure
  - Umbrella Fund
    - Each sub-fund is run as independent funds, with different investors
    - Same legal structure, save time and cost when setting up
  - Feeder Fund
    - Usually for regulatory purpose
    - More efficient in management
    - More cost-effective, if no double charge
    - Can be cross-jurisdictions
  - Fund of Funds
    - Similar to Feeder Fund
    - More efficient in management
    - Recently cross fund houses, best of breed

Instrument	Single e.g. Equity Fund	Multiple e.g. Balanced Fund
Market	Single e.g. Philippines Fund	Multiple e.g. Asean Fund
Risks	High e.g. Derivative Fund	Low e.g. Bond Fund
Investment Pattern	Open-ended e.g. Equity Fund	Closed-ended e.g. Private Equity Fund

#### I. Market Development

1. Industry groups helps the development of the markets
2. Most managers are members to such industry groups, with associate members like trustees and custodians, lawyers and accountants
3. Most industry groups are set up with the following objectives:
  - ❖ To represent members collectively to deal with regulatory issues that affect investment products, investment management companies and the market in which the members operate
  - ❖ To give recommendation to the regulator as to how best promote the long-term development of the industry
  - ❖ To promote higher standards of practice including professionalism and ethics within the industry
  - ❖ To promote the education of the investing public on investments
4. Benefits of Industry Groups
  - ❖ It creates a bridge between the market players and the regulators
  - ❖ Industry groups are often asked to join the different law drafting committees in investment and pension plans in the markets
  - ❖ Involvement of market players results in commitment
  - ❖ Commitment from managers and trustees/custodians helps the successful implementation of rules and regulations
  - ❖ Through regulated sales activities, it helps promote education of the investing public

#### J. Conclusion

1. Development of Collective Investment Schemes is subject to the specific environment of each market and the investing public
2. There is no one single success formula
3. The key is the common objectives of the Regulator and market players
  - ❖ To develop the market for the long-term benefits of both the market players and investors
  - ❖ To provide basic infrastructure to protect the investors
  - ❖ To educate the investors of the risk and benefits in investment products and eventually help them make informed investment decisions

## VII. Investment & Risk Management Process in the Management of Retail Funds

*Speaker: Ms. Juliet Dytoc, Trust Credit and Risk Officer, Metrobank – Trust Banking*

Portfolio Management Process consists of three general steps:

### A. Planning

#### 1. Investor's Objectives and Constraints

- Portfolio Return
  - ❖ Return Objectives
    - To specify return measure
    - To determine investor's desired return
    - To determine required rate of return
  
- Portfolio Risk
  - ❖ Two Sources of Risk
    - Financial Risk
      - Market (Equity Prices, Exchange Rates, Interest Rates)
      - Credit
      - Liquidity
    - Non-Financial Risk
      - Operations
      - Model
      - Settlement
      - Regulatory
      - Legal
      - Tax
      - Accounting
  
  - ❖ Risk Objectives
    - Specify risk measure
      - Standard Deviation (volatility), beta, duration, convexity, delta, gamma
      - Value at Risk (measure of expected absolute losses relative to portfolio's expected value that one anticipates will be equaled or exceeded over a given horizon)
      - Tracking Risk
    - Determine willingness to take risk
      - Nature of investors (individual versus institutional)
      - Behavioral concerns
    - Determine investor's ability to take risk
      - Spending needs
      - Long-term wealth targets
      - Investor's financial strength
  
  - ❖ Risk Management Process
    - Identifying the level of risk that an entity wants
    - Measuring the level of risk that it currently has
    - Taking actions to bring the actual level of risk to desired level of risk

- Monitoring the new actual level of risk so that it continues to be aligned with the desired level of risk
- Implementing revisions to reflect new policies, preferences, and information

- Liquidity Constraints
- Investment Horizon
- Taxes
- Regulatory Requirements
- Unique Needs

## 2. Investment Policy Statement

- Client description
- Purpose of policies, guidelines, objectives, goals, restrictions and responsibilities
- Duties and responsibilities of parties involved
- Statement of investment goals, objectives and constraints
- Schedule for review of investment performance and the IPS
- Asset allocation considerations in the development of the strategic asset allocation
- Portfolio adjustment guidelines

## 3. Capital Market Expectations

## 4. Strategic Asset Allocation

- Passive (indexing and strictly buy-and-hold strategy)
- Active (beating the benchmark)
- Semi-Active (enhanced indexing)

## B. Execution

1. Portfolio Construction (within the guidelines of the IPS)
2. Portfolio Optimization
3. Portfolio Revision (in response to changes in investor circumstances or capital market expectations)

## C. Feedback and Control

1. Performance Evaluation
  - Performance Measurement
  - Performance Attribution
  - Performance Appraisal
2. Performance Monitoring and Rebalancing
  - Transaction costs
  - Taxes

## **Investment & Risk Management Process in the Management of Retail Funds**

*Speaker: Mr. James John P. Cezar, Project Manager, PricewaterhouseCoopers, Financial Advisors, Inc.*

### Objectives of the Presentation

- Highlight the reasons why there is a growing need for Financial Risk Management
- Discuss just a few financial risk management concepts
  - Some useful applications of VAR
  - Elements of Best Practice

### A. Emerging Importance of Financial Risk Management

1. The financial world is getting riskier
  - Because of the telecommunications revolution you lose faster and bigger now than ever before
1. Your competitors are employing more sophisticated risk management methods than you do
  - They may be able to fine tune their risk taking (and asset-liability management) activities and beat you in the market place
2. Basel II Capital Adequacy Requirements

$$\frac{\text{Total Capital}}{\text{Credit Risk} + \text{Market Risk} + \text{Operational Risk}} \geq 8\%$$

### 3. Requirements of the New Accounting Standards

IAS 39 Financial Instruments: Recognition and Measurement  
IAS 32 Financial Instruments: Disclosure and Presentation

Both standards require some discussion of risk management policies and procedures in your transaction documents and on your financial statements

### B. Four Reasons Why You Should Do FRM

1. For its own usefulness
2. To keep abreast with competition
3. Basel II
4. IAS 39 and 32

### C. What is Financial Risk?

#### 1. Market Risk

- The risk that the value of on- or off-balance-sheet positions will be adversely affected by movements in equity and interest rate markets, currency exchange rates and commodity prices.
- Also known as Price risk or Market Value risk

## 2. Credit Risk

- The risk of value lost in the event of default by the borrower. It is also risk that the value of a position will decline as the result of a change in the credit quality of a counterparty.

## 3. Operational Risk

- The risk attributable to failures that may occur in the course of running a business. It is the risk of failure of the people, processes or technology associated with a business unit.

