

Private Pension Schemes in the Philippines: (Regulatory Practices)

A Country Paper
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I. Introduction

The old age system of protection in the Philippines is now evolving into a four-tiered system of protection. The first tier is more of a social assistance scheme wherein different departments of government, notably the Department of Social Welfare and Development (DSWD), Department of Health (DOH) and Department of Labor and Employment (DOLE), implement various social assistance programs for the benefit of the very poor in our society.

The second tier is a mandatory defined benefit scheme which is provided for by the Social Security System (SSS) for the private sector workers and the Government Service and Insurance System (GSIS) for the public sector employees.

The third tier includes the mandatory deposits maintained at the PAG-IBIG Fund which become available at retirement and, for workers in the private sector, the mandatory retirement pay provided for under Republic Act 7641. Public sector workers receive from GSIS a benefit that is more generous than the benefit paid under SSS in part because it is a combination of both the second layer and the third layer.

The fourth tier is a voluntary tier, and this is where individuals, on their own, buy pension plans and other pre-need products to provide for the many contingencies in life.

This paper will present the different private pension schemes in the Philippines but will dwell on regulatory practices over pre-need pension plans as a fourth tier voluntary pension program. It will also discuss the different regulatory reform measures implemented by the SEC and the legislative initiatives of the Philippine Government to enact the proposed Pre-Need Code and the Personal Equity and Retirement Account (PERA) Law.

II. Private Pension Schemes:

The passage of Republic Act No. 7641² has provided for mandated payment of retirement benefits. All private sector employees regardless of their position, designation or status and irrespective of the method by which their wages are paid are entitled to retirement benefits upon compulsory retirement at the age of sixty-five (65) or upon optional retirement at sixty (60) or more but not 65. The minimum retirement pay due covered employees shall be equivalent to one-half month salary for every year of service, a fraction of at least six (6) months being considered as one whole year. The benefits under this law are other than those granted by the Social Security System.

Any employee may retire or be retired by his employer upon reaching the retirement age established in the CBA or other tax-qualified applicable

² Mandatory Retirement Pay Law which took effect on December 9, 1992

agreement contract and shall receive the retirement benefits granted therein: provided, however, that such retirement benefits shall not be less than the retirement pay required by RA 7641 and provided further that if such retirement benefits under the agreement are less, the employer shall pay the difference.

Voluntary personal pension funds are offered by pre-need and life insurance companies. Pre-need companies are plan issuers authorized under Republic Act No. 8799³ to sell or offer for sale to the public any pre-need plan in accordance with rules and regulations which the Securities and Exchange Commission have prescribed. Pre-need plans pertain to contracts which provide for the performance of future services or the payment of future monetary considerations at the time of actual need, for which planholders pay in cash or installment at stated prices, with or without interest or insurance coverage and includes pension plans. Other dominant plan types are life, education and interment plans.

On the other hand, the Philippine Insurance Code⁴ allows insurance companies to offer endowment and annuity contracts which are classified as life insurance contracts for purposes of said law. Old age and regular endowments are availed by those who want guaranteed retirement income without however, entirely losing the protection element of the plans.

