Regulatory reforms key to Philippines funds industry

The (slow) pace of regulatory reform must pick up for the mutual funds industry in the country to be allowed to flourish.

To grow the asset management industry in the Philippines, regulatory action is paramount. That's the view of leading market practitioners from fund houses and banks based in Manila.

The country's relatively small population of affluent individuals is expected to grow strongly in coming years. Yet the financial sector is relatively unsophisticated compared with many of its ASEAN neighbours.

Retail participation in equities and mutual fund markets, for example, is very low, with the majority of investments still parked in deposits.

Nevertheless, very strong economic performance in recent years bodes well for the future of financial services in the country, believe practitioners. And with financial literacy levels improving slowly, there are reasons for optimism for the historically-turbulent asset management industry in the Philippines.

MIXED PAST

The concept of mutual funds is not new to the country and its history can be traced back to the early 1950s. However, the initial mutual funds that came to market charged exorbitant front-loaded sales charges.

That led to strict scrutiny from the regulators and the public after the stock market collapse later that decade.

As a response to the fiasco of the first effort to bring mutual funds to the country, the government enacted R.A. 2629, otherwise known as the Investment Company Act. This ushered in tighter regulations for the industry.

Market and political instability again led to difficulties, following which the Securities and Exchange Commission (SEC) banned the sale of mutual funds in 1973. However, in the 1980s, the Asian Development Bank, through Jardines, initiated a study on mutual funds, after recognising their importance in the development of capital markets.

By 1989, the SEC had set up a task force to oversee the creation of the draft Implementing Rules and Regulations (IRR) of the Investment Company Act. It changed the provisions of the law, by increasing paid-up capital requirements, adding a 24-month hold-out and requiring four audits per year.

It is not a surprise, therefore, that the mutual fund industry in the Philippines has suffered from slow growth to date.

NEW CHANGES

There has been further action recently on the regulatory front; in 2016, for instance, more changes were proposed to the Investment Company Act. And according to a report in the Manila Standard, the SEC has drafted new guidelines governing mutual funds in an attempt to align them with global best practices.

Under the draft rules, a mutual fund company applying for incorporation should have a minimum subscribed paid-up capital for PHP50 million (USD1 million), according to the report.

That firm will also be required to appoint a fund manager with an investment adviser license, and if the company plans to distribute or sell shares to the public, it will need to file a registration statement about the planned offering with the SEC.

Because of the country's chequered past with mutual funds and the more stringent regulatory requirements in terms of capital, another collective investment scheme known as the unit investment trust funds (UITFs) have become more popular.

A third type are variable universal life insurance policies (VULs).

The UITF industry is estimated at around PHP 800 billion (USD16 billion), with about PHP 600 billion accounted for by money market funds.

The mutual funds industry, meanwhile, is estimated at around PHP250 billion.

The differences in regulatory and tax treatment between UITFs, mutual funds and VULs, however, has been the subject of much discussion among industry participants.

CIS COMING?

One of the long-standing proposed regulations is the Collective Investment Scheme (CIS) Law, which could provide a big boost to the investment products landscape by removing the regulatory and tax arbitrage between the three products.

A common CIS Law will provide a uniform regulatory framework all the products mentioned, believe industry practitioners.

This is also expected to lay the legal framework for new investment products such as ETFs, real estate investment trusts (REITs) and special purpose entities or trusts to raise capital for infrastructure projects.

And with the launch of feeder funds investing in US and Japanese markets in recent years, investors also have an avenue to diversify.

However, as one leading market participant noted, for feeder funds to take off in any big way, the government must liberalise the FX market by allowing local investors to purchase US dollars to be able to invest in US dollar-denominated assets.

Overall, despite the challenges for the asset management industry, the general belief is that the end-investor is, to a large extent, protected by the prevailing regulatory checks and balances.

The issue, unfortunately, is that there tends to be long gaps in time between policy announcements and execution in the Philippines.

Nevertheless, the entry of new products suggests the retail market is gradually becoming more open.

PUSH FOR SAVINGS

A recent development that product and investment specialists in the Philippines say that they expect to give a fillip to the asset management industry is PERA (Personal Equity and Retirement Account Law).

In short, this is a long-term investment savings plan designed to help Filipinos with their retirement planning. It will achieve this by channeling these funds into appropriate financial products.

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Another way to drive broader investment participation is by ensuring mandatory pension schemes through the PERA platform.

Indeed, market participants believe that this is essential.

This also highlights that fact that there is much that the country's regulators can – and should – be doing in order to boost the domestic asset management industry. ■