## D. Efficient Frontier

1. A rational investor will always choose a portfolio with the lowest risk given the same level of expected returns
2. A rational investor will always choose a portfolio with the highest return given the same level of risk

## E. Value-at-Risk (VAR)

1. Portfolio measure of risk
2. Potential loss in a portfolio over a specified period of time
3. Usually based on history:
  - Volatility
  - Correlation

## F. Useful Variants of VAR

### 1. Relative VAR

- It measures the risk of underperformance relative to a pre-defined benchmark, such as the S&P 500 Index.
- It is relevant to many institutional investors, including investment managers and UITFs, because their performance is often compared to a target benchmark.
- For example, an Emerging Markets investment manager might have used the J.P. Morgan EMBI+ index as a performance benchmark. If the investment manager's portfolio rose 9% while the EMBI+ index rose 10%, we would say that she underperformed her benchmark by 1%. Assuming 99% confidence, a 1-month relative VAR of \$8 million means that on average, only 1 month in 100 would you expect to underperform your benchmark by more than \$8 million due to market movements. Relative VAR is also commonly expressed as a percentage of present value.

### 2. Marginal VAR

- Marginal VAR measures how much risk a position adds to a portfolio.
- Specifically, marginal VAR measures how much portfolio VAR would change if the position were removed entirely, (i.e., VAR with position minus VAR without position).
- Marginal VAR is useful for measuring which position (or risk category) is the largest contributor to portfolio risk. It can help answer the question of which position to eliminate entirely in order to most effectively reduce risk.

### 3. Incremental VAR

- Incremental VAR is closely related to marginal VAR.
- Marginal VaR measures the difference in portfolio risk brought about by removing an entire position, whereas incremental VaR measures the impact of small changes in position weighting.
- For example, we can estimate incremental VAR by:
  - Increasing a position weight by 1 dollar and measuring the change in diversified portfolio VAR
  - Multiplying this change by the position weighting
- The sum of all incremental VARs adds up to the total diversified portfolio VAR. Therefore, incremental VAR may be used to calculate percentage contribution to risk.
- One of the most common uses for incremental VAR is to generate reports that rank contribution to risk hedging opportunities. Incremental VAR is useful for identifying best candidates for gradual risk reduction (i.e., where the question is not which position to unwind entirely, but rather which position to partially hedge).

## G. Elements of Best Practice

Requisites for best practice risk management function in an organization are listed below:

### 1. Independent Risk Oversight

- Independence of the risk management function is a must in order for it to act as the devil's advocate in an investment organization. If this function is not independent of investment management, there will be biased decisions.

### 2. Written Policies and Guidelines

- Many institutions rely heavily on culture. While the structure may be clear to old-timers, it is not always clear to newcomers in the firm. Specific written documents that highlight the requisite checks and balances are an important aspect of a properly functioning risk management program.

### 3. Education and Knowledge

- Top management should have the requisite, detailed knowledge of the risk-management process. If the auditors and oversight people are to know what is going on, they need to understand, for example, the calculus and the graphics with which front office people deal and the front office people need to report what they are doing in ways the auditors can understand. Management must make very clear to everyone that it needs to receive information in an understandable and timely fashion.

### 4. Matching accountability and authority

- One of the biggest problems in funds is that portfolio managers are often the equivalent of lords or knights in a feudal system; they are untouchable by the people in operations or risk management who are charged with monitoring the managers' activities.

5. Use of Value-at-Risk

- Value-at-Risk (VAR) is a vital component of current best practices in risk measurement. It is embraced by practitioners, regulators and academics alike.

H. Risk Management Principles for the Persons at the Top

1. There is no return without risk.  
Rewards go to those who take risks.
2. Be transparent.  
Risk should be fully understood.
3. Seek experience.  
Risk is measured and managed by people, not mathematical models.
4. Know what you don't know.  
Question the assumptions you make.
5. Communicate.  
Risk should be discussed openly.
6. Diversify.  
Multiple risks will produce more consistent rewards.
7. Show discipline.  
A consistent and rigorous approach will beat a constantly changing strategy.
8. Use common sense.  
It is better to be approximately right, than to be precisely wrong.
9. Return is not only half the equation.  
Decisions should be made only by considering the risk and return of the possibilities.

## VIII. UITF Regulatory Direction

*Speaker: Mr. Nestor A. Espenilla Jr., Deputy Director, Supervision and Examination Sector, Bangko Sentral ng Pilipinas*

### ➤ Objectives of the Presentation

- To appraise participants of the regulatory directions and challenges
- To increase participants' awareness on the need to heighten customer protection

### A. The Need for Trust Reforms

1. To deepen the domestic capital markets
2. To revitalize trust business by widening investor base
3. To introduce better products
4. To make the industry more competitive coupled by conducive regulatory environment
5. To pave the way for long-term investment opportunities

### B. Trust Updates

#### 1. Universal / Commercial Banks Level (in billion pesos)

	Dec-00	Dec-01	Dec-02	Dec-03	Mar-04	Jun-04	Sep-04	Dec-04	Mar-05	Jun-05
Trust Assets	473.04	451.47	573.89	680.74	661.69	699.79	735.32	780.68	804.38	798.49
TOFA	317.16	254.66	283.53	335.68	307.78	330.50	348.15	381.49	406.33	406.09
CTF	85.46	113.49	200.99	245.39	256.95	268.70	287.56	293.60	284.63	257.60
IMA	70.41	83.32	89.37	99.67	96.96	100.59	99.61	105.59	113.42	133.99

#### 2. Universal / Commercial Banks Growth Rate (in percent)

	12/00 vs. 12/01	12/01 vs. 12/02	12/02 vs. 12/03	12/03 vs. 03/04	03/04 vs. 06/04	06/04 vs. 09/04	09/04 vs. 12/04	12/04 vs. 03/05	03/05 vs. 06/05
Trust Assets	-4.6%	27.1%	18.6%	-2.8%	5.8%	5.1%	6.2%	3.0%	-0.7%
TOFA	-19.7%	11.3%	18.4%	-8.3%	7.4%	5.3%	9.6%	6.5%	0.1%
CTF	32.8%	77.1%	22.1%	4.7%	4.6%	7.0%	2.1%	-3.1%	-9.5%
IMA	18.3%	7.3%	11.5%	-2.7%	3.7%	1.0%	6.0%	7.4%	18.1%