III. Pre-Need Pension Plans Regulatory Framework

A. Background

Evolutionary Process

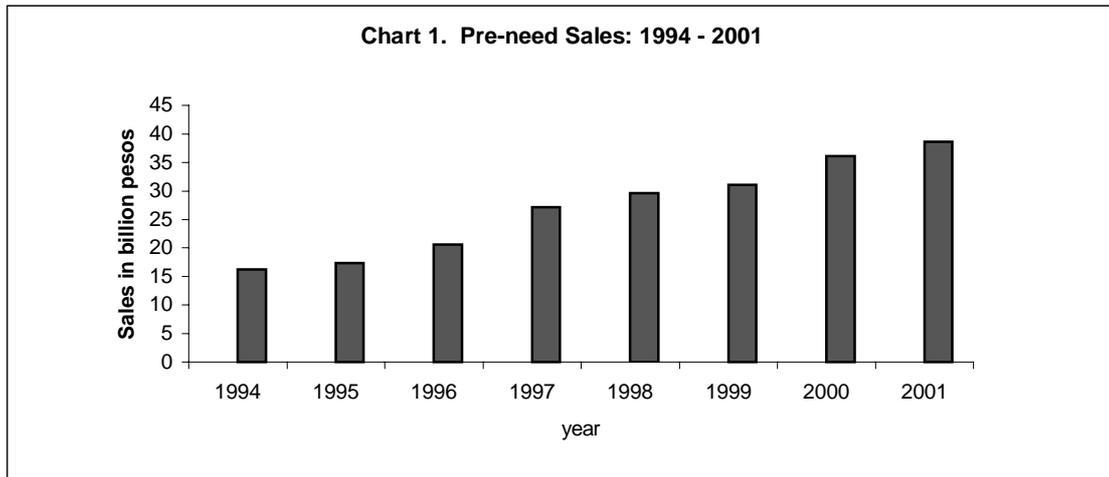
The pre-need concept evolved from the appreciation of the basic deficiency of the life insurance product that it does not provide protection against the erosion by inflation of the value of the benefits promised. The benefit expressed in cash was subject to depreciation such that its real purchasing power became a mere fraction of the amount originally contracted for, thereby compromising the well-being of the beneficiary at the most unpropitious and distressing of times. This therefore led to the idea of presenting the benefit in kind or in terms of a commodity, instead of inflation-vulnerable cash.

The first pre-need company in the Philippines began operations in 1966. It offered memorial or life plans. In 1977, the pre-need pension plans were introduced. These were fixed-value plans with guaranteed interest income. By 1980, the pre-need education plans came out of the market. It seeks to cover actual cost of tuition fees at the time the nominee entered college.

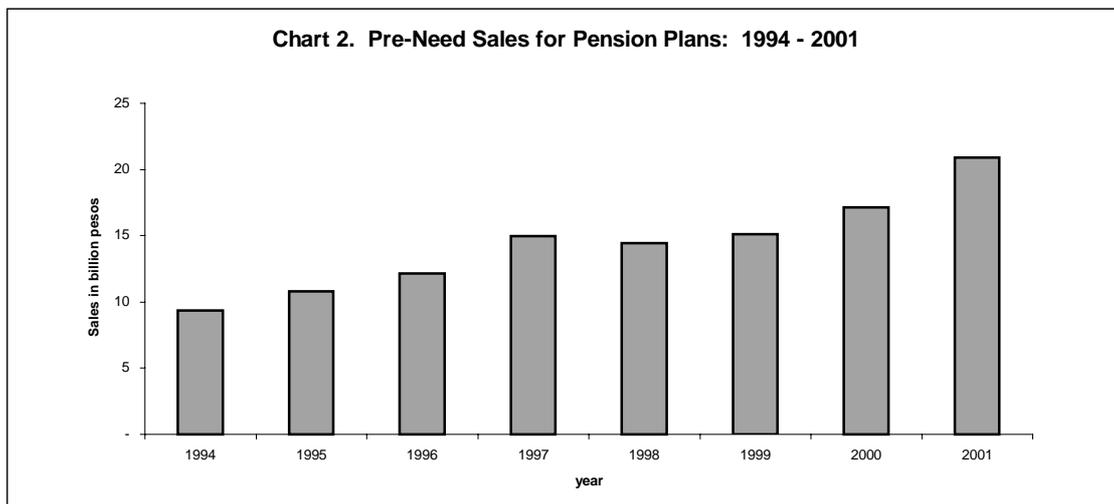
³ Securities Regulation Code which took effect on August 8, 2000

⁴ Enacted on December 18, 1974

Since then, the industry grew at the rate of 30% per year with its 2001 sales performance reaching 675,173 plans sold with an aggregate worth of P38.6 billion⁵ or an increase of 16% in number of plans sold and 7.04% increment in peso sales compared to the previous year. Please see Chart 1 below.



Of this sales figure, pension plans accounted 54% of industry sales with P20.9 billion. Chart 2 shows the accelerating trend of pension plan sales from 1994 to 2001.



Operating Characteristics of Pre-Need Pension Plans

⁵ One US dollar = 52.70 Philippine pesos as of October 9, 2002

Pre-need pension plans are savings schemes offered by pre-need companies. They share some features in common with individual insurance policies. Typically, they represent a combination of endowment insurance policies with deferred annuities. They are combined with credit life policies that cover the unpaid balance of the pre-need pension plan price in the event of the demise of the planholder during the paying period. Likewise, they usually provide for a group yearly renewable term insurance in an amount equivalent to the maturity benefit of the pension program.

These voluntary financial arrangements guarantee holders a fixed amount of cash in the future. Their ability to meet the retirement needs of savers depends on the solvency and investment performance of the pre-need companies and their trust funds.

More specifically, pre-need pension plans have the following features:

- a.) Payment of contract price averages five years. Thus, a 5-year plan requires payment to be made in monthly, quarterly or yearly installments.
- b.) The maturities of pre-need pension plans are either upon reaching a certain age of the planholder or over a period of years after full payment.
- c.) Pension benefits may be paid out in lump sum or installments or both at the option of the planholder.
- d.) In case of death of the planholder before the maturity date, pay-out will still be at maturity date.
- e.) To ensure payment of benefits, pre-need companies are required to contribute to a Trust Fund which are funded from their collections.

Number, size and capital market impact

For 2002, there are 41 licensed pre-need pension plan companies. The top ten pension plan companies and their trust fund equities are as follows:

Name of Pre-Need Company	Trust Fund Equity
Comprehensive Annuity Plans and Pension Corp.	P 2,919,900,000.00
Pacific Plans, Inc.	2,105,900,000.00
Prudentialife Pension Plan, Inc.	1,696,200,000.00
CMG Plans, Inc.	978,400,000.00
Philam Plans, Inc.	977,200,000.00
PET Plans, Inc.	648,600,000.00
Ayala Plans, Inc.	286,000,000.00
Cocoplans, Inc.	274,100,000.00
TPG Corp.	249,600,000.00
Loyola Plans, Inc.	231,600,000.00

As of fiscal year ending 2001, the pension trust fund equities administered by various trustees amounted to P13,296,985,000.00. The aggregate investment portfolio mix of the pre-need pension trust funds is shown below.

Investment Instrument	Amount	% of Total
Total	P 13,296,985,000.00	100.0
Cash on hand/bank	85,343,000.00	0.6
Foreign Account	344,157,000.00	2.6
Government Securities	6,659,841,000.00	50.1
Time Deposit	184,916,000.00	1.4
Commercial Papers/Promissory Notes	178,382,400.00	1.3
Private Bonds	81,079,700.00	0.6
Loans	565,163,800.00	4.3
Common Trust Fund	58,219,800.00	0.4
Mutual Fund	35,001,000.00	0.3
Total Equities	1,817,558,700.00	13.7
Real Estate	1,875,477,600.00	14.1
Other Investments	659,449,600.00	5.0
Receivables and other Assets	752,395,800.00	5.7

Government has been a primary beneficiary of the pre-need industry. While the rules provide that no less than ten percent of the trust fund equity must be invested in government securities, treasury bonds do offer higher yields. This, in effect, prompted trustee banks to lodge a significant percentage of the trust funds in this investment outlet. Equities and real estate investments came in as close second favorites.

B. Regulatory Environment

Supervisory Agency

Pre-need companies are under the supervision and regulation of the Securities and Exchange Commission. Section 16 of the Securities Regulation Code provides that no person shall sell or offer for sale to the public any pre-need plan except in accordance with rules and regulations which the Commission shall prescribe. Such rules shall regulate the sale of pre-need plans by, among other things, requiring the registration of pre-need plans, licensing persons involved in the sale of pre-need plans, requiring disclosures to prospective plan holders, prescribing advertising guidelines, providing for uniform accounting system, reports and record keeping with respect to such plans, imposing capital, bonding and other financial responsibility, and establishing trust funds for the payment of benefits under such plans. Pursuant thereto, the SEC promulgated the New Pre-Need Rules on Registration and Sales of Pre-Need Plans last August 16, 2001.

There are, however, existing bills pending before Congress that propose the transfer of supervisory and regulatory powers of the SEC over the pre-need industry to the Insurance Commission.