#### ➤ Universal / Commercial Banks Level (in billion pesos)

	Dec-00	Dec-01	Dec-02	Dec-03	Mar-04	Jun-04	Sep-04	Dec-04	Mar-05	Jun-05
Living Trust	56.57	48.34	46.92	93.77	98.16	104.91	110.96	114.66	120.16	127.98
CTF Trust Asset	85.46	113.47	200.95	245.39	256.95	268.70	287.56	293.60	284.63	226.23
UITF										31.37

### UITF Updates

	UBs	KBs	TBs	NBQs	Total
Approved as of 10/11/05	46	16	8	1	71
Pending as of 10/11/05	14	2	7	2	25
Volume as of 6/30/05					Php31.37B

## C. Trust Directions

### 1. Residual Risk Elimination

- Clear distinctions between fiduciary and agency account
- Safeguards to clearly distinguish trust from a deposit / deposit substitute
- Marked-to-market daily so that investors will not be misled as to the real performance of their investments
- Not subject to reserve requirements

### 2. Enhanced Investor Protection

#### i. Proper Marketing

- Proper Training of Marketing Personnel
  - To enhance marketing skills
  - To better ensure that investors are properly informed of the risks of their investments
  - To make sure no promises are made that would tend to guarantee financial performance of trust investments
- Certification process for marketing personnel
- Per-sales disclosures
  - Investment strategy of trustee
  - Kind of investment
  - UITF is a trust product
  - Inherently riskier than deposits
  - Maybe rewarded with potentially higher returns compared to deposit
  - UITF is not a deposit account
  - Not insured by PDIC
  - Does not carry guaranteed rate of return
  - Any income/loss for the account of participant

#### ii. Core Conduct and Client Suitability

- Risk profiling
- Fitness of product to client

#### Core Conduct

- Honesty and Fairness
- Diligence
- Capabilities
- Information about clients
- Information for clients
- Conflict of Interest
- Internal Training Program

#### Client Suitability Standards

- General Standards
  - ✓ Client Suitability Rule
  - ✓ Client Agreement
  - ✓ Periodic Statements
  - ✓ Marketing Communication
  - ✓ Confirmation of Client Order



- Enhance supervisory techniques
  - ✓ Develop trust specialists
  - ✓ Adopt a formal rating system tailor-fitted for trust
- Improve financial transparency through proper market discipline
  - ✓ Align accounting standards with international accounting standards to promote fairness, accuracy and transparency in the financial statements of trust entities
  - ✓ Set higher standards of conduct for external auditors for the proper enforcement of reliable financial statements of trust entities
- Accelerate development of capital market
  - ✓ Develop seamless market infrastructures
    - Fixed exchange, credit bureaus, more domestic credit rating agencies
  - ✓ Develop a more conducive regulatory environment
    - Strengthen mark-to-market regulations
    - Phased lowering of reserve requirements
    - Reasonable application of SBL, DOSRI, FCDU, liquidity cover, DST, etc.
  - ✓ Expand allowable investment alternatives
  - ✓ Diversify funding sources towards the direction of capital markets by issuing tougher standards on management of large exposures, SBL and DOSRI lending
- Increase financial literacy of investors by mounting comprehensive information campaign
- Strengthen controls on connected lending
  - ✓ Policy on DOSRI ceilings and single borrower's limit (SBL)
  - ✓ Stricter rules on borrowings from retirement funds
- Promote robust appraisal industry
  - ✓ Accreditation process for appraisers
- Strengthen Pre-Need Trust Investment
  - ✓ Coordinate with SEC in the monitoring and supervision of pre-need companies
  - ✓ Support the proposed Pre-Need Code of 2005
  - ✓ Support the placement of pre-need companies under the supervision and regulation of Insurance Commission
- Increase coordination between the BSP and the banking industry
- Intensify coordination between the BSP and Financial Sector Forum members (SEC, IC, PDIC) in the areas of effective supervision of financial conglomerates, information exchange and consumer protection
- Pursue passage by Congress of critical laws that develop the financial market (BSP Charter, SPAV II, Credit Information, Corporate Recovery Act, PERA, RICA, Pre-Need Code, etc.)

## IX. Competition in Retail Funds in the Philippines

Speaker: Mr. Mario Miranda, TOAP Director

### A. Mutual Funds

- Investment Company → is a company that pools funds from numerous investors through the issuance of its shares to the public. The proceeds from the sale of the shares are then invested according to the investment objectives and policies of the company.
  - ❖ Closed-End Investment Company
    - An investment company that issues a limited number of non-redeemable shares which are then traded in the open market.
  - ❖ Open-End Investment Company
    - An investment company which continuously issues new shares and stands ready to redeem such shares from investors at the prevailing Net Asset Value per Share. Also referred to as Mutual Funds.

### B. Classifications of Mutual Fund Industry

1. Equity Funds
  - Invest primarily in equity securities such as common stock, preferred stock, and warrants
2. Balanced Funds
  - Invest in both equity and debt securities, typically at a 50-50 ratio
3. Bond Funds
  - Invest in fixed income (debt) instruments like government securities (T-Notes and municipal bonds) and corporate bonds (mortgage bonds and debentures)
4. Money Market Funds
  - Invest exclusively in short-term (less than a year) debt instruments such as T-Bills and commercial paper
5. Index Funds
  - Provide investment returns that track the performance of the PHISIX

### C. History of Mutual Funds

The *Filipinas Mutual Funds (FMF)* was the first mutual fund to be established in the Philippines. It was incorporated on December 6, 1957 and started commercial operations later that month.

1. From 1958 to 1960, four more funds were organized. Some of these funds were able to achieve some success. FMF, for instance, started out with 34 investors and P72,652 in assets.
  - People's Mutual Fund (1958)
  - Industrial Mutual Fund (1959)
  - Commercial Mutual Fund (1959)
  - United Mutual Fund(1960)
2. 1960 → It was reported to have 95,000 shareholders and over P12 million in assets. Unfortunately, the mutual fund concept caught on with some unscrupulous individuals who began promising outrageous returns to unsuspecting investors, only to later run away with their money. These scams were exposed by the then Dean of

newspaper columnists, Ka Doroy Valencia in his newspapers column and radio program Over a Cup of Coffee. The scandal caused the budding industry's untimely demise.

**RA 2629 of June 1960**, the Investment Company Act is the best document that marks the origin of the Philippine Mutual Funds Industry. It was patterned after the United States' Investment Company Act of 1940 it was obvious from the language and tone of R.A. 2629, especially on its Declaration of Policy, that it was passed primarily as a response to the fiasco of the late 1950's.