Licensing of Pension Plans and Actuarial Review

The pre-need company has to register its pre-need pension plans with the Commission. Further, any issuer or pre-need company selling its own plan shall obtain a license as dealer of pre-need plans from the Commission. If the issuer contracts general agents or agencies to sell its pre-need plan, such company shall secure a license for such general agents or agencies from the Commission.

As part of the approval for registration of new pre-need pension plans, the provisions of the plan contract and all of its benefits and guarantees are checked whether they were considered in the pricing as contained in the actuarial feasibility study submitted to SEC.

At the end of the fiscal year of the company, which is also the valuation date, the actuarial valuation report submitted to SEC is reviewed. The computed actuarial reserve as of the date of valuation is compared with the trust fund to determine the adequacy of its funding level. Based on this valuation reserve, the sufficiency of the monthly funding level of the pension fund is assessed. Actuarial valuation reports can be certified only by appointed actuaries of the company who are duly accredited as such by the SEC.

Funding Requirements and Investment Regulations

Pre-need companies must deposit 51% of the total amount collected to the trust fund. Trust funds must be established by the pre-need company with a trust entity. The relationship is evidenced by a trust agreement, which is subject to the approval of the SEC. While trustees are under the direct supervision of the Bangko Sentral ng Pilipinas (BSP), Commission personnel are allowed to conduct audits of trust entities managing pre-need trust funds.

The Trustee shall exercise due diligence for the protection of the planholders guided by sound investment principles. It has exclusive management and control over the funds and the right at any time to sell, convert, invest, change, transfer or otherwise change or dispose of the assets comprising the funds. The Trustee shall not use the trust fund to invest in or extend any loan or credit accommodation to the pre-need company, its directors, officers, stockholders, and related interests as well as to persons or enterprises controlling, owned or controlled by, or under common control with said company, its directors, officers, stockholders and related interests.

To provide for risk diversification, investment in real estate must not exceed 25% of trust fund equity. Equity investments must not exceed 25% of trust fund equity. In both cases, investment in a single asset must not exceed 10% of the allowable maximum limit.

Further, investments in equities and real estate are limited to the following:

a. Investments in stocks listed on the Main Board of a local Stock Exchange which are valued at the aggregate of the lower of cost or market.

b. Real properties located in strategic areas of cities or first class municipalities recorded acquisition cost. However, it can be appraised every three years by a licensed real estate appraiser, accredited by the Philippine Association of Real Estate Appraisers to reflect the increase or decrease in the value of the property. In case of increase, only 60% of the appraisal increase is allowed to be recorded in the books of the trust fund but in case of decline in value, the entire decline shall be recorded.

Reporting and Off-Site/On-Site Inspections

Trustees are required to submit monthly reports on the trust fund financial condition. On the other hand, the pre-need company is required to comply with the following reportorial requirements:

Type of Report	Frequency
1) Audited financial statement	Annual
2) Actuarial Valuation Report	Annual
3) Consolidated Trust Fund Statements	Quarterly
4) Sales Report	Monthly
5) Collection Report	Monthly

There are teams with three technical staff each who conduct regular off-site and on-site inspections in addition to the evaluation of the application for licenses. For cause audits are also conducted when necessary.

Accounting and Disclosures

The role of the external auditor is to render an opinion if the financial statement fairly presents the company's financial condition in accordance with generally accepted accounting principles and standards. The Commission has mandated the strict adherence to the Pre-Need Uniform Chart of Accounts (PNUCA) to allow comparability and better appreciation of the over-all financial standing of the industry. The PNUCA is currently being revisited to ensure that the same conforms to International Accounting Standards (IAS).

The issuer submits to the Commission five (5) copies of its audited annual financial statements within one hundred five (105) days after the end of its fiscal year. To properly reflect the correct amount of liabilities as of the end of the fiscal year, the Actuarial Reserve Liabilities presented in the audited financial statements should be the amount shown in the Actuarial Valuation Report duly certified by an accredited actuary. The said financial statement shall be signed by the President and Finance Officer of the pre-need company certifying that said statement has been audited by an independent auditor.

Said annual statement shall be published together with the trust fund balance sheet, once a year within one hundred and twenty (120) days from the end of the fiscal year in a newspaper of general circulation in the city/province where the pre-need company has its head office. A copy of such statement as published, together with the publisher's certificate, shall be submitted to the Commission within ten (10) days after said publication.

On disclosures, the New Pre-Need Rules provide that no pre-need plans registered with the SEC shall be sold unless an Information Brochure has been filed pursuant to Rule 4.1, par.4 (c) and approved by the SEC together with the Registration Statement and is made available to the prospective planholder .

An Information Brochure shall not be used if the information contained therein is outdated or does not accurately reflect the terms of the plan or the financial ability of the pre-need company through the use of trust fund assets. In such cases the pre-need company shall submit an updated Information Brochure for approval of the SEC. The SEC may suspend the Permit to sell Pre-Need Plans when there is a material change in the information contained in the Information Brochure.

Taxation of Pension Plans

Contributions to pre-need pension plans are not deductible from taxable income. Further, investment yields of the trust fund are subject to the following tax rates:

- a.) 20% final tax on interest from any currency bank deposit and yield or any other monetary benefit from deposit substitutes, commercial papers, government securities and other fixed income instruments.
- b.) 7½% final tax on interest income for the expanded foreign currency deposits.
- c.) 6% final tax on capital gains realized from sale, exchange or disposition of lands and/or buildings based on the gross selling price or current fair market value, whichever is higher.
- d.) 5% final tax of not over P100,000 or 10% final tax of amount in excess of P100,000 for capital gains from the sale of shares of stock not traded in the stock exchange.

The sale of pre-need pension plans is subject to the 10% value-added tax which is usually passed on to the planholders. However, pension benefits like social security benefits and retirement gratuities are exempt from income tax.

IV. Reforms

A. Regulatory Initiatives

As a policy prescription to address problems besetting the industry, the Commission used its rule-making authority under Section 16 of the Securities Regulation Code with the promulgation of the New Rules on Registration and Sale of Pre-Need Plans. Aside from what has already been discussed in the earlier sections of the paper, there were specific provisions in the New Pre-Need Rules that were so promulgated to meet solvency and fairness to the planholders issues, to wit:

1. Thus, to address the issue of solvency of pre-need companies:

a. The New Pre-Need Rules prescribes under Rule 2 thereof that any new corporation applying for registration to act as an issuer of Pre-Need Plans shall have a minimum paid-up capital of One Hundred Million Pesos (P100,000,000.00); provided, that existing Pre-Need Companies with paid up capital of less than One Hundred Million Pesos (P100,000,000.00) were given until April 30, 2002 to comply with this requirement. This provision intends to limit the number of industry players to only those which have the financial capability to meet their obligations. It serves as deterrence against fly-by-night entities which prey upon innocent planholders. Of the 11 companies that closed down or curtailed operations, the paid up capital of said companies ranged only between P2.7 million to P15 million.

b. While the industry financial statements show that the industry is solvent as of December 31, 1998, said reports were not considered as definitive and reliable in analyzing solvency as they were not prepared using uniform accounting standards. Thus, as pointed out earlier, Rule 31 of the present Rules prescribes the adoption of the Pre-Need Uniform Chart of Accounts (PNUCA) and format in the accounting and reporting of their operations and of the Trust Funds. A total of 60 accounts, with some considered peculiar to the industry, have been defined under the Rules.

2. Fairness to planholders are further ensured:

a. As regards the questioned qualifications of sales agents, the New Rules addresses this under Rule 15.7 which states that their registration shall not be approved unless the issuer or general agent engaging the salesman's services certifies under oath that the salesman has been duly trained pursuant to a training program approved by the Commission and has successfully passed an examination given by the issuer or general agent and approved by the Commission or the Federation. The mechanics on how the examination will be administered is the subject of current dialogues with the Federation.

b. As an added measure to address possible abuses in their marketing activities, all pre-need companies were required under Rule 7 to constitute a complaints action unit in their respective offices which shall have telephone hotlines to handle complaints and answer the concerns of planholders.

c. The New Rules also impose a limit to the payment of commissions. Rule 35.1 provides that as commission, the pre-Need company shall not pay in cash or securities, directly or indirectly, any amount in excess of ten *per cent* (10%) of the contract price of the plans authorized to be sold.