1. August 1969 → Trinity Shares, Inc. (TSI) became the first mutual fund to register under the Investment Company Act of 1960. Shortly thereafter Pacific Fund, Inc. was established. Again, these two funds were just starting to gain acceptance and achieve some success when the 1st Quarter Storm of 1970 erupted. The ensuing political turmoil, social unrest and deteriorating peace and order situation caused the stock market to crash. Without alternative investment instruments to invest in (there were no government securities or commercial paper to speak of during this time), the two funds soon became dormant.
2. 1989 → The Securities and Exchange Commission wanted to revive the mutual funds industry in order to help develop the domestic capital markets sector
3. 1989 (Oct 31) → The Commission promulgated the Rules and Regulations Governing Investment Companies under R.A. 2629. Magellan Income Fund, Inc. (now the First Galleon Family Fund, Inc.) was the first fund to register under the said rules. It began commercial operations on February 1, 1991.
4. 1991 (May 9) → The Filipino Fund, Inc., the first closed-end investment company was incorporated. On March 28, 1995 FFI was registered with the SEC under the Investment Company Act and the Revised Securities Act. The Shares of FFI were approved for listing in the PSE by a resolution of the PSE Board of Governors dated June, 14, 1995.
5. 1995, (Oct 24) → The Investment Company Association of the Philippines (ICAP) was organized. Its primary purpose is :
  - To further the interest of the Securities and Exchange Commission in protecting the investing public
  - To cooperate with the Commission in the implementation of the Corporation Code, the Revised Securities Act, the Investment Company Act and any other relevant legislation, together with their guidelines and implementing rules and regulations for the registration and regulation of investment companies
  - To act as a self-regulating body for the purpose of raising the investment company industry's standard by promoting a better understanding of the functions of investment companies in the Philippines and their contribution to the Philippine economy
  - To enhance the development of the capital and financial market sectors, and to foster their growth

D. Variable Life Insurance

1. Variable life insurance is similar to traditional life insurance, except that the cash value and/or death benefit vary based on the investment performance of the assets in which the premium payments are invested.
2. Premium payments under a variable life policy are invested in an insurance company, which generally is not subject to state law investment restrictions or withdrawal penalties. As the market changes, policyholders can reallocate their investment without incurring any tax charges.
3. A variable life policyholder typically is offered a variety of investment options (*e.g.*, equity, bond, and money market mutual funds). Death benefits and cash values are directly related to performance of the separate account, although typically there is a guaranteed minimum death benefit.

E. History of Variable Life Insurance

1. 1970s → First introduced in the Philippines

During the years from the end of World War II to the late 60's, there was a significant decline in the share of savings dollars invested with life insurance companies. In an effort to counteract this trend, insurers began to offer a greater variety of products, including equity-based products such as variable life insurance.

2. 2000 → Variable life insurance accounted for 51.3% of first year individual life insurance premiums, and 19.6% of total individual life insurance premiums.

Its popularity has been on the rise in Asia. Even as early as eight years ago, variable life insurance products (VLIPs) are observed to be more preferred compared to traditional life plans, with Hong Kong nearly doubling the sales, accounting for 35 percent of the territory's 897-million-dollar life insurance market. Moreover, Malaysia, Singapore, Taiwan and China reported VLIPs fast catching up according to the October 2001 issue of Asia Week Magazine.

F. UITF vs. Mutual Fund and Variable Life Trust

<b>Nature of Differences</b>	<b>Unit Investment Trust Funds</b>	<b>Mutual Fund</b>	<b>Variable Life</b>
<i>By Origination</i>	Initiated by a Trust Group of a bank	Investment Companies	
<i>By Distribution</i>	Through Branches of Trustee Bank	Open-end: authorized selling agents Close-end: PSE	

<i>By Ownership</i>	No direct ownership, interest in the fund is represented by units	Investors are Stockholders and Owners	
<i>Regulatory Body</i>	BSP	SEC	OIC (Office of Insurance Commission)
<i>Valuation</i>	Marked-to-Market	Marked-to-Market	
<i>History</i>	2005	1957	1970

**X. UITF Industry Issues**

*Speaker: Ms. Marily De Vera, TOAP Director*

➤ UITF Industry Issues

A. Regulatory (& Industry)

1. Risk to the bank in case investments go sour
2. Clearly distinguish depositors from investors
3. Investor protection
4. No residual risk to Trust and Bank on investments due to risks and volatility

B. Empowering the Investors

1. Creating Awareness of the UITF: UITF Product Campaign

▪ Print-Ads and Press Releases

- Ad Agency (chosen) → OP Communications
- Media Plan Requirements

The visuals (lay-out) will be released in Business World, Philippine Daily Inquirer and Philippine Star

- ❖ Philippine Daily Inquirer → 10 releases
- ❖ Philippine Star → 10 releases
- ❖ Business World → 4 releases

❖ Specifications:

- 1st 2 releases → 7 col. X 40 cm + advertorial (full color)
- Succeeding releases → 9 col. X 27 cm (black and white)

Confirmation of Participation in Ad Campaign	Oct. 12, 2005
Final Artwork	Oct. 17, 2005
Confirmation of Cost of Campaign per Institution	Oct. 26, 2005
Schedule of Ad Campaign and Press Releases (Per Institution, alphabetical)	November to December 2005
Media Briefing	November 2005

▪ Investors Briefings

Proposed Dates	October to November 2005 Weekday – from 3:00 pm to 6:00 pm
Proposed Number of Briefings	6

Proposed Areas	<ul style="list-style-type: none"> <li>▪ 2 Makati</li> <li>▪ 1 Ortigas</li> <li>▪ 1 Quezon City</li> <li>▪ 1 Cebu</li> <li>▪ 1 Davao</li> </ul>
Target Number of Participants per Briefing	200 to 250 participants
Sponsorship Package per Area per Briefing	Php10,000.00 = free 10 participants
Expenses	<ul style="list-style-type: none"> <li>▪ Venue/Food (usually costs P400 to P500 per pax)</li> <li>▪ Token for speakers</li> <li>▪ Airfare (for Cebu and Davao)</li> <li>▪ Token</li> <li>▪ Materials/Handouts</li> <li>▪ Streamers</li> <li>▪ FAQ</li> <li>▪ Others (contingency)</li> </ul>

- UITF Investors Roadshows
  - FAQ
    - Objective:
      - To have a standard Frequently Asked Questions (FAQ) on UITFs for distribution to clients of member institutions
        - One pager, full color, glossy paper (sample distributed)
        - Cost → Php 2.00 per piece
        - Expense shall be charged to member institutions requesting for copies
  - UITF Website
    - Objective:
      - To provide an interactive website for all UITF in the market
        - Daily NAVPU Update
        - Fund Features
        - Search Engine
          - Type of funds
          - Profiling → suggested fund type
          - Best Performing 90 days, 1/3/5 years/s
          - Links to Banks' Website
          - Trading
2. Educating the investors
3. Protecting the investing public
- Distinguishing the depositors from the investors
  - Certification of marketing personnel

- Provisions in UITF Circular: custodian, external audit, disclosures required, NAVPU publication

## C. Industry

1. Maintaining competitiveness
  - Mutual Funds
  - Insurance Funds
  - Pre-need
  - Off-shore Funds
2. Undeveloped capital market
  - Predominantly GS for both Peso and USD securities
  - Thin markets for GS of short or long term tenors
  - No Tradable Loan Platform
  - Limited corporate issues
3. Investment in FCDU equities of foreign markets – currently not allowed
4. Institutionalize “Profile” based concept, where UITFs are primarily limited to the objectives, horizon and unique risk tolerance of target market (applicable to the following: )
  - Hedge funds
  - Derivatives
  - Structured notes
  - even SPAVs
5. Expressly allow investment by UITF in asset backed securities, derivatives, structured products, tradable offshore securities
6. Application of Global Investment Performance Standards (GIPS) for standard performance measurement
  - Comparison across all UITFs
7. Tradable loans
  - Unresolved legal & tax issues
8. Risk Management and Compliance Standards for UITF/Trust Industry
  - Documentation
  - Disclosures
  - Client Suitability
  - Riskmetrics
9. Standard (Risk) Disclosures
  - Market/Interest Rate/Price, Credit, etc.
10. Unbundling of Trust Duties to define responsibilities of each function
  - Trustee
  - Fund Management
  - Fund Administration
  - Custody

11. Provision for other fees
  - Performance fees
  - Front-end and/or back-end fees
  - Switching fees
  - Custody fees
  - Fund Administration fees

D. Product Breadth

1. Long Term UITF
2. Closed Ended UITF
3. Capital Protected
4. Structured Products/Derivatives
5. Real Estate Investment Trust
6. Hedge Funds
7. Exchange Traded Funds
8. Feeder Funds
9. Fund of Funds
10. Multi-currency Funds

## XI. The Investment Industry and the Filipino Investor

Speaker: Ms. Marilen Sarmiento, TOAP Director

1970's	
<b>Financial Developments</b>	
<ul style="list-style-type: none"> <li>➤ There was increased diversity of financial institutions and services coming into the market.</li> <li>➤ Banks remained the dominant financial intermediary.</li> <li>➤ Non-bank financial institutions, development banks and rural banks emerged.</li> </ul>	
Investment Vehicles	The Filipino Investor
<ul style="list-style-type: none"> <li>▪ Savings deposits</li> <li>▪ Time deposits</li> <li>▪ Insurance</li> <li>▪ Real-estate</li> </ul>	<ul style="list-style-type: none"> <li>▪ <i>Experience</i> Predominantly a depositor</li> <li>▪ <i>Risk Appetite</i> The average Filipino investor was conservative.</li> <li>▪ <i>Horizon</i> Short Term</li> <li>▪ <i>Objective</i> Security of capital; continue to leave his money with banks.</li> </ul>

1980's	
<b>Financial Developments</b>	
<ul style="list-style-type: none"> <li>➤ The market was rocked by the Dewey Dee fiasco in 1981, triggering a rash of insolvencies for investment houses and finance companies.</li> <li>➤ This resulted in flight to quality, with money flowing back to banks.</li> <li>➤ Interest rates were deregulated in 1981.</li> <li>➤ Aquino assassination in 1983 further eroded investor confidence. Government was forced to:               <ul style="list-style-type: none"> <li>○ Devalue the peso</li> <li>○ Impose a moratorium on external debt payments</li> <li>○ Raise interest rates</li> </ul> </li> <li>➤ The Central Bank introduced the Jobo bills to control liquidity in the system.</li> <li>➤ Interest rates reached 50% p.a.</li> <li>➤ The change in government in 1986 led to the gradual decline in interest rates.</li> </ul>	
Investment Vehicles	The Filipino Investor
<ul style="list-style-type: none"> <li>▪ Savings deposits</li> <li>▪ Time deposits</li> <li>▪ Insurance</li> <li>▪ Real-estate</li>   <li>▪ Traditional Trust products started to appear</li> <li>▪ IMA was offered to retail investors</li> <li>▪ Common Trust Funds (CTFs) emerged</li> <li>▪ Treasury Bills (Short Term)</li> </ul>	<ul style="list-style-type: none"> <li>▪ <i>Experience</i> Investors began to look outside of bank deposits and into the higher yielding and safe CB instruments.</li> <li>▪ <i>Risk Appetite</i> He continues to be <i>risk</i> averse because of his experience of bank run and volatile interest rates. Conservative.</li> <li>▪ <i>Horizon</i> He prefers to stay <i>short term</i> to ride the volatility, which at some point run</li> </ul>

	<p>into the 50%.</p> <ul style="list-style-type: none"> <li>▪ <i>Objective</i> With inflation running very high his <i>objective</i> is to beat inflation. To be able to do that he rides the volatility.</li> </ul>
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<b>Early 1990's</b>	
<b>Financial Developments</b>	
<ul style="list-style-type: none"> <li>➤ Brownouts were a significant part of the day.</li> <li>➤ Bank branching was relaxed, increasing ability of banks to tap retail markets.</li> <li>➤ Foreign exchange was deregulated.</li> <li>➤ ROP sovereign bonds were issues (NMBS, DCBs, FLIRBs, PARs)</li> <li>➤ Establishment of ATMs</li> <li>➤ Interest rates remained volatile.</li> <li>➤ Commercial Papers started to be floated abundantly (SMC LTCP up to series J)</li> <li>➤ Booming Stock Market (Best Performing in the World in 1993)</li> <li>➤ Entry of foreign stockbrokers and foreign banks</li> <li>➤ Credit cards started to emerge to become a common item in every Filipinos wallet</li> <li>➤ Consolidation of the Makati and Manila Stock Exchanges</li> </ul>	
<b>Investment Vehicles</b>	<b>The Filipino Investor</b>
<ul style="list-style-type: none"> <li>▪ Savings deposits</li> <li>▪ Time deposits</li> <li>▪ Insurance</li> <li>▪ Real-estate</li> <li>▪ Traditional Trust products, IMA, CTFs</li> <li>▪ T-Bills (Short Term)</li>   <li>▪ Equity and Dollar denominated CTFs</li> <li>▪ FXTNs</li> <li>▪ FRTNs</li> <li>▪ Commercial Papers</li> <li>▪ Stocks (IPOs)</li> </ul>	<ul style="list-style-type: none"> <li>▪ <i>Experience</i> With wider choices Filipino investors became open to diversifying outside of GS; though not experts in investing they tried their hands at stocks, CTFs, CPs, FRTNs, etc.</li> <li>▪ <i>Risk Appetite</i> Though still a rate shopper, the Filipino investor began to experiment with higher risk assets (stocks) for additional yield. Conservative to Moderate to Aggressive.</li> <li>▪ <i>Horizon</i> Investor's mindset widens to include medium term in addition to their short-term investments because of wider choices and a booming stock market.</li> <li>▪ <i>Objective</i> In addition to beating inflation he is now looking at capital growth.</li> </ul>