d. Increased accountabilities have been imposed on the accountants and actuaries under Rule 35.5 which states that any person who issues a false or misleading statement or omits to state a material fact when required to do so and who prepares certifications required under the Rules containing such false or misleading information shall be barred from practicing his profession in the Commission without prejudice to criminal or civil liabilities imposed under the Securities Regulation Code.

e. Three SEC Circulars had been promulgated on the following policy areas: (a) Standards for Valuation of Actuarial Reserve Liabilities for Pre-Need Plans; (b) Required Information to Accompany the Actuarial Reserve Valuation Report of Pre-Need Companies; and (c) Responsibilities of Actuaries in the Submission of Actuarial Reserve Valuation Report. They provide for interest rate assumption benchmarks, minimum termination values and prescribe the net level reserving method.

f. All pre-need companies have been enjoined to submit a manual of good corporate governance. With its adoption, the manual institutionalizes the principles of good corporate governance in the entire organization. The Board of Directors and Management, employees and shareholders, undertake to adhere to corporate governance as a necessary component of what constitutes sound strategic business management.

B. Proposed Legislation

The Pre-Need Plans Code of 2002

While the pre-need regulatory system that has been set in place as a result of the Commission's twenty five-year supervision over the industry and gravely enhanced by drastic policy reforms implemented these last few years, proves to be a workable policy framework, the passage of a legislative measure would further strengthen the industry in terms of decisively addressing solvency and fairness to planholders issues with a tighter grip that only legislation may lay down. Thus, the SEC supports the passage of the New Pre-Need Plans Code. The New Pre-Need Rules serve as a good working model for statutory prescriptions that would have immediate profound effect to the industry and its constituents. Current bills pending before Congress have incorporated identical provisions found in the New Pre-Need Rules. Further, the SEC's crusade towards good corporate governance has been enshrined with the specific fit and proper requirements; higher accountabilities of management and allied business professionals; greater disclosure and transparency; and other good governance principles incorporated in the proposed Code.

The Personal Equity and Retirement Account (PERA) Act of 2002

The PERA bill was deliberated on February 27, 2002 before the House Committee on Economic Affairs. It calls for the establishment of voluntary individual retirement accounts that would receive favorable tax treatment to encourage more private saving for retirement. An important secondary objective of the PERA reform is to induce capital-market innovation through competition among financial institutions trying to attract savers to open PERAs. For this purpose, Congress seeks to rationalize the functions of SEC, BSP and IC with the main objective of generating investments and accelerating savings mobilization by providing tax incentives to eligible PERA Investment Vehicles.

PERA contributions would be completely deductible under the income tax, but subject to a flat five percent (the Department of Finance or DOF advocates a flat 15% tax) on contributions. All PERA investment earnings are to be tax exempt. All withdrawals are to be excluded from income taxation, while early withdrawals, defined as those made before age fifty, may be subject to penalty, the level of which is to be established by DOF. In the parlance of tax analysis, this tax treatment of PERA cash flows may be characterized as tEE, with the t being lower case to represent the partial taxation of contributions, the middle capital E representing the complete tax exemption of investment earnings, and the final capital E representing the complete tax exemption of withdrawals. This tax treatment differs from the most common international practice (EET) primarily because of DOF concerns about short-run revenue loss.

V. Future Directions

Pre-need companies, just like other pension plan providers, play a significant role in the development of the capital market and nation building. The presence and continued growth of their industry assures the government as well as the business sector of uninterrupted flow of funds, through their equity and other investments. Government must therefore endeavor to pass legislation to offer preferential tax arrangements to the industry and its clients, and to promote the development of the capital market by encouraging savings and trading of financial instruments. The regulator, on the other hand, should work on more prudential regulatory measures that ensure planholder protection while at the same time provide the pre-need pension industry the necessary flexibility for growth and product innovation.

For its part, the pre-need industry must closely monitor the compliance of its constituents with good corporate governance principles. While the industry can readily attribute its growth to its adherence to pertinent laws and regulations, such growth can still be further bolstered if sound corporate governance principles are observed at the individual firm level, particularly among those who wield corporate clout. As borne by the experience of developed economies, pre-need companies like other public companies can look forward to good business prospects that corporate governance principles promise to their adherents.

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