<b>Late 1990's</b>	
<b>Financial Developments</b>	
<ul style="list-style-type: none"> <li>➤ A more robust Eurobond market – PLDT, DBP, ROP, CMP, PAL</li> <li>➤ FRCs were issued MBT, SB, PCIB, etc.</li> <li>➤ Convertible Dollar Bonds emerged – Piltel, PDC, etc.</li> <li>➤ Start of the Asian financial crisis</li> <li>➤ Significant depreciation of the peso</li> <li>➤ Increasing incidences of loan defaults</li> <li>➤ National Internal Revenue Code of 1997 providing for tax-exemption for long-term investments</li> <li>➤ Stock Market hit low points</li> <li>➤ Proliferation of “pyramiding” schemes/scams</li> </ul>	
<b>Investment Vehicles</b>	<b>The Filipino Investor</b>
<ul style="list-style-type: none"> <li>▪ Savings deposits</li> <li>▪ Time deposits</li> <li>▪ Insurance</li> <li>▪ Real-estate</li> <li>▪ Traditional Trust products, IMA</li> <li>▪ CTFs, Equity and Dollar</li> <li>▪ T-Bills (Short Term), FXTNs, FRTNs</li> <li>▪ Commercial Papers</li> <li>▪ Stocks (IPOs)</li>   <li>▪ Peso Dollar Swap</li> <li>▪ Longer dated FXTNs</li> <li>▪ Re-emergence of Mutual Funds</li> <li>▪ Off-shore products</li> <li>▪ Double your money products</li> </ul>	<ul style="list-style-type: none"> <li>▪ <i>Experience</i> With his experience in stocks and real estate (boom and bust) and credit defaults the Filipino investor took stock but product choices also deepened, more CTFs, access to FXTNs and double your money schemes.</li> <li>▪ <i>Risk Appetite</i> Flight to quality was the order of the day, he is more credit conscious. His range – Conservative to Moderate.</li> <li>▪ <i>Horizon</i> Investors’ horizon is wider in range from short term to long term; double your money schemes changed him.</li> <li>▪ <i>Objective</i> Because of his experience his objective is more of capital preservation and some growth.</li> </ul>

<b>2000 onwards</b>
<b>Financial Developments</b>
<ul style="list-style-type: none"> <li>➤ Continued political saga (Erap impeachment and others)</li> <li>➤ Implementation of CTRP</li> <li>➤ Lower inflation environment</li> <li>➤ Lower interest rate environment</li> <li>➤ Increased long term borrowings from corporate borrowers</li> <li>➤ Renewed resurgence of the stock market</li> <li>➤ RTBs, Progress bonds, Erap bonds</li> <li>➤ Structured products</li> <li>➤ Introduction of Unit Investment Trust Funds (UITF)</li> <li>➤ More robust ROP market</li> <li>➤ Emergence of the “sophisticated” investors</li> </ul>

Investment Vehicles	The Filipino Investor
<ul style="list-style-type: none"> <li>▪ Savings deposits, Time deposits</li> <li>▪ Insurance, Real-estate</li> <li>▪ Traditional Trust products, IMA</li> <li>▪ CTFs, Equity and Dollar</li> <li>▪ T-Bills (Short Term), FXTNs, FRTNs</li> <li>▪ Commercial Papers, Peso/\$ swap</li> <li>▪ Stocks (IPOs), Mutual Funds, Off-shore</li> <li>▪ Double your money products</li>   <li>▪ P/\$ Long Term ROP Issues</li> <li>▪ Tier 2 Capital Notes</li> <li>▪ Derivative/Structured products</li> <li>▪ UITF Products</li> <li>▪ Off/on-shore Private Bank</li> <li>▪ Portfolio Management Products (Living Trust)</li> </ul>	<ul style="list-style-type: none"> <li>▪ <i>Experience</i> He has come full circle having experience wide variety of investments not only in the domestic but increasingly the global market from his off-shore banker. He has gone through periods of boom and bust, stable regimes and negative real returns. He had withstood market risk with his ROPs, FXTNs and now UITF. He has trusted his trustee for Portfolio Management Products.</li> <li>▪ <i>Risk Appetite</i> He can be conservative, moderately conservative or aggressive. He has learned to trust his private banker for advises and his trustee to manage his portfolios. He has taken market risks and being educated about volatility and UITFs. Understands that market risk is negated when investments are held maturity. Willing to take market and credit risks for better yields.</li> <li>▪ <i>Horizon</i> He has now appreciated the value of long-term investment considering the disparity between long-term (5-yr.) and short term (30-days) rate. Still keeps portion of funds in short term deposits / investments for liquidity. Understands that market risk is negated when assets are held to maturity i.e. comfortable with long term investment.</li> <li>▪ <i>Objectives</i> He can be conservative, moderately conservative and aggressive. He's beginning to plan for the future by segregating his funds into different buckets for different uses (e.g. first car, house, vacation, etc). He is learning the different investment options available to him including the variety of UITFs.</li> </ul>

➤ SUMMARY:

❖ 1970's

Experience	Deposit	Investment	Hybrid/ Derivatives
Horizon	Short	Short to Medium	Medium to Long
Risk	Conservative Risk Averse	Moderate Risk Tolerant	Aggressive Risk Taker
Investment Objectives	Capital Preservation	Income	Capital Appreciation

Products: Savings deposits  
Time deposits  
Insurance  
Real estate

❖ 1980's

Experience	Deposit	Investment	Hybrid/ Derivatives
Horizon	Short	Short to Medium	Medium to Long
Risk	Conservative Risk Averse	Moderate Risk Tolerant	Aggressive Risk Taker
Investment Objectives	Capital Preservation	Income	Capital Appreciation

Products: Savings deposits                      Traditional Trust / IMA  
Time deposits                                      Common Trust Funds  
Insurance                                              Treasury Bills  
Real estate

❖ 1990's

Experience	Deposit	Investment	Hybrid/ Derivatives
Horizon	Short	Short to Medium	Medium to Long
Risk	Conservative Risk Averse	Moderate Risk Tolerant	Aggressive Risk Taker
Investment Objectives	Capital Preservation	Income	Capital Appreciation

Products:	Savings deposits Time deposits Insurance Real estate	Traditional Trust / IMA Common Trust Funds Treasury Bills FXTNs FRTNs Commercial Papers Mutual Funds Peso Dollar Swap Longer dated FXTNs	Stocks (IPOs) Mutual Funds Off-shore products Double your money products
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❖ 2000

Experience	Deposit	Investment	Hybrid/ Derivatives
Horizon	Short	Short to Medium	Medium to Long
Risk	Conservative Risk Averse	Moderate Risk Tolerant	Aggressive Risk Taker
Investment Objectives	Capital Preservation	Income	Capital Appreciation

Products:	Savings deposits Time deposits Insurance Real estate	Traditional Trust / IMA Common Trust Funds Treasury Bills FXTNs FRTNs Commercial Papers Mutual Funds Peso Dollar Swap Longer dated FXTNs	Stocks (IPOs) Mutual Funds Off-shore products Double your money proucts P/\$ Long term ROP Tier 2 Capital Notes Derivative/Structure products UITF products Off/On-shore private bank Portfolio Management Products (Living Trust)
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## **XII. Workshop 1: Product Development & Distribution**

*Facilitator: Ms. Marily De Vera, TOAP Director*

The group looked into how the UITF product offering can be broadened and how this will be delivered in order to help promote investments in the Philippines. Inputs were obtained from presentations given by regional experts on the experiences of countries in Asia Pacific, with more developed investments system.

Level of priority for development and implementation = Immediate (I) within 1 year; Medium (M) within 1 to 3 years; and Long (L) within 3-5 years).

Participants:	Ching Garcia – BSP	Marily de Vera – BDO
	Mario Miranda – BPI	Guia Legaspi – TOAP
	Concep Cruz - ING	Stella Sampayan – Amex
	Raul Diaz – PBCom	Andrew Chua – AUB
	Joy Cervero - MBTC	

### **A. Product Development**

#### **1. Required: BSP Guidelines / Clarification for:**

##### **a. Long-term Tax-Exempt UITF – I**

To help promote long-term investments.

##### **b. Investment in Offshore securities – I**

As allowable investments for UITFs as interpretations may vary from one department to the other. Investments by UITFs in offshore securities should not be interpreted to allow investments only in securities that are registered with the local SEC. As long as the security has a two-way quote and is liquid and tradable, this should be considered as eligible for UITF investment.

##### **c. Fund-of-Fund / Feeder Fund - M**

There is a need to secure the approval of the BSP to allow a UITF to invest 100% in a fund/s, both local and offshore fund/s. This is to enable local UITFs to offer global investments to Filipino investors at a cost-efficient manner.

#### **2. Required: BSP to amend Circular 447 to allow:**

##### **a. Derivatives / Structured Products – I**

Currently, derivatives are allowed for hedging purposes only. Allowing investment in derivatives would open the door for enhanced returns as well as manage risks of UITF funds.

##### **b. Closed End UITF - I**

Currently, the regulation covers only open ended UITFs to the exclusion of closed ended UITFs.

c. Various Participation Classes – M to L

Currently, UITFs are allowed to have only one type of unit class. Unit trusts and mutual funds in more developed countries are allowed to have various types of participation classes i.e. institutional share class, high net worth share class, and retail share class. This will enable institutions to offer one UITF to all types of investors. What will vary would be the fees charged i.e. an institutional share class would have a lower trust fee than a retail share class. This will make investment management and operations of the fund more efficient.

According to Ching Garcia of BSP, they are already studying / working on fund of fund / feeder fund structures.

B. Distribution

1. Open Architecture:

To ensure a success in promoting savings and investments through UITFs, there is a need to open up the distribution channels for UITFs (i.e. open architecture). Banks should be allowed to offer non-propriety UITFs to their clients. Open architecture allows investors to access the best investment managers and investment products in the market through the bank of their choice.

See attached Exhibit ‘A’ for the Position Paper on Open Architecture.

2. Required:

- a. Legal opinion has to be obtained on the intent of Section 20 of the General Banking Law. – I

The opinion will clarify if the sale of a bank of UITF of a subsidiary or that of the mother company is allowed.

- b. A position paper will be prepared by TOAP and presented to the BSP. (Responsible: Stelle Sampayan of Amex and Concepcion Cruz of ING will work on the draft position paper for submission to Marilyn de Vera of BDO and Atty. Guia Legaspi. Target submission to BSP: December 2005) – I

**Note from RG Ayuste:** Done; Attached Exhibit ‘A’ for the Position Paper on Open Architecture.

- c. Ensure that UITF products are sold properly to investors through institutionalizing a certification of licensing process. Continuous education of both sales force and public on UITFs must be done. - I

3. Finally, the group agreed that all member banks must adhere to the TOAP Code of Ethics and to market conventions that may be agreed upon by the association to

ensure a level playing field for all players as well as to minimize any negative event (i.e. overpromise, misrepresentations, etc.) that may compromise the integrity of UITFs. - I

### **XIII. Workshop 2: Investor Protection**

*Facilitator: Mr. Serafin Tongco, TOAP Director*

Participants: Dolly Yuvienco – BSP                      Reeve Vergara – LB  
                    Bong Tongco – BF                                      Marilen Sarmiento– PNB  
                    Tito Legasto – BPI                                      Marvin Fausto - EPCIB

#### **A. UITF Sponsor**

##### **1. Continuous training of trainers – I**

Ensure continuing training of trainers to update them of developments in the market as guidelines for new products or investments are issues by the regulatory body. The training may also cover area or areas that may need particular attention such as marketing, valuation, disclosures, etc.

**Note from RGAYuste:** In addition to continuous training of trainers is the possibility of outsourcing of certification examination to third party to ensure integrity of the education and certification process of front-line marketing personnel.

##### **2. Update training modules for developments – I**

In consonance with item no. 1 above, the training modules would have to be updated to keep up with changing regulatory environment as well as market development.

##### **3. More experienced front liners / marketers – I**

**Note from RGAYuste:** Similar in context to Sec. XII.B.2.c, refer to this section for details.

##### **4. Update Code of Ethics – I**

**Note from RGAYuste:** Similar in context to Sec. XII.B.3, refer to this section for details.

#### **B. Investing Public**

##### **1. Pre-investment (macro and micro), investors’ briefs, institutionalize client suitability, disclosures, press releases, website, FAQs – I**

Institutionalize client understanding of the UITF products through proper disclosures, press releases, dedicated website and FAQs and standards such as client suitability and disclosure.

##### **2. Post investment – I**

Periodic review and updates per fund with ROI and largest assets data based on standardized calculation and disclosure and (implementation of) best practice standards.

3. Complaints handling – I

Institutionalize complaints handling at TOAP level to inform investors the existence of a body to receive complaints as well as ensure these are processed properly.

4. Credible Rating Agencies - M

The group proposes the rating of UITF funds by credible rating agencies to ensure professional fund management and administration and implementation of best practices.

**Note from RGAyuste:** To encourage good performance, depth of product breath, best practices and transparency in fund management and administration. Please see attached Exhibit ‘B’, Information on Lipper. Communication has been initiated with Lipper and Moody’s. Other agencies Morning Star and S&P’s will follow.

**XIV. Workshop 3 – What Needs to Be Done?**

*Facilitator: Mr. Rolando Esguerra, TOAP Director*

Participants:	Remy Torregrosa– BSP	Rafael G. Ayuste, Jr. –MBTC
	Judith Sung sai – BSP	Ador A. Abrogena – BDO
	Rolando Esguerra – EPCIB	Juliet Dytoc - MBTC

A. What needs to be done?

1. Document the investment management process - I

The investment management process is included in proposed product classification jointly being developed by TOAP and BSP. The documentation of the process ensures the establishment of policies and procedures in the management of the funds as well as the adherence to such policies to ensure integrity in the management and administration of the funds at the trustee level as well as that of the other entities involved in the delivery of the UITF such as the fund manager, fund administrator and the custodian..

2. Credit process (credit policies, standards) - I

The investment management process is included in proposed product classification jointly being developed by TOAP and BSP. It documents the credit process undertaken by the UITF trustee to establish the standards acceptable to the trustee in undertaking credit accommodation for the fund.

3. Valuation (process, pricing) - I

The UITF Council to prescribe standards in valuation, pricing and cut-offs (if possible) to ensure uniform process and application among UITF industry players. This will ensure that performances are comparable among the players.

4. GIPS - L

In coordination with the Association of Investment Professionals Manila (AIPM) the Philippine association of Chartered Financial Analyst (CFA), draw up a blue print for development and implementation of Global Investment Performance Standards in the long term.

5. Disclosure standards (what we need to disclose, disclaimers, prospectus) - I

Related to item no. above. Pre and post investment disclosure standards should be prescribed to ensure proper understanding of investment prior to sale and after sale. Disclosure may include: Historical performance - past 30 / 60 / 90 day ROI (simple/absolute), ROI YTD (simple/absolute), ROI YOY, disclaimer on historical performance, disclaimer on insurance with Philippine Deposit insurance Corporation (PDIC), risks, prospectus, role of the various entities engaged in the UITF, etc.

6. Standard definition of types of risk - I

UITF Council to prescribe standard definition of risks attendant to UITF to ensure uniform definition and presentation of risks to investors. Risks should include market/price, credit and liquidity. Risks may be defined in both English and Pilipino for proper understanding of various types of investors.

**Note from RG Ayuste:** In addition to the various standards mentioned above, standards for marketing collaterals (i.e, advertisements, brochures and flyer) shall also be prescribed by the UITF Council to ensure appropriate and uniform disclosures, disclaimers and ROI presentation.

7. Unbundling of services / functions

- a. Fund manager
- b. Trustee
- c. Custodian
- d. Administrator
- e. Distributor
- f. Selling agent

Cognizant of expertise of each institution, for better control and effective compliance monitoring and in alignment to international best practices, the various functions attendant to the delivery of UITF to the investing public shall be unbundled. The responsibilities of each entity and outsourcing (if any) shall be documented and disclosed in the Declaration of Trust and the prospectus.

8. Code of conduct of fund managers and marketing personnel

*Note from RGAYuste:* Similar in context to Sec. XII.B.3, refer to this section for details .

9. Expressly allow investments in structured products as long as it is within the investment policies of the fund

*Note from RGAYuste:* Similar in context to Sec. XII.A.2.a, refer to this section for details .

10. Risk policies and risk manual. – I

The Risk policies and risk manual process is included in proposed product classification jointly being developed by TOAP and BSP. Prescribe risk manual standards to ensure proper risk identification, measurement and mitigation.

B. How to do it?

1. UITF Council – to implement medium term plan and ensure: (I)
  - a. Continuity – to ensure continuity in the development and implementation of identified development areas, the council shall have members on a permanent basis.
  - b. Staffing – Cognizant that volunteer members to the council may not be sufficient to develop and implement the requirements of this plan, a recommendation is made to hire a permanent staff to assist in this process.
  - c. Funding – Funding shall be requested for development and implementation of this plan.
  - d. Industry participation – Active participation of the members of the UITF industry shall be required of UITF players to ensure the success of the implementation of this plan.

*Note from RGAYuste:* Refer to attached Exhibit ‘C’ for the TOAP Board approval (dated December 5, 2005) on the creation of the UITF Council (renamed Council for UITF Development and Promotion) and the general scope of responsibilities of the council. .

**XV. Closing Remarks**

*By: Mr. Reeve Vergara, TOAP Director and Vice-President*

**Other Matters Critical to the Development of the UITF Industry**

*As Approved By the TOAP Board of Directors*

- I. Creation of the Council for UITF Development and Promotion
- Objective:
    - Promote the development and promotion of the UITF industry based on the output of the UITF Workshop Conference: Crafting a Medium Term Plan (2006 to 2011)
    - Update development plan, with approval of the TOAP board of Directors, as necessary to adapt to changing regulatory, competition and market.
    - Put the 'Medium Term Plan' into action considering the drawn timeline.
    - Coordinate and communicate with Regulatory Bodies and UITF institutions, as necessary
  - Composition:
    - Council President
    - Members
  - Membership:
    - Membership shall come from the TOAP institutional and individual members
  - Meeting:
    - Meeting shall be held at least once a month
  - Responsibility and Reporting:
    - The Council President shall report directly to the TOAP President.
  - Term of the Council
    - The council shall have a term of 5 years to coincide with the termination of the Medium Term Plan. The life of the council may be extended at the option of the TOAP board of Directors.
  - Term of Council President
    - The Council President shall not have any term to ensure continuity of service but shall serve at the pleasure of the TOAP Board of Directors
  - Budget
    - A budget for the council shall be requested by the Council from the Board of Directors for proper funding of its activities.
- III. Membership with international retail funds management organization.
- Objective:
    - To create networking with other organizations around the world for technology transfer, sharing of information and knowledge and place the Philippine Unit Trust in the world map for retail investments.